

Auckland Economic Quarterly

Chief Economist's Newsletter



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From the Chief Economist Unit

Hello Auckland

I'm delighted to introduce the first Auckland Economic Quarterly in my 18 month tenure as Auckland Council's Chief Economist.

My background is as a Senior Economist at NZIER, where I undertook industry studies and I specialised on the economic cases for public investments, policies, and regulations. Auckland projects I worked on include the City Centre Masterplan, the City Rail Link, and the Additional Waitematā Harbour Crossing.

My young family and I have moved up from Wellington and we make up six of the one million new Aucklanders expected over the next 30 or so years. We are enjoying our stay in Auckland, and as internal migrants we will see the city with new eyes, and bring a fresh perspective.

My priorities

Issues I am focused on include:

- Making Auckland the world's most liveable city – for all – including for future Aucklanders. For me, 'liveable' includes being affordable, with internationally competitive dwelling prices.
- Helping ensure that regulations (including planning regulations) are high quality and add value to Auckland as a whole. 'Auckland as a whole' includes: future Aucklanders; people that don't own land; people who are unaware of how they are ultimately affected; and people (e.g. our youth) who may not be as vocal. I want Aucklanders to be informed of the wider trade-offs from regulation. This will support informed public consultation about the big picture issues.
- Ensuring investments in public infrastructure have clear and robust business cases. I favour the 'better business case' framework, whereby a business case is progressively developed and made available to the public. That will help support scrutiny, input, and ultimately better quality investments.
- Sustaining our long-term futures, including that:
 - costs and prices do not become needlessly high because of our regulations, public investments (or lack of them), and how we manage our infrastructure assets
 - we look after the important resources that make us love this place
 - our youth, particularly in South Auckland, are engaged. They feel that the world is their oyster because they live in this global city that is Auckland.

Property prices

What struck us as new internal migrants was not so much how expensive property is to buy (we knew that already), but that it is reasonably priced to rent (Rents in Auckland account for an average 31% of annual household income, which is comparable to international cities and other cities around New Zealand).

But property is expensive, and concern is high. Below I outline my initial views on what some of the major issues are, why there is so much national interest in it, and how Council's potential regulations may affect these issues.

(Please note that this article does not reflect what Council's submissions will be to the Proposed Auckland Unitary Plan (PAUP) hearings. Rather it reflects one of my briefs to keep the public informed of the economics and trade-offs of important Auckland issues).

What people are saying about high house prices

Demographia finds Auckland to be one of the most 'severely unaffordable' cities on Earth.ⁱⁱ The NZ Property Council describes Auckland house prices as "an abomination" and says "we've reached the point of madness".ⁱⁱⁱ Graeme Wheeler, the Governor of the Reserve Bank of NZ, is concerned with the risk Auckland's house prices are posing to the financial stability of the broader economy.^{iv} He describes that the housing market is at risk of a sharp correction, which would lead to financial instability, "in Auckland, much more needs to be done, especially in creating opportunities for residential construction in Auckland central."

Building and Housing, and Environment Minister Nick Smith has announced major reforms to the Resource Management Act to reduce house supply barriers.^v In that announcement Minister Smith quoted from a Motu report^{vi} about the large impacts of Council regulations on the cost to construct homes.*

NZIER pointed out house prices have grown out of all proportion from rents, and that the assumed capital growth that must underpin investors' thinking is unsustainable relative to historical averages.^{vii}

The price of land is driving high house prices

As Figure 1 shows, it is the price of land that has ballooned relative to incomes, not rents, nor construction costs. Rents as a fraction of income has been largely unchanged, whereas the ratio of section prices to income has doubled since 1998.

