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Chief Economist Unit



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Funding a fair deal: Beneficiary pays

- Those who benefit from a policy or new infrastructure should, by and large, pay a proportionate share of the cost.
- A more frequent, quicker train service once the City Rail Link is completed is an example of where the beneficiary pays principle could be applied.
- Properties near train stations will increase in value from shorter travel times and increased frequency. A targeted rate to fund the new trains could be applied to these properties.

Our previous [Auckland Economic Quarterly](#) touched on the “value capture” tool as one way to fund the infrastructure Auckland needs to take the city forward. In this edition, we look at how a value capture model could work.

A more accurate name: beneficiary pays

The idea of value capture is simple and economically defensible. Value capture means those who benefit from a policy or infrastructure change should contribute a proportionate share toward the cost of that change.

For instance, Auckland’s Unitary Plan significantly increased the number of dwellings that can be built on each of thousands of properties across the city, increasing the value of many properties.

But the value gains of these properties assume that when the owner builds more houses on those properties, the toilets will flush and the taps will run. They assume that the roads will support the extra cars, that there will be buses or trains to take the new residents to work, and that there will be libraries, rugby fields and swimming pools in the community.

Delivering all these services costs a lot of money, and so fairness issues arise.

Is it right that the property owner who has benefitted from the rise in land value should expect the infrastructure needed to underpin that price rise to be funded by others (the general ratepayer)?

A reasonable person, and certainly an economist, would answer that the general ratepayer should not typically have to fund infrastructure that benefits a specific property owner.

Value capture is a popular but weak name. It seems to imply some additional tax, but it is simply the economic **beneficiary pays** principle. Those who benefit from a policy or infrastructure change should contribute a commensurate share of the cost to make those changes.

An existing precedent

In other jurisdictions, such as the United States, local governments have more tools at their disposal through which to undertake value capture. In New Zealand, without a legislative change, the primary tool is a targeted rate on properties that benefit.

Auckland local boards have the ability to charge targeted rates to pay for local infrastructure such as community swimming pools. Outside of Auckland, the Wellington Regional Stadium is funded by a targeted rate on households and businesses that diminishes with distance from the stadium.

And the new Special Purpose Vehicle (SPV), announced by central and local government in July 2017, may use targeted rates or development contributions as mechanisms to recoup some of the cost of infrastructure to support new subdivisions.

A clear candidate

There are several projects in Auckland where the direct benefit to property owners may justify a beneficiary pays cost recovery mechanism. One example is the trains required to increase service levels once the City Rail Link (CRL) begins operating in 2023. The CRL will significantly reduce travel times to the city centre, and is expected to double the number of people living within 30 minutes' travel of the CBD. It will also double the number of passengers that can be transported through Britomart each hour.

Two things make this dramatic change possible: the underground rail line, and the extra trains to run on that rail line.

Rail infrastructure is typically funded by central government. The CRL has been funded by central and local government, with the council share being funded in large part by general rates. But the extra **trains** have yet to be funded, at a cost of around \$10 million per three-carriage set, and Auckland Council is likely to have to pay for half of that. There is a strong argument for funding these trains from a targeted rate on those who benefit most.

Why? The main results of this investment will be:

- improved service levels for existing and new (induced) users of public transport – both speed and frequency
- increased value of properties near train stations because of improved access for individuals and increased foot traffic for businesses.

Determining who benefits

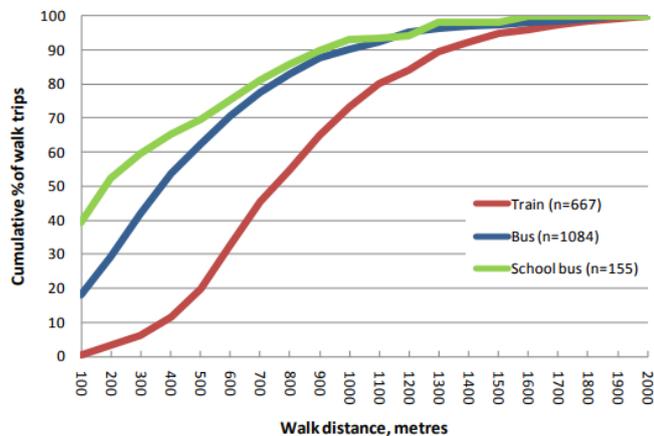
Much of the value of the new trains will accrue to property owners within walking distance of existing and new stations. Simply announcing CRL, its expected completion date and the impact on train frequency and travel times, will already be affecting property prices even before the project is completed.

