THE TREASURY
Kaitohutohu Kaupapa Rawa

The Importance of Being Auckland: Strengths, Challenges, and the Impact on New Zealand

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Introduction

Good afternoon. It's a pleasure to be with people who have a deep interest in important issues for Auckland and who want to help this city achieve its potential.

The Treasury is right with you on this. We know New Zealand has a lot vested in Auckland's success, just as Auckland is affected by the fortunes of the rest of the country. It's of national importance that the city builds on its strengths, takes up its opportunities, and addresses its challenges.

Today I want to talk about these strengths, opportunities and challenges and why they matter for all New Zealanders.

Auckland's strengths

This is a city that a multitude of New Zealanders and new arrivals want to make their home. It's growing fast, and that doesn't look like changing any time soon – indeed the city's population is expected to grow by another 716,000 people over the next 30 years. Auckland is projected to account for around 60 percent of New Zealand's population growth between 2013 and 2043, and to reach two million in the early 2030s. That's as many as the total number of New Zealanders when the Queen took the throne.

As well as the expected scale of population growth in Auckland compared with the rest of New Zealand, the features of this growth are also distinct.

For example, the population growth here is projected to be more youthful than the rest of New Zealand whereas in 56 out of 67 territorial authorities, it's the 65-and-over age group that's burgeoning.

But what I find exciting is that Auckland is one of the most diverse cities in the world. Two in five residents were born overseas. It's a living example of the rise of the Asia-Pacific region, home to 70 percent of New Zealand's Pacific and Asian population. Tangata whenua have a strong presence in Auckland too, with about one in four Māori residing here. Why do I find this exciting? It's because high levels of diversity provide dividends including through increases in innovation and productivity.

Auckland's diversity is particularly critical for our international connections. There's much more to international connections than trade. It's the other international flows – flows of capital and people, and the accompanying flow of ideas – which are the key to reinventing trade, and which will lay the foundation for a more prosperous New Zealand in the long-run.

The high number of overseas-born Aucklanders can bring new skills, new ideas and a diversity of perspectives and experiences that help to make our businesses more innovative and productive. And perhaps most importantly, they often retain strong personal and cultural connections to other parts of the world, which opens up, and helps us to pursue, new business opportunities.

Auckland is truly New Zealand's gateway to the world. It's not just that there is a big number of companies here doing business internationally. It's the port and airport linking the country to global markets; and tertiary institutions, researchers and innovators linking us to global knowledge.

Maximising Auckland's personal, cultural and commercial ties to the world will be essential to making us a more prosperous country and raising living standards for New Zealanders. Of course you are already making a big contribution. At present, Auckland accounts for 35 percent of New Zealand's economy and is home to 60 percent of New Zealand's top 200 companies. However, I believe Auckland has the potential to make a greater contribution to New Zealand's economy than it currently does.

Social outcomes

Aucklanders can be proud of the dynamic, cosmopolitan, international city they live in. But I'm not here to deliver a 'puff piece' about Auckland. In reality, some aspects of the city aren't going to make it onto the postcards. And we all recognise that there are people doing it tough on Struggle Street, just as there are people making it big on Queen Street.

It’s great that groups like the Committee for Auckland have a positive vision about what Auckland **could** become. Nevertheless there are some very big, very complex challenges standing in the way of Auckland fulfilling its potential – challenges that affect people in the provinces just as they do the people of Panmure.

Let me start with social outcomes. Auckland scores well on quality of life indicators but other measures suggest not everyone is able to enjoy what Auckland has to offer. Social outcomes vary significantly across Auckland, highlighting the potential importance of sub-regional thinking and analysis to lift social outcomes across the board in Auckland.

Issues with the labour market contribute to patchy social outcomes across the city. While Auckland has higher productivity than other urban centres in New Zealand, it also has an underutilised labour force. For example, the five year average unemployment rate in South Auckland is 11.7 percent compared with 6.3 percent for the rest of Auckland and 6 percent for New Zealand overall. That’s the sort of discrepancy that has a real impact on the quality of life of families and communities.

