

Why do normally smart people say such dumb things when they discuss urban planning?

The quality of evidence in Australian Housing Policy

Peter Phibbs

Marsden's Local Government, Planning & Environmental Law Conference June 2018



THE UNIVERSITY OF
SYDNEY
—
Henry Halloran
Trust



Outline

- Three Australian case studies of smart “people”
 - A Property lobbyist
 - Two economists from the Australian Central Bank (the RBA)
 - An Australian think tank
- Why?
- What we might be able to do about it



Media

The Urban Taskforce regularly releases information on the challenges facing the property development industry and our responses to it.

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Media Releases

NSW housing approvals flat and behind Victoria

April 4, 2018

The February 2018 data from the Australian Bureau of Statistics (ABS) shows NSW housing approvals flattening while Victorian approvals are higher, says the Urban Taskforce.

"NSW approved 5673 new dwellings in trend terms in February 2018 which is similar to January but well down on the July 2016 high point of 6,800" says Urban Taskforce CEO Chris The University of Sydney

Chris Johnson – April 2018

“The current flattening of housing approval numbers in NSW reflects the uncertain environment created by tighter bank lending and the potential for future levies for affordable housing by councils and the removal of the infrastructure contribution cap.”

Research Discussion Paper

RDP 2018-03

The Effect of Zoning on Housing Prices

Ross Kendall and Peter Tulip

How secret 'zoning effect' costs home buyers hundreds of thousands

By Jessica Irvine

10 March 2018 – 5:38pm



70

[View all comments](#)

Dear diary,

It has been three months since my last entry. Confession time. I remain chaste – no smashed avos have passed these lips. But my quest for home ownership has otherwise faltered.

First there was Christmas, and the inevitable seasonal splurging. Then the New Year took its toll on the credit card with some new summer dresses, shoes and a holiday at the coast.



Local council zoning decisions have added hundreds of thousands of dollars to the average cost of a house in Sydney and Melbourne, the RBA says.

Photo: Glenn Hunt

Mar 8 2018 at 1:18 PM
Updated Mar 8 2018 at 5:44 PM

☆ Save article

Zoning rules cost home buyers a fortune - and RBA




The report found evidence of a large gap opening up between apartment sale prices and construction costs.
Dominic K Lorrimer



Zoning rules - a potent combination of government market intervention aimed at appeasing nimbyism, retaining the livability of suburbs and block sizes, and preventing prices from falling - cost the average Sydney home buyer almost \$490,000 and it's going to get worse.

NIMBYs are costing Australia billions and it's simply not sustainable

CHRIS KOHLER  DOMAIN BUSINESS EDITOR | MAR 8, 2018



So-called 'nimbyism' is stunting the growth of Australian cities and remains at the glowing centre of the housing affordability debate.



Now an astronomical price tag has been associated with the zoning laws guarding against suburban development by the Reserve Bank of Australia, in a report set to fuel a gear shift in conversation about the future of Australian cities.



Home buyers in Sydney must hand over \$489,000 above the marginal cost of their property – what the house costs to build and how the market would otherwise value the land – not because of a physical land shortage, but an “administrative” scarcity of land channelled through restrictive zoning laws.

RBA research shows that zoning restrictions are driving up housing prices

March 8, 2018 2.23pm AEDT

State and local governments should change planning rules to allow more medium-density housing. [AAP](#)

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Restrictive zoning contributes about 40% to the price of houses in Sydney and Melbourne, according to [new research from the Reserve Bank of Australia](#). The study looked at zoning restrictions, such as minimum lot sizes and maximum building heights, which affect what kind of housing can be built, and where.

Of course, zoning and planning rules [play an important role](#) in managing the growth of cities and protecting the character of particular neighbourhoods. But as Australia confronts a housing affordability crisis,

Authors



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Daley et al, 2018

“Zoning restrictions added A \$489,000 to the price of a detached house in Sydney in 2016, according to the research by RBA economists Ross Kendall and Peter Tulip.”

Median Sydney House 1.16 million.





