Enabling City Growth: **Lessons from the USA Executive Summary**

New Zealand cities have growing pains.

Failure to deliver infrastructure and housing in step with population has increased relative demand, pushing up asset prices while an increasing number of New Zealanders struggle for adequate homes and services.

High growth centres have attracted the most attention, but urban areas across New Zealand are struggling with housing undersupply, rising land prices and transport and water infrastructure needs which exceed affordability and environmental limits.

What's going on?

US urban growth management

The United States of America can give us some idea. It has cities which are growing in step with population growth and cities which are not. What do cities which deliver infrastructure and housing to meet demand do which others don't, and are the trade-offs worth it?

Infrastructure New Zealand led a delegation of New Zealand representatives to four growing US cities – Portland, Denver, Dallas and Houston. Each is growing more affordably than Auckland, but Dallas and Houston more responsively and affordably than Portland and Denver. How are they doing what they're doing and what can we learn?

There are two principal differences in the growth management system of American versus New Zealand cities.

Incentives and flexibility

First, the American system is better incentivised. Cities and city governments want growth. They need it to attract federal, state and private investment, without which America's thinner social welfare system will leave cities carrying the cost of unemployment, homelessness and crime.

Second, America's growth management system is more flexible. Cities have more tools in the tool box to meet growth. Property, sales and income taxes give local authorities multiple funding options. Bond markets are the first choice to finance infrastructure. Different tools mean financial and development risks and costs can be better allocated to beneficiaries.

Where funding or financing constraints limit the ability for cities to invest, even governance arrangements themselves have the flexibility to evolve. Special districts are resident authorities with the power to finance, tax, fund and operate infrastructure independent of councils.

Collaboration

Incentives and flexibility make US cities more responsive to growth by influencing the attitudes of leaders and the culture of institutions. Authorities collaborate, locally and regionally, to achieve shared objectives. Community engagement is direct and comprehensive. Long term planning is regional and vision is bipartisan.

Competition between cities drives a focus on value above cost. Cooperation within cities is encouraged by state and federal funding. If cities as a whole do not thrive, prosper and grow, private and public capital will gravitate elsewhere.

Competitive urban land markets and taxes

But even with improved incentives for city growth and greater scope to meet need, some cities still struggle to deliver affordable housing. Portland and Denver are confronted with housing unaffordability and projections are for the situation to worsen. Gentrification has become a major political issue in Portland and funding challenges across both cities are significant.

Portland has greater physical constraints, but also materially lower growth. Population growth and geography are otherwise similar across all cities and do not explain variations in performance. Instead, two major policy differences account for housing supply and infrastructure affordability performance in the Texas cities.

First, Dallas and Houston have competitive land markets. There is no urban boundary and developers can purchase large land holdings on the urban periphery as an alternative to zoned land. This generates scale efficiencies and delinks land price from planning processes which lag the market.

Competition in land supply enables commercial development to move to where populations are growing and vice versa. This leaves city centres less vibrant and increases private vehicle dependency, but lessens congestion by reducing convergence on the network. It also enables homes to be built at under three times median household income.

Second, Texas cities have higher taxes on property and lower taxes on income. Property tax is generally levied in proportion to capital value and averages 2 per cent across Texas, most for funding schools. Increasing property values lead to more tax being levied, sending a price signal to property owners and a political signal to decision makers regarding urban value and performance.

Denver and Portland have implemented legislation to delink property taxes from changes in property values. Property owners feel less financial impact from rising home prices and council revenues increase more slowly. Higher land costs drive council activity costs higher and, with limited added revenue, public investment achieves less. Funding pressures squeeze resources, resulting in less real investment, limiting developable land and perpetuating urban price dysfunction.

Long Lake/Woodmere Development Houston

180m^2 home | 450m^2 section | NZ $290,000

New Zealand growth management

New Zealand cities operate similarly to Denver and Portland. Land supply is constrained to limit environmental impacts and council costs. Unlike Houston and Dallas, growth does not provide sufficient revenue for councils to pay for infrastructure. Rates are a cost allocation method, whereas in Houston and Dallas ad valorem taxes (based on a fixed percentage of property value) increase revenue.

New Zealand cities lack the incentives and flexibility of US cities. Council revenues are largely divorced from economic performance, providing local authorities with limited incentive to support growth. Central government covers the cost of urban failure via its responsibilities for housing, welfare and justice.

With few direct costs from failure and little benefit from success, councils have few reasons to want growth and work collaboratively to achieve it. A culture of cost minimisation prevails over a desire for value creation. Leadership, vision, cooperation and integrated long term planning and investment are undermined. Siloed decision making and politicisation of projects are major issues.

Councils that do want to grow do not have the funding and financing tools to do so. Property rate increases hit ratepayers in the pocket and the few funding alternatives which exist, like development charges, impact supply. Developers held back by constrained councils and government agencies have no alternatives under a rigid governance system framed around portfolios, not outcomes.

Council efforts to charge ratepayers – those with homes – more to deliver services for people without homes has met with growing public opposition to growth and investment. Reprioritised spending to existing residents is increasing amenity and with it property values, but not resulting in more revenue. Increasing transport charges and congestion are materialising as higher land values closer to amenity as wealthier residents seek to limit transport costs.