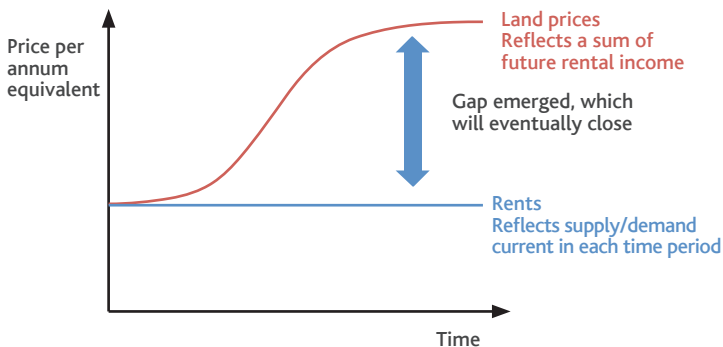
As Figure 2 shows, the price of land is highest on the isthmus and south-eastern parts of the North Shore.

High prices are not evidence of the failure of markets or public policy

Very generally, even well-functioning competitive markets can experience extreme price spikes.^{viii} It can be a market's 'call to arms' for people to invest, innovate, and repurpose resources (in this case land) to meet unanticipated or emerging needs. The economic issue is whether or not there are barriers that prevent a market from making the adaptations that it needs to make to moderate prices.

Figure 3 shows a very stylised representation of annualised land prices divorcing from rents.^{ix} Rents have stayed steady, but land prices (in annualised terms) have increased. In the long-run the two move in tandem; gaps can and do emerge, but large gaps eventually close. That is because cashflow is the fundamental determinant of capital values. How might the market adapt?

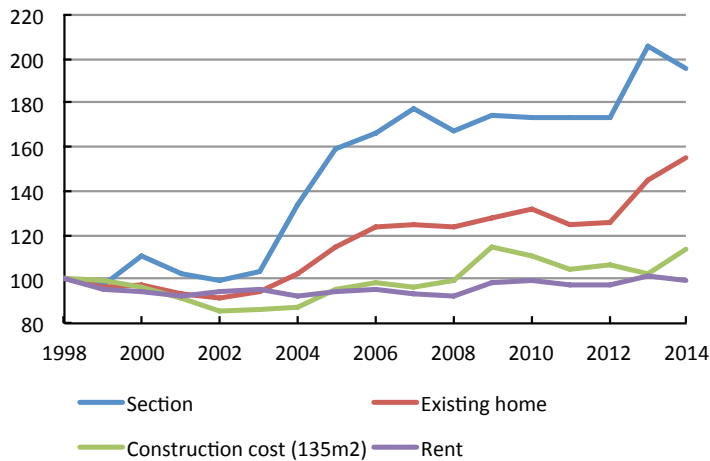
Figure 3: Auckland Housing costs relative to household income (June years).



Source: Auckland Council Chief Economist Unit

Figure 1: Auckland Housing costs relative to household income (June years).