673 sq
metres:

Total
lot area

1 sq
mtre

Disaggregate the values



Outcomes

- **Average Cost per square metre of land:**
 - $765/673 = 1137$ per sq metre
- **Marginal Cost for one additional metre:**
 - 411 per sq metre (physical cost of land)

The difference is the land use regulation effect because it's claimed without land use regulation there would be no difference in these two values

For the average block this difference is
 $(1137 - 411) * 673 \text{ (sq metres)} = 489\text{k}$

Page 2 of the RBA paper

Excluding the effect of zoning the marginal buyer could have been supplied with an average house for \$671k.

It would have cost \$395k to build the structure and landowners (existing and potential) would have been prepared to forego the land for \$277k (673x411).

Instead buyers pay \$1.16 million. The extra 489k reflects administrative restrictions.”

Problems with the RBA approach: The title

- Zoning is not restricting housing supply
- The Effects of Land Use Regulation on House Prices would have been a better title
- “In the absence of zoning, an investor could purchase properties where the marginal value of land is lower than the average value, subdivide them to create multiple smaller properties and make a profit”

Problems with the RBA approach: The use of shadow prices

- The average price of land, the cost of physical land and the value of apartment sites are estimated using indirect methods, sometimes called shadow prices
- Why not use the actual markets to estimate these prices or at least double check the RBA estimates of prices.

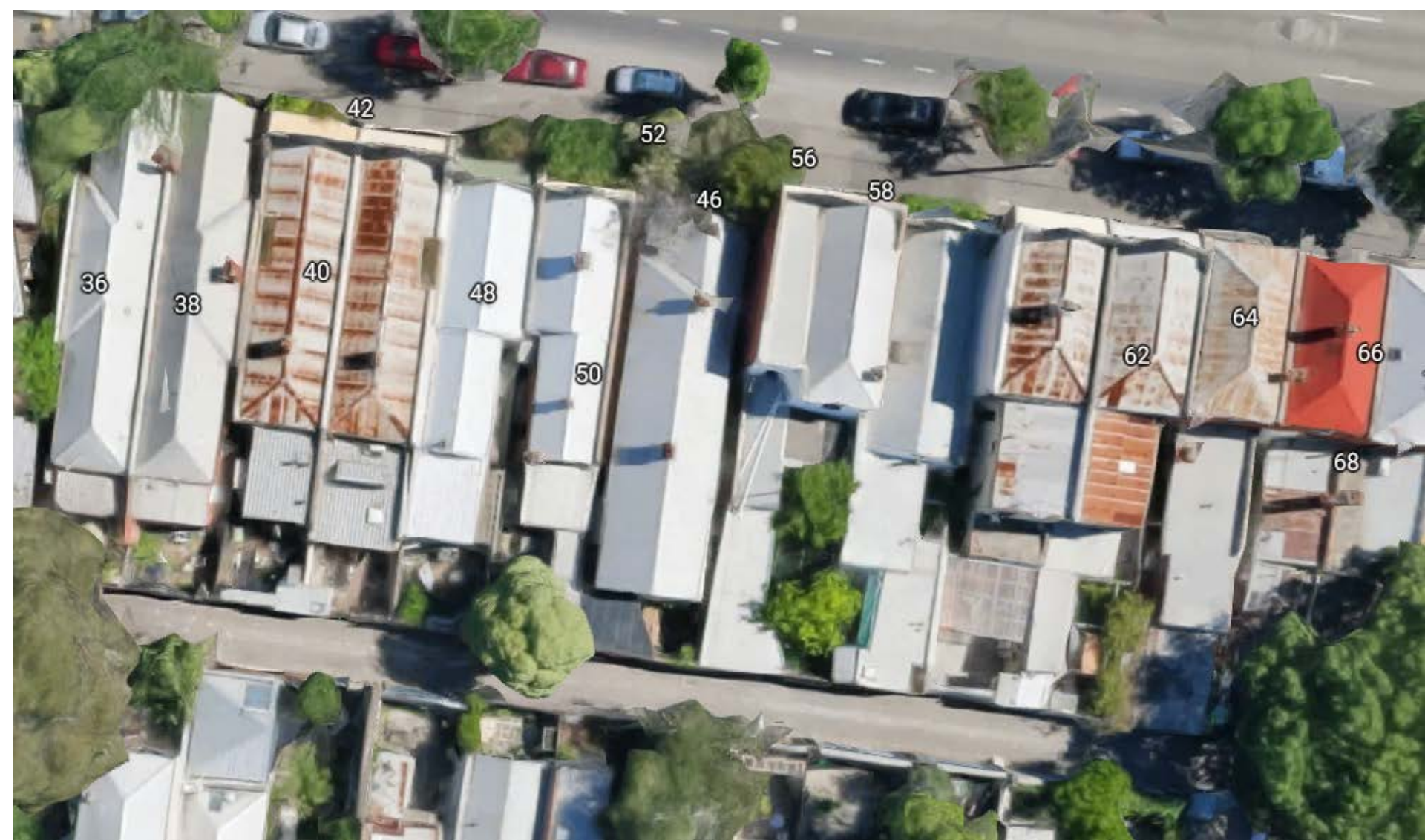
Problems with the RBA approach: The data is wrong