This is because people will pay more to live near these stations as the CRL and its extra trains dramatically improve access to other parts of Auckland. Property prices will increase at these transport nodes relative to other parts of the city. Business locations near train stations will similarly become more attractive because of easier access and more foot traffic.

This increase in property value is a private benefit that would otherwise be paid for by all ratepayers.

This does not sit well with the principle of beneficiary pays, and suggests a strong argument for a targeted rate on properties near train stations. This is especially true since ratepayers more broadly have already picked up the tab for half the actual rail infrastructure cost.

Several studies provide a starting point for estimating use of the train depending on a user's distance from a station. A study from Sydney shows two things.¹



First, people are willing to walk substantially longer distances to a train station than to other public transport. Second, graphs like this provide a starting point for apportioning a targeted rate across the catchment area in a way that considers how proximity to a station affects expected patronage and thus property prices.

An Auckland Council study at train stations yielded similar results.² It showed that the median walk-up passenger walked between 860 metres and 1.2 kilometres to the station and 15% of walk-ups were from more than 1.5 kilometres away.

Train patronage and property price changes for dwellings near stations would allow council to split the cost of the new trains fairly across the properties most likely to increase in value from the new infrastructure.

A further benefit of a targeted rate is that it can be levied over many years. This reduces the burden on beneficiaries in any one year, and spreads the costs **inter-generationally** across those who will continue to benefit from the service for many years.

The limitations of beneficiary pays

Good public transport in poorer neighbourhoods can act as an enabler for people who would otherwise be left behind economically. A targeted rate on properties in these neighbourhoods would likely translate into rent increases that residents may not be able to afford.

There is an **ability-to-pay** argument, and potentially a strong economic argument, for not passing the full burden of the improved train infrastructure on to properties in particularly poor areas. These equity impacts would need to be considered alongside the beneficiary pays principle.

¹ Daniels, R, and Mulley, C. (2011). *Explaining walking distance to public transport: the dominance of public transport supply*. World Symposium on Transport and Land Use Research, Whistler Canada.

² Chung, P. (2012). *Walkable Catchments Analysis at Auckland Train Stations: New Lynn, Glen Innes and Mt Albert – 2012*. Auckland Council Technical Report 2012/023.

Auckland Economic Commentary

Harshal Chitale

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- The economy will continue to grow, but at a slower rate over the medium-term, led by retail, construction and tourism.
- The housing market will remain subdued as credit tightens and the election nears.
- Economic growth has not led to an increase in real wages over the last twelve months, suggesting population growth remains the driver.

Net long term migration into Auckland was 36,700 for the year ended June 2017 and 72,300 for the whole of New Zealand. We estimate Auckland's population growth at 50,000 in the year to June 2017.

Population growth helps fuel economic activity through demand for goods and services and fills skills gaps, but also adds pressure on infrastructure and housing. The number of migrants arriving with work visas was 15% higher for the June year than a year ago, while student arrivals have fallen slightly.

What's driving our economy?

As in the last two quarters, construction, retail and tourism remain our key economic drivers. However, the rate of growth across all three of these industries is slowing. Business confidence in the building sector was lower than in the last quarter according to NZIER's Quarterly Survey of Business Opinion (QSBO). The annual growth in non-residential floor area consented was slower than in the last quarter. Annual residential consenting growth has also slowed to 7.4% from 16% at the same time last year.

Annual guest nights from international visitors in commercial accommodation grew 7.3% for the year to June 2017. But total guest nights grew 2.3% for the year to June compared to a growth of 4.4% for the year to December 2016.

Annual retail trade growth was marginally slower in the year to June at 6.3% compared to 7.0% last quarter. However, with interest rates likely to remain low for a while, unless there is a drastic change to immigration policy post-election, we would expect retail growth to continue reasonably strongly.

Overall, slower growth in the three major drivers of the Auckland economy points to a slower rate of economic growth over the medium term.

Employment

Auckland's unemployment rate was down to 4.5% in the June quarter, but that is mainly because of a lower labour participation rate as compared to the previous quarter. The number of people in employment is actually lower than in the March quarter, and we would caution that quarter-to-quarter regional level unemployment data has bigger margins of error.

The QSBO showed that skilled labour was harder to find in the June quarter and businesses expressed strong hiring intentions looking forward.

