Financing Growth Infrastructure

Purpose

1. To outline the options and implications of proposed changes to the council's financial strategy in relation to financing infrastructure necessary to support new housing and business developments.

Summary

2. The Auckland Unitary Plan has provided sufficient zoning capacity to support substantial amounts of new housing development. However, the capacity of infrastructure needed to support these new houses is a constraint.
3. The infrastructure required to support growth includes arterial roads, public transport works, stormwater drains, sewer mains, pump stations, reservoirs, water mains, parks and community facilities.
4. Auckland Council's current financial strategy is to primarily finance this kind of housing-related infrastructure through borrowings which are repaid over time from development contributions or Watercare's infrastructure growth charges which are paid by developers as and when they develop their land.
5. While this general approach will continue, there are several reasons why we need to consider making some adjustments:
    a) the infrastructure costs per dwelling in some areas are considerably higher than our current charges and so some pricing increases will be necessary
    b) the council faces borrowing constraints
    c) many growth infrastructure projects also provide benefits to existing dwellings, and it is not appropriate to recover all of the infrastructure costs through development contributions which are charged on new developments. These infrastructure projects can only proceed if another funding source is available to cover the gap in funding.
    d) charging large one-off payments when developers choose to develop their land may incentivise land banking rather than early release of land supply to market.
6. To complement and enhance our existing approach, we are proposing to:
    a) review development contribution pricing in key growth areas
    b) be ready to introduce new growth infrastructure targeted rates in key growth areas
    c) work with central government on the establishment of new legal entities to take a lead role in financing this infrastructure in a way that doesn't rely on significant increases in council debt.

Background

<u>The growth challenge</u>

7. Auckland faces significant challenges in funding its critical infrastructure, including its transport and wastewater network. Auckland's population has grown by over 45,000 per year for the past two years, and is some four to five years ahead of official population growth projections.
8. Given these pressures, Auckland Council is firmly committed to increasing the supply of land for housing, as evidenced by the significant lift in zoning capacity enabled by the Auckland Unitary Plan. However, the council's lack of debt headroom is constraining our ability to provide the necessary infrastructure to service this land.

<u>Current financial strategy and funding policy</u>

9. The current financial strategy provides that the costs of growth will be met by those who are benefiting from that growth. When the council invests in infrastructure to support growth the beneficiaries are:
    a) land owners whose properties rise in value as they can now be developed
    b) developers who undertake construction
    c) future buyers of the homes constructed.
10. The council presently uses development contribution and Watercare's infrastructure growth charges as its primary tools to fund growth infrastructure, but can also use targeted rates.

<u>Development contributions</u>

11. Development contributions are only payable on development. If no development occurs then no payment is required. Developers can adjust the timing of development and their liability for development contributions to match the market and their cash position. However, this means that the council sometimes has to make major investments in infrastructure with no certainty of when costs will be recovered.
12. Development contributions are currently widely used and the current contribution policy aims to fund $2.2 billion of growth infrastructure assets over 10 years. While this will provide substantial infrastructure capacity to support new development across the Auckland region, it is not sufficient to keep pace with infrastructure demand in all areas, particularly in the greenfield areas where current infrastructure capacity is very low.
13. The average development contribution charge is currently $19,990 plus GST per household unit.

<u>Infrastructure growth charges</u>

14. Infrastructure growth charges are very similar to development contributions except that they are charged directly by Watercare Services Limited on connection to the water and wastewater networks.
15. Infrastructure growth charges are expected to be able to fund around $1 billion of growth infrastructure assets over ten years. Again, while this will provide substantial additional capacity across the Auckland region, it is not sufficient to enable accelerated development in every location where land owners want to commence development.
16. The infrastructure growth charge for the metropolitan area is currently $11,340 plus GST per household unit.

<u>Growth infrastructure targeted rates</u>

17. Targeted rates can be struck before development occurs and even before infrastructure is built. They are then collected whether development proceeds or not. Targeted rates provide the council with a certain revenue stream.
18. Targeted rates discourage land banking because they raise the costs of holding undeveloped land. However, implicit in higher holding costs is an element of compulsion. Targeted rates push land owners to develop to a timeframe that may not be their preference.
19. There are some practical implications that will need to be considered as part of any proposal to implement targeted rates. These include:
    - Ensuring appropriate timing and duration of any targeted rate e.g. balancing the timing of councils need to fund infrastructure with the developer's ability to commence development
    - Finding the fairest way to distribute the costs of development between landowners where there may be quite disparate values and benefits because of existing development, geography etc.
    - Managing the impact on existing residents who may be within a development area but not have the ability and/or desire to develop their own property

- Ensuring that future purchasers are aware of the additional rating obligations.