- In calculating the physical costs of land, the study has used all observed sales of separate houses in Australian cities.
- But if you wanted to examine the “zoning” effect you would only look at transactions where the administrative rules impacted the ability to construct a dwelling
- In many lots in Australia it's not land use regulation but the nature of the lot that's restricting supply

Harrington Park



Carlton Melbourne



Summer Hill, Sydney



Problems with the RBA approach: The law of diminishing marginal utility

- The RBA paper assumes that you will sell the land at the price they purchased the last sq metre (\$411)
- But its likely that the landowner will value larger amounts more highly.
- One additional sq metre for a house with a 10 metre boundary is 10 cms
- If you are giving up 160 sq metres then you are losing 16 metres of your backyard. Will you still be willing to give it up at the same \$411 a sq metre?
- The authors acknowledge this but still think a developer will be able to acquire land at \$411 a sq metre (I think by buying land from a number of landowners)
- But this would be a complex transaction



The RBA thinks that zoning is stopping people buying 'marginal' pieces of land for their home

But what is the marginal piece of land, and how do you buy it?

The marginal piece of land is the least valued small part of each plot of land.

To buy marginal land you need to purchase a few square metres from many different plots of land. How smart!

Like this

Good luck building your house!

Are people not doing this because of zoning?

Or because of geography?

And this

Problems with the RBA approach: The prices wont be symmetrical

- The authors claim they can use prices that owners purchase their land to capture the price the same landowner would sell their land to a developer for. i.e their purchase price would be their selling price
- But these aren't symmetrical transactions.
- When a homeowner sells land to a developer they are selling land to construct a dwelling on an adjacent lot.
- This could have a negative impact on their views, sunlight, trees, noise and overall amenity which could reduce the value of their remaining property
- They would want some additional compensation for this risk