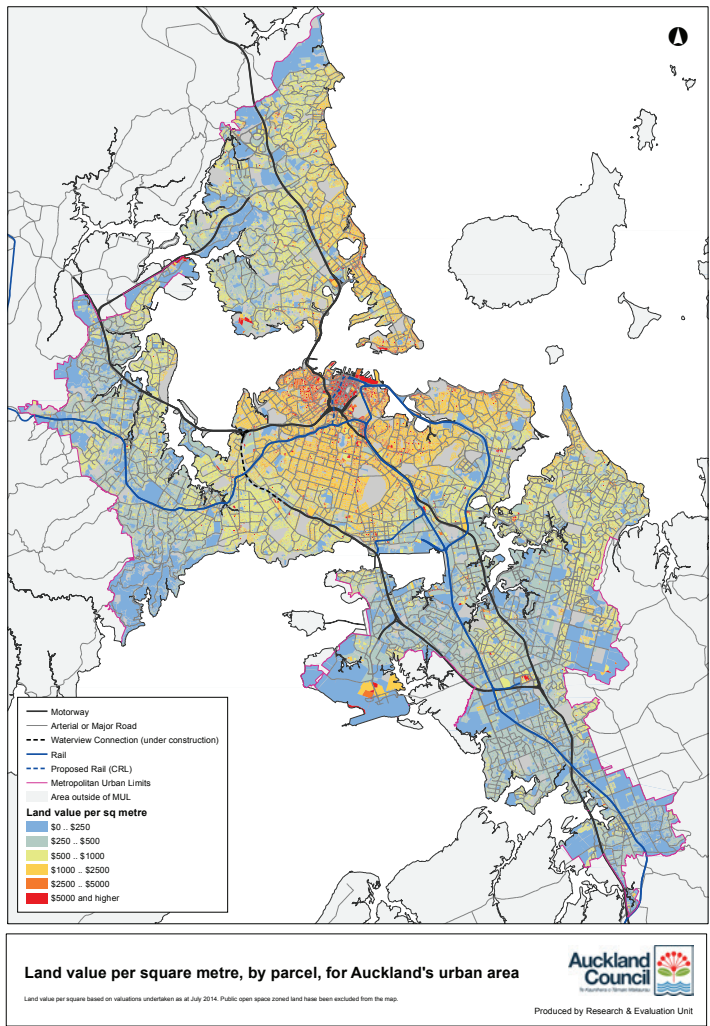
Index (1998 = 100). Section prices reaching over 200 points in 2013 means the ratio of section prices to income has doubled over 15 years.



Source: Statistics NZ, REINZ, MBIE, NZIER

Figure 2: Land prices per unit of land.

Land prices, as estimated in the recent rates revaluation.



Source: Research and Evaluation Unit, Auckland Council

Future population growth caused the gap to emerge

High land prices make sense given the expectation of some one million more people in Auckland in the decades to come. They need to live somewhere. Some may live in the outskirts of Auckland, but I would wager that the bulk would prefer to live near the major centres. Plus, land in the outskirts of the city is not a perfect substitute for inner city land. Land will need to be repurposed (i.e. redeveloped and intensified) to accommodate future Aucklanders.

Getting higher rents per dwelling isn't a solution

Can rents per dwelling increase markedly to close the unsustainable gap? No, this is very unlikely. The market for loose-footed residents is workably competitive, and high rents here will push people elsewhere. Auckland competes for residents against Hamilton, Tauranga, Wellington etc domestically, and Melbourne, Sydney, Brisbane etc internationally. Although Auckland is indeed a special place, it can't sustain massively higher rents than those alternative cities.

More dwellings per unit of land can make a big impact to close the gap

More dwellings per unit of land increases the cashflow per unit of land. This can go a long way towards closing the gap, as notionally illustrated in **Figure 4**. As land costs are shared across dwellings, the purchase cost per dwelling can fall back to more reasonable levels.

National macroeconomic risks otherwise

If there are barriers to repurposing land, more so than the market anticipated, then land prices may have overshot. In that case we could reasonably expect a 'price correction' eventually. As the RBNZ Governor said, this presents a major macroeconomic risk. Economies such as the USA, Ireland and Spain have all recently experienced the pain of a plummeting house market. The cost is a weaker economy, with more risk averse behaviour, as well as a weakened financial system (that cuts off funding for all kinds of activity, not just housing).

Is there a barrier to realising this value proposition?

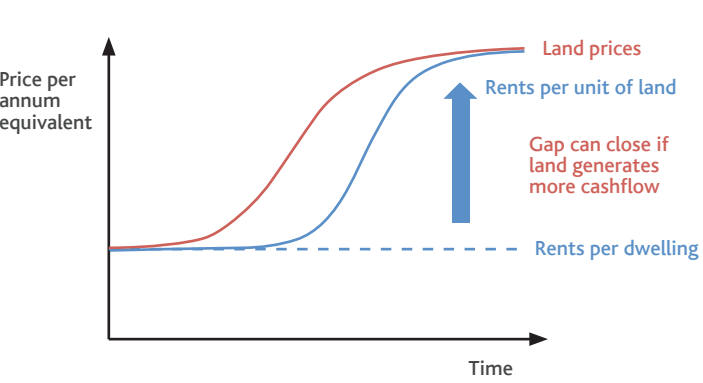
Auckland Council created the Housing Project Office to develop a range of solutions to increase the supply of quality affordable housing and to deliver on the Auckland Housing Accord. One key feature is accelerating the supply of serviced land for homes.