A fuller discussion of these issues is attached as an Appendix.

20. While the council's Revenue and Financing policy has recently been amended to provide for the use of targeted rates to fund growth infrastructure, no such rates have yet been implemented. As proposals for individual areas are developed, appropriate tools for managing the issues outlined above will be recommended.

Infrastructure demand in key growth areas

21. Auckland's Council strategic growth planning envisages that 60 per cent of Auckland's future growth will occur in existing urban areas. A key focus is currently Housing New Zealand's intended large scale redevelopment activity in areas such as Mt Roskill, Mangere, Favona and Northcote where they have a high concentration of housing stock. Auckland Council is currently working with Housing New Zealand and its subsidiary Homes. Land. Community (HLC, formerly Hobsonville Land Company) to determine the additional growth infrastructure requirements to support these redevelopment plans.

22. The remainder of Auckland's growth is expected to occur in rural and coastal areas (15 per cent) and on around 15,000 hectares of land identified in the Auckland Unitary Plan (AUP) as areas for future urban growth (25 per cent). These future urban areas are located primarily in:
    - Kumeu, Whenuapai and Redhills in the Northwest
    - Silverdale, Dairy Flat, Wainui and Warkworth in the North
    - Pukekohe, Drury, Paerata and Takanini in the South.

23. Auckland Council is currently working with central government on a business case for $300 million of growth infrastructure over the next 10 years to support an estimated 10,500 additional houses in Whenuapai and Redhills. The government has agreed in principle to provide some support with financing this infrastructure through its Housing Infrastructure Fund. While this financing support will enable this infrastructure to be provided earlier, it does not remove the need for Aucklanders to ultimately bear the cost.

24. Auckland Council has also been working closely with central government on finding a way to enable investment in $600 million of growth infrastructure to support 5,500 additional houses in Wainui in Auckland's North and 17,800 houses in the South.

Investment partnership model

25. Work on the infrastructure investment for the North and the South has focused on a new investment partnership model, with this work now being led by Crown Infrastructure Partners.

26. Significantly, work on this model has focused on ways in which the accelerated investment can proceed without significant impacts on Auckland Council's balance sheet.

27. It has also focused on ways in which significant third party private sector capital can eventually be used to finance this infrastructure rather than Crown capital. All parties involved see significant opportunity to apply this model to finance a wide range of housing enabling infrastructure in other greenfield and brownfield intensification areas.

28. As with the Housing Infrastructure Fund approach, this new financing approach would not remove the need for Aucklanders to ultimately bear the cost of the infrastructure.

29. A specific example of a large scale infrastructure project that this model could be applied to is Watercare's $1.1 billion Central Interceptor wastewater project. This project will facilitate the substantial intensification of large parts of the Auckland isthmus. It will also reduce the significant wastewater overflows into our harbours.

30. Financing the Central Interceptor project through an investment partnership model would free up council debt headroom, and this headroom could then be utilised to progress transport and housing outcomes for Auckland.

Options

31. The main options are:

    Option One: Do nothing – growth infrastructure investment is not built at the pace needed to keep up with demand. This is likely to exacerbate existing housing issues.

    Option Two: Adopt a strategy of using higher development contributions and infrastructure growth charges in the key growth areas to help pay for the additional infrastructure.

    Option Three: Adopt a strategy of being ready to implement new infrastructure targeted rates alongside existing development contributions and infrastructure growth charges in the key growth areas to help pay for the additional infrastructure.

    Option four: In conjunction with options (ii) and/or (iii) implement an investment partnership model to finance growth infrastructure.

32. Attachment A sets out the key implications of these options.
33. The council is proposing to proceed with a combination of options (ii), (iii) and (iv) to maximise our ability to provide the critical infrastructure needed to address Auckland's urgent housing issues.
34. A combined approach allows the mix of targeted rates and development contributions to be customised for each growth area based on its own unique set of circumstances.
35. While we acknowledge that implementing higher growth charges may create affordability issues for some, we consider that it is fair that those landowners who benefit from large increases in land values make an appropriate contribution to the cost of infrastructure that has enabled those large increases. We also consider that there are sufficient tools available to the council to deal with any specific cases of genuine financial hardship.