Nearby dwellings might affect property values



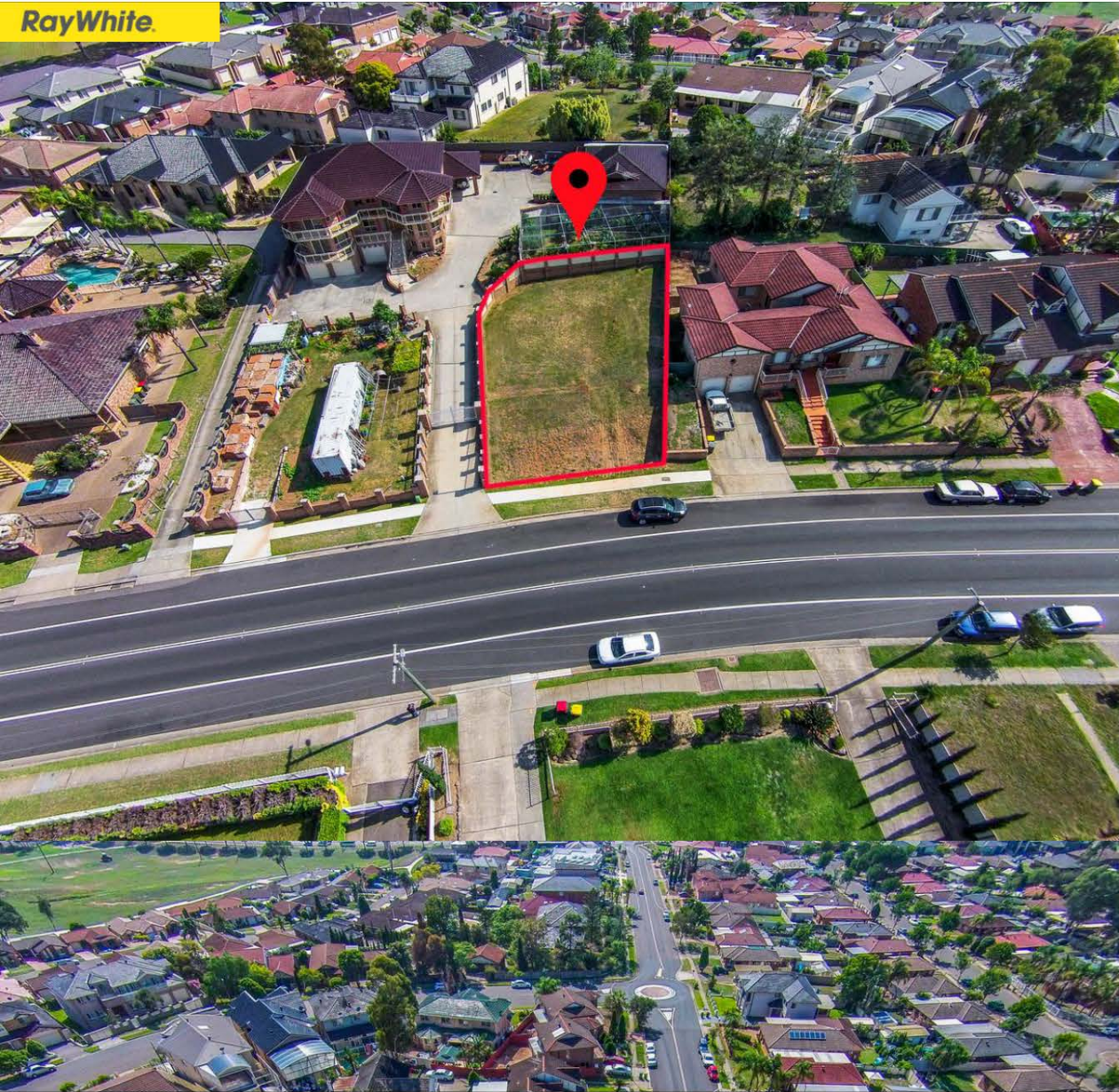
Problems with the RBA approach: Are landowners idiots

- People in the development industry have often told me that landowners are optimists
- Would a landowner sell their land to a site accumulator for \$41 1 a sq metre?

So how would a homeowner value their land?

1. If they were numerate they might use a method called residual valuation.
 - They would estimate the selling prices of property in the area, deduct the construction costs and work out the land costs per sq metre
 - A surprising number of Sydney households are employing property consultants to do this when they are approached by developers/real estate agents to sell their land
2. Or they could use a real estate app

RayWhite



\$699,000 | Blaz Dejanovic

Residential Land

49 Boomerang Road, Edensor Park, NSW, 2176

Home Loan Calculator

\$2,665/month

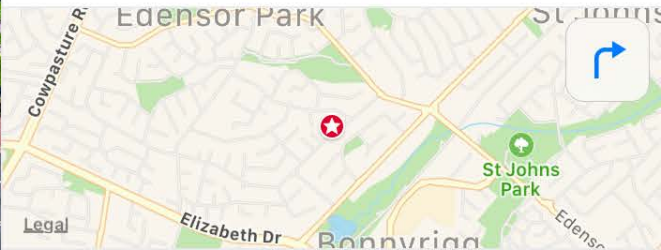
estimated repayment



Calculate

Your Home Loan

Apply for conditional approval



VACANT BLOCK AND READY TO BUILD

\$699,000/509 =
\$1373 per sq metre

Opportunity will not last: within walking distance to bus stops, shops and schools this vacant block will not last long.