The PAUP allows for more intensification than the legacy district plans (as illustrated in **Figure 5** in contrast to **Figure 6**). This increased ability to repurpose land, in conjunction with development potential outside the Metropolitan Urban Limit (not illustrated), and the fast-tracking work of the Housing Project Office would seem to alleviate major concerns about regulatory constraints.

One area of concern is that which was raised by the RBNZ Governor, which is the isthmus (broadly the old Auckland City Council boundary). The isthmus is in the centre of Auckland's urban area and it has the highest land prices. Therefore one would expect the highest densities and more height in areas of the isthmus outside of the city centre. This has not been achieved consistently in the PAUP.

Furthermore, the isthmus has the greatest degree of walking, running, and cycling to/from work^x. Intensifying outside of this 'active modes' catchment means Auckland can expect to pay billions of dollars more for transport infrastructure upgrades that could otherwise be avoided or delayed. This additional cost is mitigated by the PAUP targeting intensification around road and rail transport corridors that have capacity, but it would be a significant cost nonetheless.

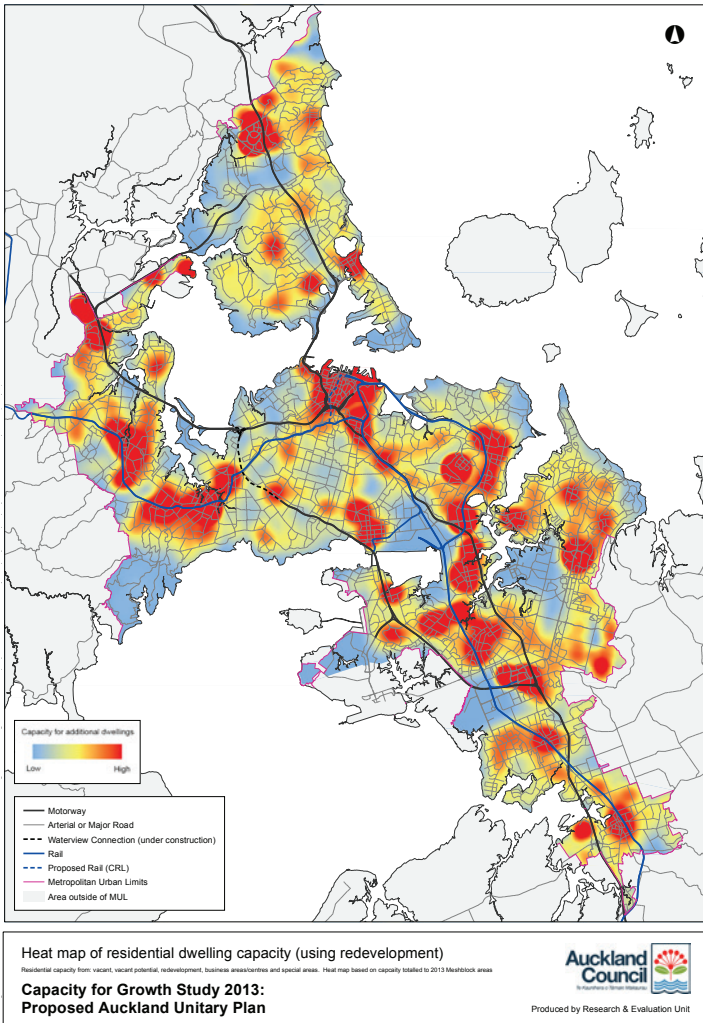
Figure 4: Intensification will make a big impact.