Infrastructure funding

Infrastructure – in particular infrastructure investment – is another issue where Auckland is experiencing growing pains. There is no doubt that Auckland’s growth has created pressure on infrastructure. And it’s clear that the current system across planning, governance and funding is not optimising the delivery of infrastructure to enable this growth.

We all know that growth costs, and that we all face constraints. Central government has been investing in Auckland but we will always need to balance this investment against other priorities. Local government also has its own responsibility to fund local infrastructure. That responsibility can entail some tough calls, and it also means the Auckland Council needs to manage its resource base well if it’s to invest in the future of the city. Both the Government and Auckland need to think creatively about how to fund infrastructure. And when we do invest, it’s important that the investment represents the best value for money.

Transport

There’s no doubt we have some challenges. But I’m pleased to say that central and local government are working on challenges together. A great example is the Auckland Transport Alignment Project, or ATAP. This project has the Treasury working alongside Auckland Council and Auckland Transport, together with our central government colleagues from The Ministry of Transport, New Zealand Transport Agency and State Services Commission.

The genesis of the project was a call from the Mayor of Auckland for Parliament to legislate more funding tools that could help the Council bridge the significant financial shortfall in the 30 year Auckland Transport Plan. So the ATAP partners are doing a joint investigation that will test the Auckland Transport Plan and see whether better results from transport investment can be achieved.

Together we're looking at different intervention packages and testing them for value for money and in relation to some important objectives including access to employment and labour and reduced congestion.

The final ATAP report is expected to be published in August, but the Preliminary Findings and Conclusions report released today has some significant observations. I'll start with the positives:

- Specific interventions look like they can help in the west and south, which were identified as problem areas in the ATAP Foundation Report. For example, the Northwestern Busway appears to make a substantial difference to public transport accessibility in the west.

- New initiatives, including variable network pricing, shared mobility and connected vehicle technology, have potentially significant positive impacts and could defer or reduce the need for investment in infrastructure.

- Technology advances provide new avenues to improve congestion and could have fundamental implications for transport investment.

- Emerging transport and communications technologies have the potential to radically alter future travel demand and supply.

- Public transport mode share in the morning peak is expected to increase from 7 percent to 15 percent over the next 30 years.

But a few other findings highlight the size and complexity of the issues ATAP involves:

- The existing and pending commitments to large projects in the next 10 years reduce the funding available for discretionary investment up until 2028.

- Even with these investments in place, there is a projected decline in network performance by 2026.

- The existing Auckland Harbour Bridge has limits on its ability to cater for heavy traffic growth, and increased private vehicle and public transport demand. A new crossing has very high opportunity costs meaning it is very important to understand key drivers, alternatives, costs and benefits before any investment decisions are made.

As I said, these are big, complex issues.

The impact of high housing costs

That brings me to arguably the biggest, most complex issue of all, housing. Let me say a few things up front.

Auckland has 3 people sharing a home on average, the highest number in the country. Between 2001 and 2013, the average number of usual residents living in a private occupied dwelling within Auckland increased 1.7 percent, compared to a 3 percent decrease for the rest of New Zealand. When it's clear that population growth is outstripping housing supply in Auckland, there is little doubt there's a problem that needs to be tackled.

When investors are content to leave land undeveloped when there is such a high demand for housing, something's not working.

And when New Zealand's housing debt is around $215.9 billion, a 26.6 percent increase in five years, nobody should be surprised the Treasury is concerned.

The Treasury cares about these and other issues in the Auckland housing market because they have impacts for everyone from Cape Reinga to Stewart Island.

One of those impacts is the level of indebtedness. The housing debt I mentioned is far and away the biggest component of New Zealand's $246 billion household debt, which itself has grown 26.2 percent in 5 years. By the beginning of 2016, the level of household debt to disposable income had risen to 163 percent. This is higher than in the lead-up to the global financial crisis and is likely to go higher still, with the Reserve Bank expecting credit growth to continue to outpace income growth.

Debt in itself is not automatically a concern, as long as households are able to service their debt. Current low interest rates are making it easier for home owners to repay their mortgage. But those low interest rates have also contributed to rising house prices. Debt to income ratios are at historically high levels, and it now takes nine times the average household income in Auckland to buy an average house in this city.

