AucklandEconomicQuarterly

Chief Economist Unit

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Absolutely THABulous: Making more apartments work for Auckland

- The Terrace Housing and Apartment Buildings (THAB) zone allows for the most intensive redevelopment of the four main residential zones created under the 2016 Unitary Plan.
- The THAB zone was slow to take off after the Unitary Plan became operative compared to other development types, but is now growing rapidly.
- Still, the development community believes several challenges remain to more intensive, optimal redevelopment of THAB land.
- Sub-optimal take-up of THAB zoned land (say three-storey terrace houses instead of five-storey apartment blocks) is a wasted opportunity to use existing infrastructure, limit congestion growth, maximise feasibility of public transport, and create more viable communities.
- Auckland Council has a role to play in tackling some of these perceived problems, while others are determined by market forces and preferences, including revenue drivers, the higher construction costs of apartments, and numerous costs of risk.

Under the Unitary Plan, the THAB zone allows for the most intensive redevelopment among residential zones, at heights of up to 16 metres. And despite its name, let's be clear: this zone is about building five-storey apartments, not three-storey terrace houses. There is more than enough capacity for terrace housing in the Mixed Housing Urban zone, which accounts for 15% of all development zoned land inside the Rural Urban Boundary (RUB), compared to 5% for the THAB zone.

The four main Auckland residential zones

Single house zone	Single dwelling, up to 8m high
Mixed housing suburban zone	Multi-units, up to 8m high
Mixed housing urban zone	Multi-units, up to 11m high
Terrace housing and apartment buildings zone	Multi-units, up to 16m high

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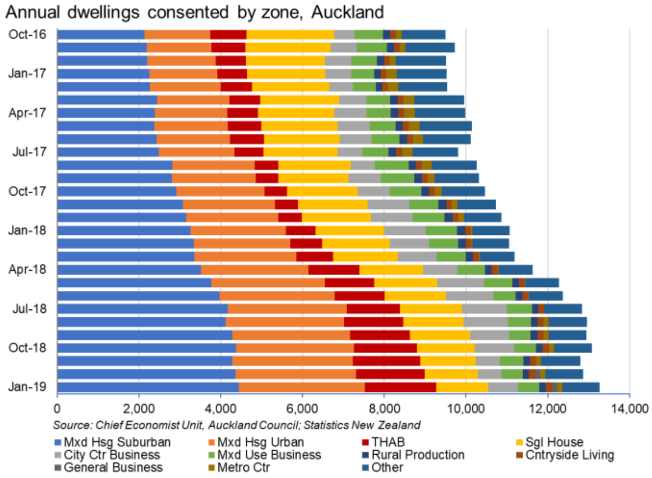
This raises two questions. First, are we redeveloping the THAB zone at pace, like we are doing more generally (building consents in aggregate are up 25% year on year)? Second, what does the development community highlight as the biggest challenges to maximising development of THAB zoned land?

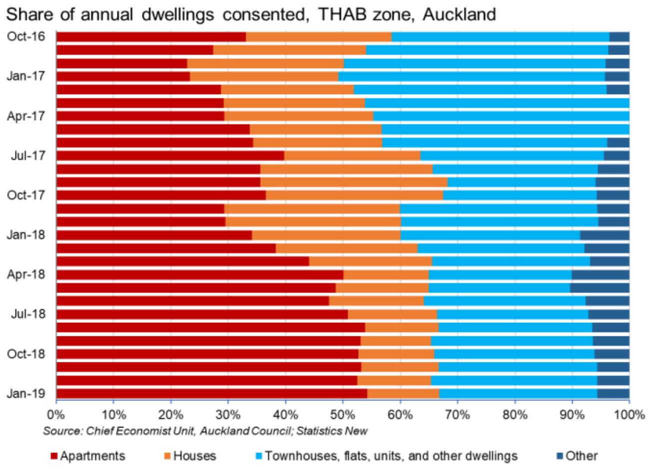
Slower to start, but quickly growing

We have previously [written about the lag between the Unitary Plan being implemented and a resurgence in building consent growth]() starting in August 2017 – back into newly upzoned areas closer to jobs and with existing infrastructure and amenities. But redevelopment in the THAB zone lagged other zones. In fact, if anything, its consenting activity sank. Until January 2018, that is.

In hindsight, this makes sense. Larger-scale developments are more complex. They require more design work, are more difficult to fund, and require more review during the resource and building consent stages for instance. As a result, the THAB zone took an extra five months to kick into gear.