Source: Auckland Council Chief Economist Unit

Figure 5: Capacity for residential redevelopment in the PAUP.

Red areas have more capacity for residential redevelopment; blue areas the least. This map seeks to represent multiple features of the PAUP.



Source: Research and Evaluation Unit, Auckland Council

What does this mean?

Given that land prices are the highest on the isthmus, there is a need to further understand the potential for macroeconomic risks from barriers to repurposing land. There are also potentially significant welfare losses to future Aucklanders (many of whom are the next generation of our own families) from barriers to being able to live near the city centre and from high house prices generally. Understanding these trade-offs better to advise stakeholders is one of my key priorities over the next six months.

Chris Parker

Chris Parker
Chief Economist

* However, the figures quoted to the media were that regulations add an extra \$30,000 to the cost of an apartment and an extra \$15,000 to the cost of a home. That was actually the starting cost for some individual regulations. The final (January) version of the report claims regulations can add between \$32,500 and \$60,000 cost per dwelling in a subdivision, and between \$65,000 and \$110,000 per apartment. That's excluding the cost of Watercare and reserve and development contributions. Another recent study had similar findings.^{xi} However, like the 'cost of harmful alcohol and other drug use' study that was panned by the Treasury^{xii}, Motu stress that only the gross costs and not the benefits were assessed. My unit is taking the lead on reviewing the expected benefits and costs of these residential regulations.

ⁱ Annual rent as percentage of annual Auckland household income in 2013 Census. This differs from the 40.6% in the scorecard on page 6 because the latter relates to a full time employee, not a household.

ⁱⁱ Demographia (2015) *11th Annual Demographia International Housing Affordability Survey: 2015 Ratings for Metropolitan Markets*. demographia.com

ⁱⁱⁱ guide2.co.nz/money/news/property/auckland-house-prices-an-abomination/11/27697

^{iv} Graeme Wheeler, *The outlook for the New Zealand economy*, 4 February 2015. rbnz.govt.nz/research_and_publications/speeches/2015/6012526.html

^v *RMA reform agenda outlined*, 21 January 2015. beehive.govt.nz/release/rma-reform-agenda-outlined

^{vi} Motu (2015) *Impacts of planning rules, regulations, uncertainty and delay on residential property development*, Motu Working Paper 15-02, motu.org.nz/publications/detail/impacts_of_planning_rules

^{vii} NZIER (2014) *The home affordability challenge. Suite of policy reforms needed in New Zealand*. NZIER public discussion paper 2014/4, July 2014

^{viii} Refer, for example, to Stoft, Steven (2002) *Power System Economics: Designing Markets for Electricity*, Wiley-IEEE Press, ISBN: 978-0-471-15040-4, 496 pages.

^{ix} This ignores the value of improvements on land.