Attachments

No.	Title
A	Options table
B	Issues for consideration – targeted rates for growth infrastructure

Signatories

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Attachment A: Options Table

<table>
<tr><th>Options</th><th>Description</th><th>Rationale</th><th>Impact on developers/land owners</th><th>Wider policy implications</th></tr>
<tr><td>Option One:</td><td>Do nothing – growth infrastructure investment is not built at the pace needed to keep up with demand.</td><td>Does not impose any additional council charges on anyone
Leaves it to private landowners to work together to build and finance critical infrastructure to support their developments</td><td>No additional charges, would only pay current development contributions and infrastructure growth charges if they are able to develop
Many land owners will be unable to develop due to lack of infrastructure capacity</td><td>Auckland's housing issues highly likely to be further exacerbated</td></tr>
<tr><td>Option Two:</td><td>Adopt a strategy of using higher development contributions (DC) and infrastructure growth charges (IGC) in the key growth areas to help pay for the additional infrastructure</td><td>Developers should make a fair contribution to the cost of the infrastructure that enables their development
Consistent with well-established approach to paying for growth infrastructure</td><td>Developers would pay higher combined (DC plus IGC) charges as follows:
<table>
<tr><th>Area</th><th>Current</th><th>Proposed[1]</th></tr>
<tr><td>North West</td><td>$30k</td><td>$40-50k</td></tr>
<tr><td>North</td><td>$25k</td><td>$40-65k</td></tr>
<tr><td>South</td><td>$28k</td><td>$40-55k</td></tr>
<tr><td>HNZ areas</td><td>$30k</td><td>$35-45k</td></tr>
</table>
Land owners would be able to develop, but would not have to contribute anything towards the cost of the infrastructure until they choose to develop</td><td>May enable faster housing development
The use of this strategy may be limited by the availability of council debt headroom
Potentially creates a greater incentive to land bank rather than release land early for development
This policy tool does not provide a mechanism to recover any proportion of infrastructure costs that primarily benefit existing housing units</td></tr>
<tr><td>Option Three:</td><td>Adopt a strategy of being ready to implement new infrastructure targeted rates alongside existing development</td><td>Land owners should make a fair contribution to the cost of the infrastructure that enables their land to be developed</td><td>Land owners would pay new targeted rates in addition to current DCs and IGCs as follows:
<table>
<tr><th>Area</th><th>Proposed new rate[2]</th></tr>
<tr><td>North West</td><td>$900-$1,800</td></tr>
<tr><td>North</td><td>$1,300-$3,500</td></tr>
</table></td><td>Likely to enable and incentivise faster housing development
The use of this strategy may be limited by the availability of council debt headroom
Targeted rate may</td></tr>
</table>

[1] The cost per house for the infrastructure to support the development of all the land provided for in the Future Urban Land Supply Strategy (FULLS) is in the range of $80k to $110k. The costs per house noted in the table have been assessed on a marginal approach based on the infrastructure to support the developments in these areas even though they may benefit from some of the wider investments in the FULLS.
[2] As note 1 above.

<table>
<tr><th>Options</th><th>Description</th><th>Rationale</th><th>Impact on developers/land owners</th><th>Wider policy implications</th></tr>
<tr><td></td><td>contributions and infrastructure growth charges in the key growth areas to help pay for the additional infrastructure</td><td></td><td><table><tr><td>South</td><td>$1,100-$2,400</td></tr><tr><td>HNZ areas</td><td>$500-$1,100</td></tr></table>

Rates would apply for a 20 year period from when land is development ready.
Land owners would be able to develop and would be required to pay regardless of whether they choose to develop now or wait.
Where land is held in large blocks, the annual targeted rate will also be charged (e.g. a block large enough for 100 houses with a $2,000 targeted rate would pay $200,000 per annum)
</td><td>unintentionally impact on some smaller landowners in the area that will never develop their land