Land size 509.4sqm

Frontage 15.73 m

509 sq
metres

Inspections/Auction

Email agent



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Notifications



Me

Problems with the RBA approach: what are the costs of building a house?

I'm not sure a central bank economist is the best person to price the construction cost of a house although they do say they are building the house in a “frictionless world”

Would the profit margin be 5%?

I also can't see in their costs:

- Subdivision charges
- Building certification
- Stamp duty
- Infrastructure charges
- The costs of connecting services
- Land Tax/Council rates
- Any contingency for unexpected increases in building costs
- Selling costs
- Landscaping charges

Problems with the RBA approach: if costs are reduced will house prices change

“Excluding the effect of zoning the marginal buyer could have been supplied with an average house for \$671k”

What would have happened if a developer could acquire a site for \$277k and not \$765k?

Sharam, Bryant and Alves (2015)

“Policy and market analysis almost invariably follows the assumption that if input prices for housing can be lowered, housing would be more affordable; hence the ongoing debate on taxation and planning regulation, and secondly, that new supply will lower prices. This view assumes that housing supply comes onto the market on a cost plus (competitive) margin basis, whereas new housing stock in fact comes onto the market reflecting prevailing pricesCost savings, such as those achieved through construction innovation or planning deregulation, are not passed through to the consumer but accrue to the developer”

Ong et al (2017)

- “Indeed, the price of new housing is related to the price of established housing, not simply what it costs to produce. This is due to the nature of the residual based land pricing model where the cost paid for the land is a function of the revenue which can be generated from the development. This revenue is estimated based on the prevailing price of existing, comparable product in the local area.”

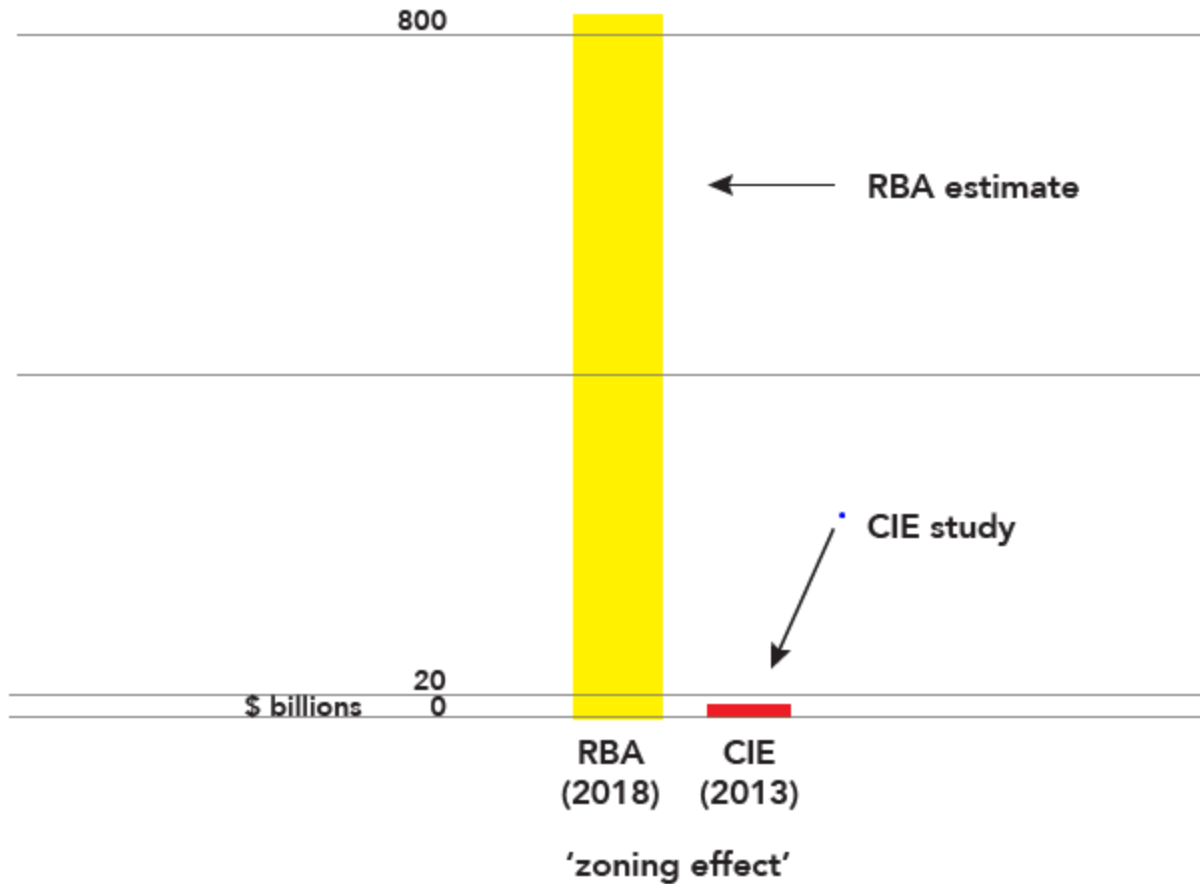
Could zoning restrictions have added 489k to the price of a Sydney house. Yes if....