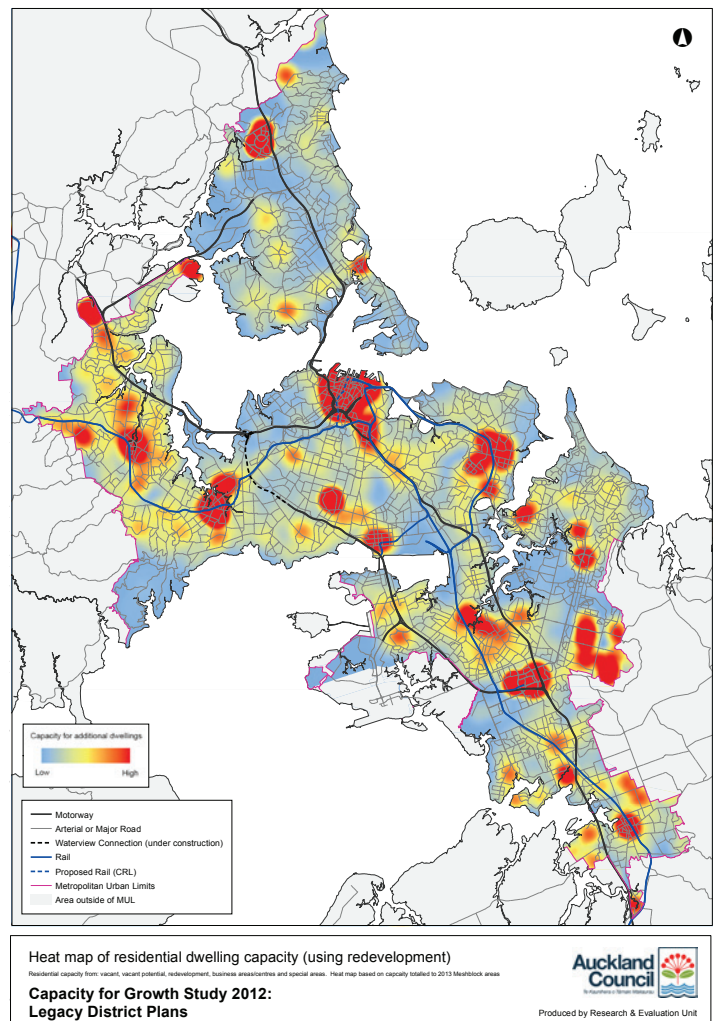
^x E.g. refer to page 59 of Richard Paling Consulting Ltd (2014) *Journey to Work Patterns in the Auckland Region; Analysis of Census Data for 2001-2013*. Report for Ministry of Transport.

^{xi} Registered Master Builders Association and the Construction Strategy Group (2015) *The impact of regulation on housing affordability*. branz.co.nz/cms_display.php?sn=234&st=1

^{xii} nbr.co.nz/article/nz-treasury-weighs-shonky-berl-alcohol-report-104204

Figure 6: Capacity for residential redevelopment in the Legacy Plans.

This map seeks to represent multiple features of the existing Legacy Plans. However not all features of the regulations contained in the legacy plans could be illustrated on the map.



Source: Research and Evaluation Unit, Auckland Council



Auckland Economic Commentary

Auckland enters 2015 with good pace

Auckland economy ends 2014 on a high

The Auckland economy is growing strongly. There is more spending, employment and investment in the economy. There is added momentum from strong international net migration. The main risk is from a very hot residential property market.

Unemployment at 6 year low

Strong hiring growth is the best indication of Auckland's economic performance. Employment increased 3 per cent in the past year and is up 14 per cent from the pre-recession highs.

The unemployment rate has fallen from a peak of 8.7 per cent in the worst of the recession to 5.7 per cent at the end of 2014.

The outlook is encouraging, with positive hiring intentions¹ and increasing job advertisements.²

Hot Auckland housing market

Strong housing

The Auckland housing market is hot. House prices in January 2015 were up 16 per cent from a year earlier (prices fell by 4 per cent in the rest of New Zealand). Sales have been volatile in recent months, likely related to the timing of the General Election.

Building more

There is increasing activity in new house building too. Consent issuance rose 20 per cent to 7,595 units last year, the highest since 2005. Apartments made up 27 per cent of the new builds, the highest since 2006

Migration boost to Auckland

Surging migration

Auckland's population is growing strongly. There was record net inward migration of 23,000 people last year, 45 per cent of the national total. This will increase spending in the regional economy and add demand for resources like housing (which will lift house prices and rents).

Growing retail spending

Strong migration is also boosting retail spending; activity in the December quarter of 2014 was 9.8 per cent higher than the same quarter of 2013, in nominal terms. However, per capita spending is being constrained by slow wage increases and caution in taking on new debt.