However, there are a range of rates policy tools available to the council to address those issues
Able to also charge a fair share of costs to existing housing units that also benefit from the infrastructure
</td></tr>
<tr><td>Option Four:</td><td>In conjunction with options (ii) and/or (iii) implement an investment partnership model to finance growth infrastructure.</td><td>
Enables faster housing development in a way that is not limited by the availability of council debt headroom
Provides an opportunity for a commercially focused entity with relevant skills and expertise to take a lead role in negotiating infrastructure financing arrangements with developers
</td><td>
Landowners will be able to negotiate with a commercially focused entity to access infrastructure financing
Developers / land owners will ultimately need to pay higher charges in some form to cover the cost of the growth infrastructure. This could take the form of higher DCs and/or IGCs, new targeted rates, higher user charges or voluntary payments under a negotiated contract.
Where private contracts are involved, land owners may need to accept a charge on the land title recognising the obligation
Charges may be slightly higher under an investment partnership model as investors (whether public or private sector) will require a rate of return on their investment that fairly reflects the risks they are taking around the timing of when they will be repaid
</td><td>
Likely to enable faster and larger-scale housing development that is not limited by council debt headroom
A third party (not the council) would take substantial risk such as the risk that development is taken up over longer timeframes than anticipated
The Auckland Council group will still lead the construction of the infrastructure and will be the long-term asset owner and operator.
Implementation of the investment partnership model could involve the establishment of a new council controlled organisation.
</td></tr>
</table>

Attachment B: Issues for consideration – targeted rates for growth infrastructure

Targeted rates provide flexibility to design funding arrangements that can accommodate a wide range of circumstances. A targeted rate can be applied in conjunction with other funding sources to:

- provide revenue security for financing infrastructure
- deliver incentives for land owners to develop
- while recognising the need to accommodate the:
  - cash flows constraints developers work within
  - interests of different land owners
  - interests of future house buyers.

This section addresses some of the key issues the council will need to consider when deciding how to apply targeted rates. Consideration of these matters also highlights areas where changes to legislation would provide the council more flexibility to set targeted rates that address both the council's goals and the particular needs of all interested land owners.

1. Timing

The commencement date and duration of a targeted rate will influence its impact on current land owners and future house buyers.

Commencement

A targeted rate can be levied at any time from when a decision is made to invest in infrastructure. Once a targeted rate is in place land owners will face an immediate increase in their holding costs and will have to find the cash to meet this additional demand. However, land owners may not be able to develop their land until the plans for infrastructure are finalised and consented or until construction is completed. Depending on circumstances the council has the following options for when it starts to levy a targeted rate. A rate can be applied from when:

- decisions are made to invest in infrastructure in a particular area – allowing funds to accumulate before expenditure is incurred
- infrastructure plans are finalised and consented – allowing developers to secure planning permission and to begin their own investments in readying land for construction
- developers are able to begin making their own investments – which may be triggered by a range of factors
- infrastructure is completed – providing complete certainty that development can proceed.

To start collecting a targeted rate the council will want to consider whether developers face any practical or regulatory barriers that would prevent them from commencing development. The timing of when land becomes "development ready" may differ depending upon the particular circumstances in different parts of the region.

Lifespan

The assets that a targeted rate will fund have long lives, for example roads. Accordingly a rate should run over a long time period. There isn't a definitive basis on which to set a repayment period. The council will need to consider this on a case by case basis. The recovery period will generally be over 10 years and more likely 20 years or more given the life of the assets. The choice of lifespan is a balance between faster repayment of debt and higher annual costs for ratepayers.

Many home owners like to pay off their mortgages early and may also wish to discharge the targeted rate liability early. In setting any targeted rates, provision will be made for early payment.

2. Sharing the infrastructure costs between land owners

A targeted rate to share the costs of infrastructure between the land owners who will benefit should aim to spread the costs as fairly as is possible. Infrastructure investments to support development provide benefits to current and future land owners:

- by allowing them to realise the uplift in land value from rezoning
- directly in terms of improved services to support a growing community.

The general rates requirement is shared between property owners based on the capital value of their properties. Capital value is the value of the land and buildings. The council can also use land value and land area. Each of these methods is discussed below.

Capital value

Capital value is the value of land and improvements (e.g. a house). Capital value does not share the costs of infrastructure required for development based on the benefits in terms of potential land value uplift. A growth infrastructure targeted rate set on capital value will be higher for a more developed property. While more developed properties are better able to take advantage of service improvements they don’t gain as much from increased development potential. Less developed properties benefit more from infrastructure investment that allows them to develop.

All of the areas where additional infrastructure investment is being considered are underdeveloped. As a result land within these areas has widely varying degrees of development. The majority of investment being considered is to support growth and allow for development. Applying a targeted rate based on capital value would impose an unfair burden on land that was more developed at any point in time.