Recent changes in dwellings consented, Auckland





In the year to January 2019, the number of dwellings consented in the THAB zone rose 197%. The THAB zone has surpassed both the Single House and the City Centre Business zones in consenting new dwellings. Just over 13% of new dwellings consented are in the THAB zone as of January 2019, up from 5.4% in the year to December 2017, even though the THAB zone is just 5% of development-zoned land inside the RUB.

But it also matters ***what*** we are building in the THAB zone – stand-alone homes, terrace houses, or more optimal apartments. The good news is apartments now dominate newly consented dwellings in the THAB zone.

Good foundation, but work to do

Yet challenges to fully maximising THAB development remain. And sub-optimal take-up of THAB zoned land is a wasted opportunity to use existing infrastructure, limit congestion growth, maximise feasibility of public transport, and create more viable communities.

The Chief Economist Unit spoke to a large number of developers, builders, private planning consultants, and quantity surveyors active in apartment development about development decisions and what, if anything, stopped them from doing more. The remainder of this paper provides an objective summary of the sometimes subjective views of the people we spoke to.

They raised four broad categories of considerations:

- limitations of the THAB zone rules
- customer preferences that affect revenue
- extra financial costs from building apartments rather than terrace or stand-alone houses
- costs of risk related to more complex development.

There's more to the storey

According to interviewees, the THAB zoning itself has limitations. They felt there was not enough THAB zoning near the city, where demand for this typology is highest. They felt current zoning seemed mechanistic in its extent around town centres and transport nodes, and perhaps ignored opportunities that could come from large existing parcels of land that were not zoned THAB. THAB rules such as height to boundary restrictions and other overlays such as volcanic viewshafts often forced less development than the THAB zone would otherwise allow.

Auckland Council is currently considering these concerns, and is reviewing the extent to which the city is delivering quality intensification in a joint work programme with central government.

Sellers will build what apartment buyers want

But to proceed, a developer needs to be confident a buyer will pay more than the sum of known financial costs and the cost of risk.

Expected revenue > Known financial costs+Costs of risk

Interviewees suggested challenges on the revenue side include market acceptance of apartment living. Most people expect to pay less to live in an apartment than in a house because apartments are smaller, have limited outdoor space, and ongoing body corporate fees.

This means the pool of people who want to live in an apartment is mostly limited to under 30s and over 55s. Only the latter typically have the money to buy; apartments for under 30s have to be investor-owned. But the limited group of possible purchasers means the market for apartments further from the CBD is small. No matter how much land further away is zoned THAB, there will be fewer buyers. Because investors, local and foreign, play an important role in apartment purchases, the foreign buyer ban reduces the pool of potential purchasers when an existing apartment is resold.

Outside the CBD, buyers also demand more car parks because public transport doesn't cater to cross-town trips as well. Buyers usually want at-grade car parks, which means less floor area for apartments to stay within impervious surface rules under the Unitary Plan.

Things that lift the cost of apartments

While market demand is limited, the costs of building apartments are far higher than for stand-alone or terrace houses. Big direct financial costs associated with apartment-building include cranes, which can cost up to $100,000 to set up and dismantle, plus monthly rental costs. Buildings four floors and higher need lifts, and bigger buildings need extensive façade engineering for weathertightness, which is another major cost. Fire-proofing between tenancies that are not side-by-side like in terrace houses, but also above and below, adds further cost, while opportunities for cost-saving standardisation between sites is limited for apartments.

Finally, known financial costs are affected by the complexity of apartment development, which reduces the pool of qualified builders. In times of high demand for commercial buildings, residential developers have to compete for builders.

Costing known and unknown unknowns

But there are also several risks that apartment developers have to price, in addition to known financial costs, many of which may also limit the scale of development.

This guy said it best

Source: US Federal Government

According to interviewees, one known risk is bank funding. Apartment developments are bigger and costlier than terrace housing, cannot be staged, and take longer to complete. This makes reliance on banks, and caution by banks, greater. Banks require high rates of pre-sales, more stringent (read: expensive) due diligence and quantity surveying work, and higher expected margins to approve funding. These hoops add risk and cost.

Interviewees highlighted the resource and building consent process as another known risk area where Auckland Council can support development. Concerns included seemingly low bars for triggering a resource consent application or public notification, and interpretations of alternative height to boundary rules allowed in the Unitary Plan but that are routinely treated by the council as a breach of the rules. These outcomes caused costly time delays and created risk that neighbours who don't support the Unitary Plan zoning could scuttle projects, reducing apartment delivery.