Moderate wage growth

Wages increased by 2.0 per cent last year. While modest, it was more than the increase in living costs (0.6 per cent). There is further relief in store from recent falls in petrol prices. Wages are being contained by strong inward migration, which is boosting the supply of workers.

Positive outlook; housing key risk

Housing activity to remain key growth driver in near term

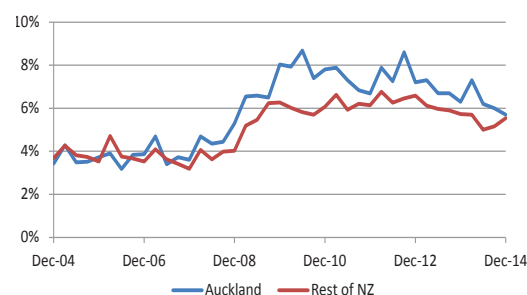
The Auckland economy continues to benefit from strong structural support factors and a cyclical surge in net migration.

The long standing urbanisation trend continues to favour Auckland. People and businesses are increasingly locating in Auckland – this is particularly favourable for skilled workers and their families and businesses that benefit from being close to markets and workers.

Annual net migration at lowest level since 2001

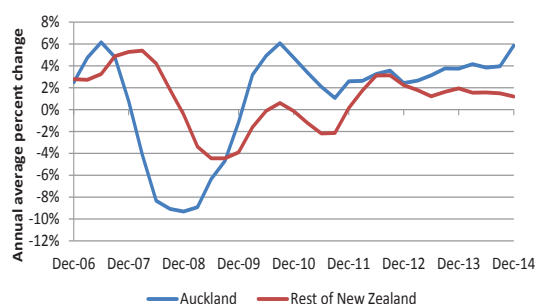
These positive forces will be sustained for the foreseeable future. But there are some near term risks. The main risk is from sustained strong increases in house prices. Houses are now unaffordable relative to income and debt servicing may be difficult in the event of a weaker labour market or tighter credit conditions. Many home owners may also be in negative equity should house prices fall.

Figure 1: Quarterly unemployment rate.



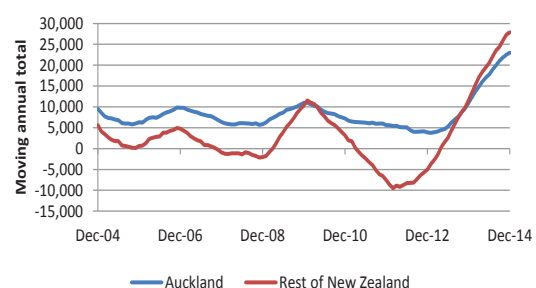
Source: Statistics New Zealand

Figure 2: Real retail sales.



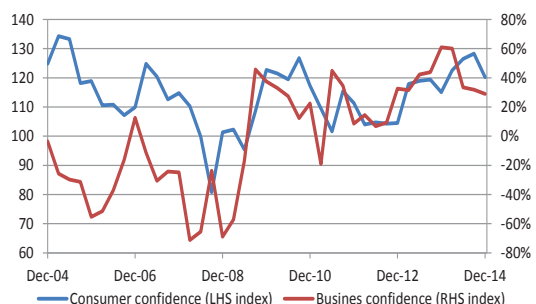
Source: Statistics New Zealand

Figure 3: Annual net migration.



Source: Statistics New Zealand

Figure 4: Business and consumer confidence.



Source: Westpac McDermott Miller, NZIER

Auckland Economic Scorecard

New Zealand Economic Indicators		Date	NZ
Inflation ¹	Annual % change	Q4	0.8%
Official Cash Rate ¹	%	Jan	3.50%
NZD/USD ¹	Month average	Jan	0.76
TWI (5 currency) ¹	Month average	Jan	78.76
ANZ Commodity Price Index ²	Annual % change	Jan	-18.8%
Current account as % of GDP	%	Q3	-2.6%
NZ population (estimate)	As at 30 June	2014	4,509,700
Auckland population (estimate)	As at 30 June	2014	1,526,900

Disclaimer

This newsletter provides general information on the Auckland economy, and is not intended to be used as a basis for any particular course of action or as a substitute for financial advice. The views and opinions expressed are those of the relevant author, and do not necessarily reflect the views of Auckland Council. Auckland Council disclaims all liability in connection with any action that may be taken in reliance of this newsletter, and for any error, deficiency, flaw or omission contained in it.