And yet, nominal wage growth in Auckland was just 1.2% for the year to June 2017, which was lower than the increase in the Consumer Price Index over the same period. Consequently, real wage growth has remained weak to negative over the last twelve months.

Housing

About 10,400 dwellings were consented for the year to June 2017 although the net addition to Auckland's housing stock was a lower figure as not all consents led to completions and some old dwellings get replaced. Multi-unit (apartment and terraced house) dwellings now consistently make up a higher proportion than a year or two ago. Assuming a ratio of three people per dwelling on average, we needed to add around 17,000 new dwellings just to keep pace with population growth in the year to June.

The seasonally adjusted REINZ median Auckland house price for July 2017 was \$838,000, a 3.4% decrease over its October 2016 peak of \$877,000. June to June, the median house price increased just 2.4%, a much slower rise than the growth rate this time last year. House sales for the year to June 2017 were 21% lower than a year ago.

Reserve bank data shows that new mortgage lending to investors in Auckland has fallen to 24% of the total, a decline from 35% in June 2016, when the latest Loan to Value Ratio (LVR) rules started being implemented in spirit by the major banks.

However, the proportion of sales to owners of multiple properties has remained near record highs, according to CoreLogic. This means, contrary to recent coverage, that investors are not being squeezed out of the market relative to other buyers. Rather, a higher proportion of *cached up* investors are buying homes as those requiring mortgages are being locked out due to the latest LVR rules.

We expect this tighter lending environment to remain as banks face tighter overseas borrowing conditions. They are already resorting to raising deposit rates to attract domestic savings, and have not passed through the last few official cash rate cuts. The slow pace of new house building and strong population

growth should provide a natural floor to how much further prices can fall. The upcoming election results may also provide new direction to the market as more policy clarity emerges.

Affordability remains a major issue for first home buyers. Although servicing a mortgage is still being helped by low interest rates and prices have come off their peak, the high levels of deposits required to be eligible for a mortgage is still a significant barrier to home ownership.

Rents have increased 3.8% in nominal terms for the year to June 2017. Given that real wages have remained largely unchanged, rental affordability has worsened over this period.

Data analyst

Ross Wilson - Analyst, RIMU

Indicator	Latest	Last quarter	12 months ago	5-year average	Rest of New Zealand latest
Employment indicators					
Annual employment growth (%pa)	4.2%	7.3%	6.5%	3.9%	2.5%
Unemployment rate (%)	4.5%	5.0%	4.7%	5.8%	4.7%
Unemployment rate among 20 to 24 year olds (%)	9.6%	9.7%	10.1%	10.6%	8.4%
Unemployment rate among 15 to 19 year olds (%)	18.7%	25.6%	17.7%	23.1%	20.7%
Earning and affordability indicators					
Annual nominal wage growth (%pa)	1.2%	1.8%	2.3%	2.1%	2.8%
Annual geometric mean rent growth (%pa)*	3.8%	3.6%	3.9%	4.4%	4.6%
Geometric mean rent to median household income ratio (%)*	29.2%	29.1%	28.5%	29.4%	26.0%
Annual median house price growth (%pa)*	2.4%	8.4%	7.8%	10.9%	6.0%
Mortgage serviceability affordability index (relative to Dec-06)	-7.8%	-10.4%	-5.8%	0.9%	NA
Construction					
Annual new residential building consents growth (%pa)	7.4%	6.6%	16.3%	19.8%	3.3%
Annual m2 non-residential building consent growth (%pa)	14.8%	36.2%	39.6%	12.6%	-2.6%
International connections					
Annual guest night growth (%pa)	2.3%	3.2%	2.7%	3.1%	4.0%
Annual net migration	36,650	35,772	31,778	23,665	35,655
Confidence					
Annual retail sales growth (%pa)	6.3%	7.0%	8.6%	6.4%	5.3%
Quarterly Survey of Business Opinion (net optimists)	15.4%	4.5%	27.0%	27.4%	18.9%
Westpac Consumer Confidence*	113.5	115.1	112.3	116.7	113.4

Sources: Chief Economist Unit, Auckland Council; Statistics New Zealand; Ministry of Business Innovation and Employment; Real Estate Institute of New Zealand; New Zealand Institute of Economic Research; Westpac; Reserve Bank of New Zealand

* Rest of New Zealand figures are for all of New Zealand including Auckland

Data is not seasonally-adjusted

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