Interviewees also felt that council subject matter experts reviewed applications from the perspective of their areas of technical expertise, but that trade-offs between specialist areas, the cost or time delays of achieving those outcomes, and the impact these costs and delays might have on housing provision in the midst of a housing crisis should be given greater weight.

Interviewees further pointed to many unknown unknowns in large-scale developments, including site and infrastructure conditions. Contaminated sites, unstable ground, or being asked to upgrade infrastructure that would also benefit other developments were three of these unknown unknowns. The bigger the development, the greater the scrutiny, and the greater this risk.

Amalgamating fragmented sites into one usable site also held uncertainty. Would the final property owner in the chain hold out for more money? And in this climate of high demand for all construction skills, the potential for sudden build cost escalations was higher than usual.

The way is up?

It's clear there are a multitude of inter-related factors that determine whether more apartments get delivered in the THAB zone. It is heartening to see the rapid growth happening there, and with a capital gains tax off the table and record low interest rates, there is significant opportunity for more large-scale apartment development.

But there is more to be done. Auckland Council is working on a number of the moving parts it has an influence over, while striving for quality intensification. Still, interviewees identified several obstacles within the private sector that have to be overcome too – funding risks, buyer preferences, and a construction industry straining under its workload.

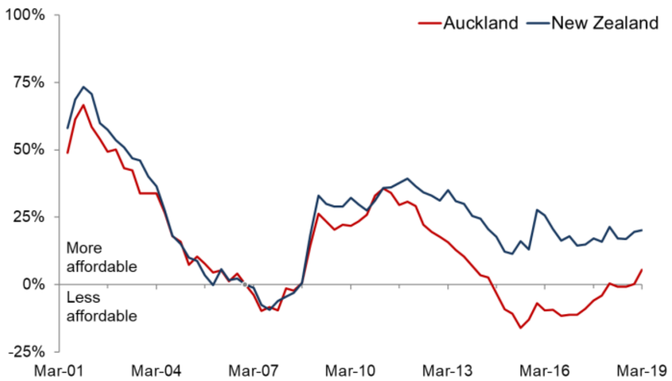
Auckland Economic Commentary

David Norman
Chief Economist

- Housing is the most affordable it has been in five years with flat prices, rising incomes and falling interest rates.
- No capital gains tax will provide a floor under prices falling further.
- Construction's growth continues unabated, and remains the main driver of Auckland's economy.
- Meanwhile retail trade growth remains moderate and tourism growth relatively weak.

The big story this quarter is what is happening to house prices and the implications for affordability. Housing in Auckland is still unaffordable for many, but for the median income household, the median priced house has not been this affordable for five years. Our Serviceability Affordability Model, which we have been publishing for two years now, shows the median Auckland household's ability to buy the median house sold, based on household income, interest rates, ability to save a deposit, and the iterative impact that unaffordability has had on household incomes (it artificially pushes up household size, and thus household earnings, precisely because people can't form new households as quickly as they otherwise would).

SAM median house price affordability relative to December 2006



source: Chief Economist Unit, Auckland Council; Real Estate Institute of New Zealand; Reserve Bank of New Zealand

Affordability bottomed out in June 2015. Since then, mortgage rates have fallen, and household incomes have risen. Nominal house prices fell a little and have then remained stable for the last two years. This has boosted affordability to about 5.6% better than it was in our index quarter of December 2006, and the best it's been since December 2013.

It's also worth pointing out that overall, New Zealand affordability remains much stronger than it was before the GFC. Stripping Auckland out of the New Zealand curve would imply that despite recent price rises, most parts of New Zealand have remained far more affordable for the last 12 years than they were just before the GFC.

With capital gains tax off the table since this March data, and even lower interest rates, we'll see some stimulus to the housing market that we think will sharply reduce the risk of any further declines in house prices in Auckland. That said, we think the effect in Auckland will be more to keep prices where they are, removing the risk of a further fall, than to start cranking them up. This means affordability will probably stay at least where it is or move up another tick over the next six to 12 months.

As we mentioned in the last AEQ, we're not convinced unemployment is about to surge any time soon – wage growth is still too subdued at just 2.8% a year. On cue, the March quarter unemployment rate was up 0.1 percentage points, to 4.4% in Auckland, still lower than it was a year ago. Given a very sensitive dataset, there's no reason to conclude now that it is doing much of anything in particular.