		10 yr trend	Date	Auckland	Year-on-Year change	Rest of NZ
Headline Indicators						
Employment	Number (000s)	675	Q4	782	↑	1,610
	Annual % change	2.4%	Q4	2.9%	n/a	3.8%
Unemployment	%	5.7%	Q4	5.7%	↓	5.5%
Real GDP (expenditure) ³	Annual average % change	2.4%	Q3	3.1%	↑	2.5%
Real wages	\$/week (average)	\$1,104	Q4	\$1,164	•	\$1,103
Jobs						
Youth unemployment – 15-19 year olds	%	22.1%	Q4	24.0%	•	19.9%
Youth unemployment – 20-24 year olds	%	10.2%	Q4	11.1%	•	10.8%
Industries						
Manufacturing (employment counts)*	Number (000s)	..	Q4	86	↑	172
Financial and insurance services (employment counts)*	Number (000s)	..	Q4	36	↑	37
Retail sales	Annual % change	1.2%	Q3	5.2%	↑	2.9%
Housing and construction						
House sales – dwellings ⁴	Annual total sales	27,228	December	28,859	↓	45,800
Real average private rent ⁵	\$/week	\$432	January	\$475	↑	\$346
Rent to wage ratio ⁵	%	39.0%	Q4	40.6%	↑	30.8%
Real median house sale price ⁴	\$	\$516,004	January	\$660,000	↑	\$426,000 (NZ)
Residential building consents – new dwellings	Annual total	5,467	December	7,595	↑	17,085
Non-residential building consents – new floor area approved (sq. metres)	Annual total	773,420	December	801,578	↑	2,367,760
Global connections						
Tourism – guest nights	Annual total	5,914,000	December	6,992,000	↑	27,619,000
Net migration	Net annual flow	9,008	December	23,006	↑	27,916
Arrivals	Annual flow	35,257	December	45,126	↑	64,191
Departures	Annual flow	26,249	December	22,120	↓	36,275
Real exports (\$2014)	Annual total	\$12.5b	December	\$11.9b	↑	\$39.7b
Real imports (\$2014)	Annual total	\$26.2b	December	\$29.9b	↑	\$19.7b
Confidence surveys						
QSBO - General business situation ⁶	net %	n/a	Q4	28.9%	↓	20.0%
Westpac – Regional consumer confidence ⁷	Index	113.3	Q4	118.4	↑	114.8 (NZ)

Notes:

All data is from Statistics New Zealand and is not seasonally adjusted, unless otherwise specified. Other sources of data: Reserve Bank of New Zealand (1) ; ANZ (2) ; Infometrics, Regional Economic Database (3) ; Real Estate Institute of New Zealand (4) ; Ministry of Business, Innovation and Employment (5) ; New Zealand Institute of Economic Research (6) ; Westpac (7). Data presented with the assistance of the Research and Evaluation Unit, Auckland Strategy and Research Department.

'.. denotes data not available. GDP data is not available due to revisions in methods employed by Statistics New Zealand.

Calculations: Annual % change is calculated as (Quarter – Quarter-4 – 1)*100 or (Month – Month-12 -1)*100; Annual average % change is calculated as (Year/Year-1 -1)*100

* Growth in the manufacturing and financial and insurance services sectors is proxied by growth in employment counts in these industries.

⁶ – Figures presented are the net percentage of respondents that believe the general business situation will improve in the next six months.

⁷ – Figures greater than 100 represent optimism at the consumer/household level.