Beneficiaries are not paying across the system and, as a result, inefficient growth decisions are being made. Costs are rising, inequality is growing and our cities are not investing enough in growth.

Enabling growth

The US urban growth system shows that New Zealand cities can grow responsively and affordably without large public subsidies. It is the policies we are pursuing which are undervaluing investment in growth and pushing up land prices.

There are some good reasons why we are pursuing these policies. American cities are widely criticised for their urban form, low relative liveability and weak sustainability.

However, the risks of current policies are not evenly spread. The urban growth system needs realigning so that beneficiaries of growth pay for growth and beneficiaries of poor growth management incur the costs.

Until these issues are addressed, New Zealand cities will not meet the needs of the growing populations they themselves require to support existing and future services.

Long term, fundamental reform of the structures, responsibilities and resourcing of cities and regions is required. There is broad support across public and private organisations for a major review of planning legislation and the structures of funding and governance across New Zealand. A bipartisan approach by political parties is critical to delivering an integrated, planning, governance and funding system.

This review needs to be accelerated and integrated with the Tax Working Group and the Local Government Funding review. A shift away from income taxes towards "ad valorem" property tax would better align the costs and benefits of growth decisions. Property tax provides a means to capture value, would realign investment away from housing and into productive activities and balance taxes on labour and capital.

Short term, central government must use its dominant position to change the incentives driving local government growth policies:

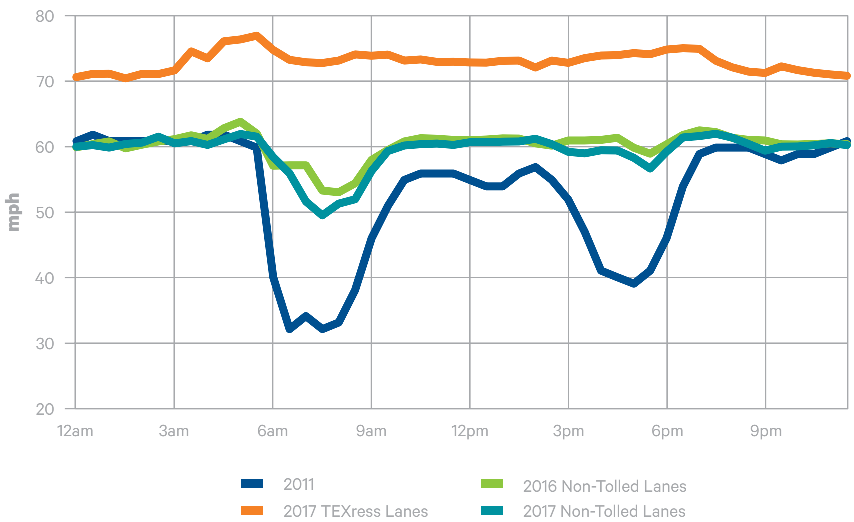
- Councils need to be rewarded for increasing housing and development supply by:
  - Enabling councils to share in taxes that the Government receives from growth through city or regional deals.
  - Greater use of competitive grants and transfers to councils, like the Provincial Growth Fund, to encourage city-regions to compete for growth and invest in their future.
- Councils need to carry the costs of growth failure by incurring funding and responsibility for some central activities, for example, homelessness.

Enhancing flexibility

Long term, flexibility for cities and regions requires change to responsibilities and accountability. Short term, the Government must intervene with tools it has at its disposal:

- Crown Infrastructure Partners (CIP) and similar special purpose vehicles should be broadened into MUD-type infrastructure financing and delivery agencies with the ability to levy rates and/or user charges. Developers should be able to apply to access CIP finance, allowing them to get paid out once the development is proven.
- Municipal water services need to be unshackled from councils' debt constraints. Structural separation from councils and water metering will provide scope to leverage capital investment and unlock billions of dollars of water investment and land development.
- Use of direct voter revenue funding approval for specified programmes should be investigated. A public debate on a specified initiative along with its cost and funding mechanism helps depoliticise investment over the long term.
- Greater use of toll roads and project financing entities to issue project bonds independent of debt constrained councils. Managed motorways and tolled express lanes can guarantee flows and speeds to ease congestion for those who pay and those who don't, and provide a revenue stream to attract private capital.

Decongestion impact of the Texpress toll road



Competitive land markets

Urban land markets need to be made more competitive. The benefits of hard regulatory instruments, like metropolitan boundaries, accrue to existing residents while costs and risks are pushed onto future residents. Development contributions do not always cover council costs. The costs and risks of urban growth need to be realigned.

- The ability for councils to constrain urban growth with regulation should be substituted by a system which ensures the costs of infrastructure are borne by the beneficiaries. If existing governments, councils, communities or residents do not want suburban sprawl, they need to provide for a superior alternative, at a similar price point, rather than preventing homes from being built at an affordable price. We must incentivise what we want, not prevent what we don't want.

In 2017, Infrastructure New Zealand costed housing on unzoned raw land between Drury and Pukekohe at $375,000 (before GST and development margin), including infrastructure, development and land. Located along the rail corridor, the Paerata satellite city presents the opportunity for major transit oriented development at scale with direct connectivity to employment centres.

- An urban development authority master planning, consenting and delivering a satellite to Auckland's south would provide an attractive alternative to low density urban expansion.

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