But with house prices fluctuating in a narrow band, even those small wage rises and subdued unemployment are helping households. Rents in Auckland were up just 1.6% year on year, meaning the share of household income being spent on rent has fallen from 28.3% on average over the last five years, to just 26.2% in Auckland today.

We haven't constructed a better story yet

As per the last two years of AEQs, the growth industry remains construction, which continues to defy all the odds. Every story of capacity constraints, prices increases, or cement truck bottle-necks seems to be answered with another leap in consented work. In the last AEQ we thought we would soon see the stimulus of the Unitary Plan peter out, and a higher level of dwelling consents remain, but with less growth. The first three months of the year have certainly not got that message. Annual new dwellings consented are up a quarter over the previous year, and while we do still think we'll see slower growth in dwellings consented in 2019, the slowdown hasn't happened yet.

But we must not ignore the big news story of non-residential construction, where the floor area consented still remains 40% higher than a year ago. With stiff competition between high-rise apartment and commercial construction for skills, this will be an interesting space to watch over the next couple of years.

The tamer growth in tourism over the last 18 months or so persists. Guest nights in Auckland are up just 0.8% year on year, but at least are growing, which was not the case a year ago. Interestingly, this doesn't seem to be an Auckland thing. Growth in the last 12 months in the rest of New Zealand has been even weaker. Replacing the currently unusable migration data, we are incorporating data on passenger numbers through Auckland Airport. These continue to grow, but as per the tourism story, growth is significantly weaker than 12 months ago.

Yet domestic spending in the form of retail trade remains strong, at around the 4% mark. With the population estimated to be growing at about 1.8% in Auckland, and stripping out inflation, this retail figure suggests weak real per capita spending growth, but from the perspective of the business, they are enjoying modest real growth.

Confident we're more confident

The confidence measures remain their usual jolly tales of doom and gloom although the QSBO is actually slightly better this quarter, and the Westpac consumer confidence measure a bit gloomier for Auckland. As we've said many times already, these results don't sit with low unemployment, modestly growing wages, and record investment in construction.

Data summary provided by **Ross Wilson** - Analyst, RIMU

Indicator	Latest quarter	Last quarter	12 months ago	5-year average	Rest of NZ latest
Employment indicators					
Annual employment growth (%pa)	2.9%	1.7%	3.8%	4.3%	0.6%
Unemployment rate (%)	4.4%	4.3%	4.5%	5.0%	4.4%
Unemployment rate among 20 to 24 year olds (%)	8.6%	9.9%	9.3%	9.5%	8.8%
Unemployment rate among 15 to 19 year olds (%)	21.4%	21.5%	20.1%	21.3%	23.8%
Earning and affordability indicators					
Annual nominal wage growth (%pa)	2.8%	2.7%	4.0%	2.4%	3.4%
Annual geometric mean rent growth (%pa)*	1.6%	1.5%	4.0%	4.2%	5.6%
Geometric mean rent to median household income ratio (%)*	26.2%	27.0%	26.4%	28.3%	24.4%
Annual median house price growth (%pa)*	-2.7%	0.3%	-2.2%	5.8%	4.5%
Mortgage serviceability ratio (relative to Dec-06)*	5.6%	0.3%	0.4%	-6.1%	20.3%
Construction					
Annual new residential building consents growth (%pa)	24.0%	18.4%	1.9%	16.3%	2.2%
Annual m2 non-residential building consent growth (%pa)	39.9%	42.3%	15.0%	9.8%	8.5%
Connections					
Annual guest night growth (%pa)	0.8%	0.9%	-0.2%	2.0%	0.6%
Annual Auckland Airport passenger movements (%pa)	2.8%	4.0%	7.3%	6.6%	*NA*
Confidence					
Annual retail sales growth (%pa)	4.1%	4.0%	3.8%	6.0%	3.9%
Quarterly Survey of Business Opinion (net optimists)	-23.8%	-28.6%	-14.8%	7.1%	-30.9%
Westpac Consumer Confidence*	101.0	109.5	109.4	112.9	103.8

*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; Auckland Airport; Westpac; Reserve Bank of New Zealand. * Rest of New Zealand figures are for all of New Zealand including Auckland. Data is not seasonally-adjusted.*

Find out more: visit the Auckland Council Chief Economist Page
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