High debt to income ratios leave households increasingly vulnerable. A drop in income or a rise in interest rates might see some struggling to meet their mortgage payments. Households' balance sheets could take a hit, as housing assets make up around half of the total value of household assets. That's not just a concern for households alone. Housing represents around 60 percent of bank balance sheets. In the event of a downturn, the high levels of debt across the banking sector and significant level of indebtedness of individual households could have knock-on effects that might cause serious losses of confidence and financial disruption. In short, inflated Auckland house prices are a risk to New Zealand's financial stability and the economy more generally.

The Reserve Bank of New Zealand is very focused on preventing threats to the stability of the financial system, as is the Treasury. The RBNZ's stress-testing of banks has provided insights to risks and helped banks identify actions they may need to take. As a result, our banks are in a stronger position to cope with major shocks than they were before the global financial crisis.

The Treasury's broad interest in Auckland housing includes its effects on the labour market. The impact of high and rising house prices in Auckland is felt nationally by way of reduced labour market mobility. I'll use the example of knowledge-intensive sectors and firms. Well over half of New Zealand's high-tech manufacturing jobs are located here, and just under half of the commercial knowledge-intensive service jobs. These require skilled and well-qualified workers. But it's difficult to attract these workers from elsewhere if they find it too expensive to buy a house in Auckland and put down roots.

We also miss out on making these workers more productive. Better productivity is the way to achieve sustainable economic growth and raise living standards. Selling ever higher priced houses to each other isn't. Distorted Investment decisions are leading to lost opportunities for the country.

As New Zealand's largest urban area, with house price increases far outpacing the rest of the country, housing affordability concerns have been largely focussed on Auckland. Nonetheless, the first half of 2016 has seen rising house prices and falling inventory levels cropping up in other regions. Evidence of this first appeared in Tauranga and Waikato, demonstrating the 'halo effect' from Auckland, but there is increasing evidence of this in parts of the country further afield.

We're feeling it in Wellington too, and not just because our own house prices are rising. The Treasury has to consider the financial consequences for the Crown. Central government faces higher fiscal costs due to the upward pressure on rental subsidies and impacts on welfare, particularly for low-income households.

So what's pushing up housing costs, and what can we do about it?

There are a number of drivers of house prices in New Zealand, most significantly supply constraints but also including low interest rates, population growth, income growth, tax settings, and high net migration. On net migration figures, it should be kept in mind that they reflect New Zealanders not moving overseas to the extent they used to, and include Kiwis returning home. A quarter of our arrivals are New Zealand citizens coming back here.

The Government and the Reserve Bank are addressing the demand side. Last year's bright-line test has made clear that gains on selling residential property within two years of purchase will be subject to income tax. Macro-prudential policy has seen the introduction of loan-to-value ratio restrictions. And at the Treasury, we continue to think hard about how the incentives in the housing market are playing out.

This is against a background where we think the primary way to address housing affordability is through supply. If the supply of housing was more responsive to demand, then the pressure on house prices in times of higher demand would not be felt as acutely. I'd like to explore the importance of price for a moment. Price can play a greater role in our understanding of the market and in the creation of a more competitive, efficient market for housing. Price signals, such as those which measure the difference in price between developable and non-developable land, can provide a useful indicator of whether the planning system is providing sufficient land for housing. The price of residential land is dynamic – shifting in response to fluctuations in both supply and demand-side factors in play at the time of purchase – thus providing a clear indication to councils of the current market and putting them in a better position to respond to actual demand for land in their communities.

Fundamentally, pricing is a mechanism for allocating resources, not just in terms of the land for housing, but the infrastructure needed to service it. Pricing mechanisms, such as volumetric charges for water or road network pricing in transport, can lead to greater efficiency in the use of these services which can help manage demand for new infrastructure.

Addressing the housing challenge

When it comes right down to it, there is no silver bullet, magic wand, panacea or lucky charm that will solve the supply issue tomorrow. It takes a lot of effort on a lot of fronts and that's exactly what's been happening.