Land value

Some development areas, both greenfields and brownfields, may not require immediate infrastructure investment to proceed. However, they may still require substantial investment over time. For these areas the land value will reflect the development potential for all properties. Where this is the case, land value will be the best means to allocate the share of infrastructure costs.

Land value is a good, but not perfect, measure of a property’s ability to benefit from infrastructure investment. Land value changes over time as property is subdivided ready for development shifting more of the burden to early developers. In addition, current rating valuation rules require land to be valued on current use potential. Some land cannot be developed until infrastructure is constructed whereas other land in the area may already be zoned and valued as residential. This is primarily an issue for greenfields development. Using land value rating would place a disproportionate share of the infrastructure cost burden on the properties presently valued as residential in the early years of any rate. This impact could be mitigated by applying the rates differentially, i.e. at a lower rate, to different land uses.

Land area

Land area better captures development potential. A larger property with space to build more houses will pay higher rates than a smaller property with less development potential.

However, land area does not differentiate between more and less desirable geography. A hectare of land in a gully will pay the same rates as land on a hill slope with a view. Land closer to a transport hub will pay the same as land more distant. Where these locational differences are material and impact on several properties they can be managed by the use of existing tools such as:

- differentials, where some land uses or locations pay more or less rates
- remissions.

Conclusion

Both land area and land value may be appropriate depending on the circumstances of individual development areas. The current mechanisms could be improved by allowing the use of land value based on development potential for the purpose of applying a growth infrastructure targeted rate. This would require a change to legislation. The current rules are appropriate for general rates purposes but not designed to fairly share infrastructure costs associated with development.

3. Managing the impact on different land owners

Rezoning land for more intensive development and investing in infrastructure to support growth, whether in greenfields or brownfields areas, requires major capital investments. Both large and small land owners will benefit from increases in land value and improved services.

While all land owners will benefit from rezoning and investment in infrastructure some are better able to realise these gains. Developers holding land in these areas will be able to realise the potential uplift in land value. Holders of smaller developable blocks of land may not be ready to realise the gains or have a different time frame for development. Many owners of existing houses may not:

- be able to realise any gain until they sell their property
- benefit from infrastructure that allows more intense development if there is limited development potential on their site
- want the additional service benefits that development will bring.

For existing home owners there may not be appeal in paying for infrastructure to support development. On the other hand the benefits may be substantial and it is more appropriate that the future beneficiaries pay rather than the cost falling on existing ratepayers. The council has a range of options to balance these concerns in how its sets any targeted rates.

The options are:

1. don’t charge existing houses for the costs of infrastructure required to allow more intense development for example trunk water and wastewater works by:
   i) funding these with infrastructure growth charges and/or development contributions as these are only charged for new properties
   ii) remitting these costs for existing houses where targeted rates are used.
2. provide for postponement for the share of the cost of other infrastructure that benefits existing houses. The existing property owner would have no requirement to pay until they sold the property or were no longer resident.

The council would prefer that the recovery of costs in these circumstances is from the buyer of the property. The new buyer would be making a conscious choice to incur these costs in exchange for the benefits. The buyer would take this additional charge into account in their purchasing decision. The existing owner would not be required to contribute to these costs but the price at eventual sale would be impacted. This would require legislative change to provide for an entirely new type of charge to be available to the council. Rates are incident on current land owns and designed accordingly. Substantial changes would be required to provide for a new type of charge incident on buyers, akin to stamp duty but location specific, or for rates to be incident on buyers in particular circumstances.

4. Informed buyers

Houses developed where infrastructure is partly funded by targeted rates will have rates obligations higher than other properties where infrastructure has been funded from other sources. We have a number of ways to ensure new home buyers are aware of their future obligations:

- include information about targeted rates on the Land Information Memorandum.

- include provision in development agreements requiring sales materials to make the future targeted rates obligations clear to prospective purchasers
- support professional bodies for advisers involved in property purchases (lawyers, real estate agents and financiers) to inform their members
- present information on the council's website
- allow vendors and buyers to discharge future targeted rates obligation as part of a property purchase.

Further assurance could be provided that buyers, and their advisers, are familiar with the obligations by allowing the obligation to be recorded on a property's title. To provide for this legislative change will be required to allow the council to record this charge on land title.