Central government is already implementing initiatives to lift housing supply, and it's quite a substantial list:

- There are provisions within the Resource Legislation Amendment Bill that is currently before Parliament to improve the planning process.
- The Government has entered housing accords with nine local authorities and established 205 special housing areas, steps which are expected to lead to over 63,000 homes being built.
- There have been changes to the way councils can charge for infrastructure for new development.
- Government agencies are releasing land they're not using, and looking at how they could release even more. We're asking questions like "What's the Government's current footprint in Auckland? Is that land being put to its most effective use? How much of a presence does central government really need to have in Auckland anyway?".

And there's more on the horizon with the Government's upcoming response to the Productivity Commission's Using Land for Housing report. The Productivity Commission has identified three key issues that restrict the supply of residential development, findings that the Treasury agrees with. These issues are:

- A slow and prescriptive planning process that neglects important priorities and is not responsive to household demand and price signals.
- Infrastructure provision that is unresponsive to growth demands.
- A strong focus on local interests and the welfare of existing homeowners, and a weaker focus on the national interests and interests of non-homeowners and future residents. In other words, NIMBYism carries a lot of weight. The Treasury recognises that it's a difficult situation the Auckland Council faces. At the same time we are concerned that the impact of NIMBYism in Auckland affects people elsewhere in the country.

Addressing the housing challenge requires a concerted effort from both central and local government, and I think that we've been working well together. That's important, because neither of us can do it alone. The initiatives I've mentioned attest to the significant role central government has had to date. Now local government is in the position to step up once again. Right now, the greatest lever to improve affordability and the supply of housing in Auckland sits with Auckland Council.

Unitary plan

The Auckland Unitary Plan is not just a huge responsibility for the Council, it's a huge opportunity that will shape Auckland over the next 30 years. I'm not here to tell Auckland Council what decisions it needs to make; I am here to tell you what outcomes the Treasury would like to see for the long-term interests of Auckland and the nation. I do this from the perspective of the Treasury's thinking about how the whole system is working, and the incentives within the system. For example, are people incentivised to develop residential land or to sit on it?

One of the crucial things we'd like to see is that the Auckland Unitary Plan provides sufficient residential development capacity – in terms of the quantum, location and typology – to support urban growth and create a competitive market for land. This would send a strong clear signal to land-bankers and speculators getting rich off the status quo. There are figures on the number of development sites that sound like a lot, but prices suggest otherwise. In large part this because of a shortage of feasible development capacity in existing areas within current plans.

Creating a competitive land market, by making more development capacity available across all parts of Auckland, would weaken the incentives for speculation and land-banking, resulting in a larger proportion of potential development sites being brought to the market.

The Independent Hearings Panel will be providing its recommendations on the Auckland Unitary Plan to the Council next month, with the Council making decisions in August. It is my strong hope that the IHP's recommendations will provide for substantially increased development capacity in Auckland. It's of major importance in the short, medium and long term.

Given both the contribution of Auckland to the national economy and that the economic and fiscal impacts of Auckland housing extend to every corner of New Zealand, the Council's decisions on the Auckland Unitary Plan should also be informed by the national perspective offered by the draft National Policy Statement on Urban Development Capacity.

The Statement requires councils to provide sufficient development capacity to meet residential and business demand, with an additional margin to take account of the likelihood that not all capacity will be developed. The total capacity should reflect the demands for different residential types and locations as well as the commercial feasibility of the plan-enabled development.

Conclusion

To summarise, Auckland has some momentous choices ahead of it – choices that can affect the whole country as well as the future of this city.

I've concentrated on housing and transport issues because they represent important foundations required for a prosperous long-term future for Auckland. But those foundations aren't the key part of the story. Fundamentally, the future of Auckland is about its people.

The famous photographer Sir Cecil Beaton once appealed to people to "be anything that will assert integrity of purpose and imaginative vision against the play-it-safers, the creatures of the commonplace, the slaves of the ordinary." From what I can see, many Aucklanders are heeding that call in their own way. And having the right infrastructure, supported by economic incentives that send clear, efficient and effective signals, will enable Aucklanders to continue to exercise their dynamism and diversity and to do the best that they can do.

The challenges are formidable but they are resolvable if we do the right things. Central government will continue working shoulder to shoulder with you on this because a thriving, successful Auckland doesn't just matter to Aucklanders. It matters to every New Zealander.