- The house was a tiny house
- It wasn't connected to services
- The homeowners who provided the land were idiots
- Its developers had the aim of minimising house prices and not maximising their profits

Problems with the RBA approach: Triangulation

Researchers, when they are looking at novel or new approaches often compare their results with other research studies or reports to “groundtruth” their findings

Triangulation



Sydney 'zoning effect' estimates (\$ billions)

*“In the Commission’s judgment, given the small size of net additions to housing in any year relative to the size of the stock, improvements to land release or planning approval procedures, while desirable, **could not** have greatly alleviated the price pressures of the past few years.”*

Productivity Commission (2004)

Data Source: Productivity Commission Inquiry Report 2004, page 154.

Zoning effect Sydney 2009 to 2016



Sydney Metro Housing Monitor

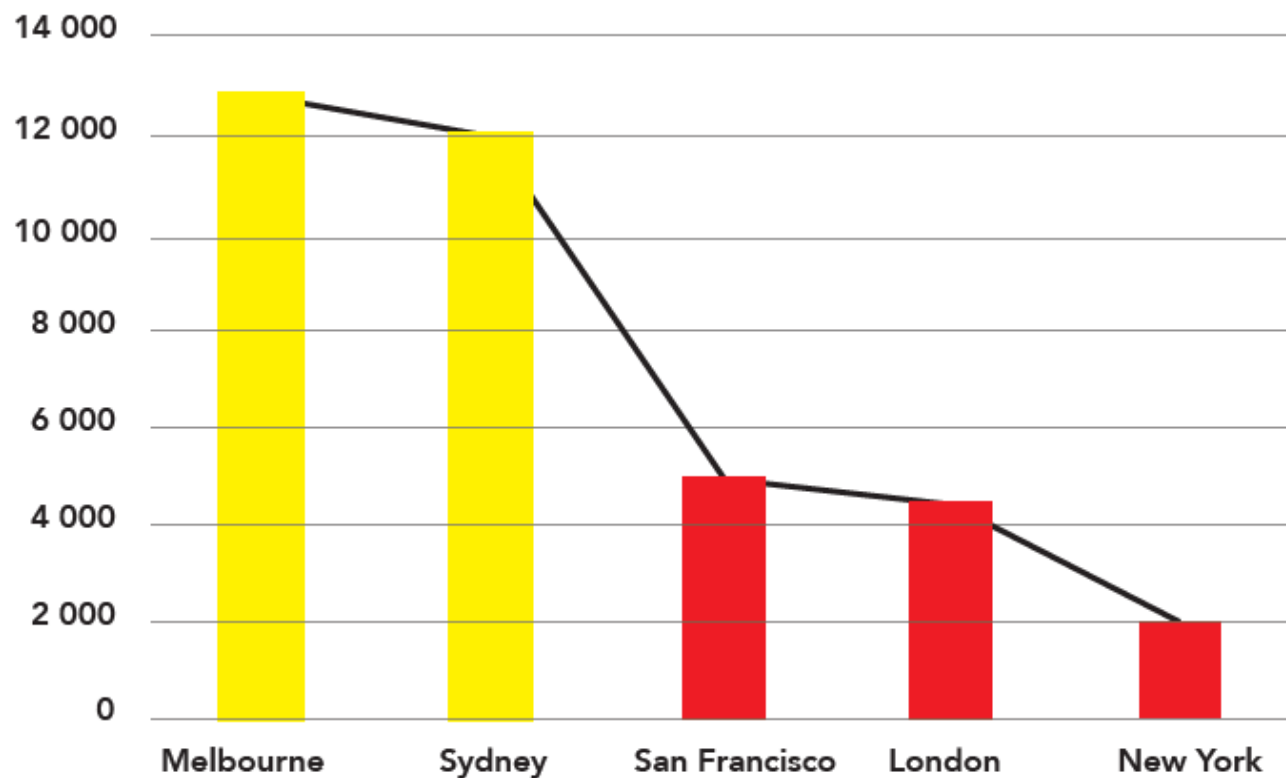
Population Change & Total Completions



Data Sources: Sydney Water Corporation, Hunter Water Corporation, Australian Bureau of Statistics, NS

Comparing 2009 and 2016 in Sydney

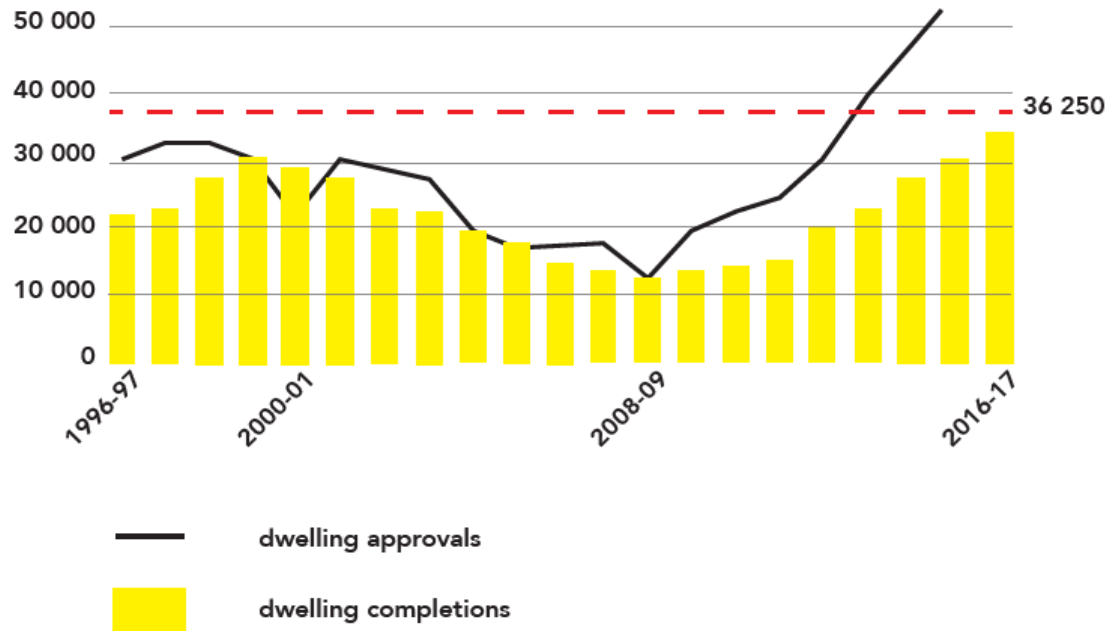
- Population growth:
 - 2009 78,361
 - 2016 88,907
- Dwelling completions
 - 2009 13,170
 - 2016 34,441
- Persons per dwelling
 - 2009 (using 2011 census) 2.7 persons
 - 2016 (using 2016 census) 2.8 persons
- Planning changes between 2009 and 2016
 - Exempt and complying SEPP gains traction/DCP amendment
 - Priority precincts accelerated
- Zoning effect increased by \$259,226 ie more than doubled??



Dwelling approvals per million people (2016)

Data Source: Australian Bureau of Statistics, American Community Survey, San Francisco Planning Department, UK Office for National Statistics, Greater London Authority, New York City Government

Sydney housing approvals and completions

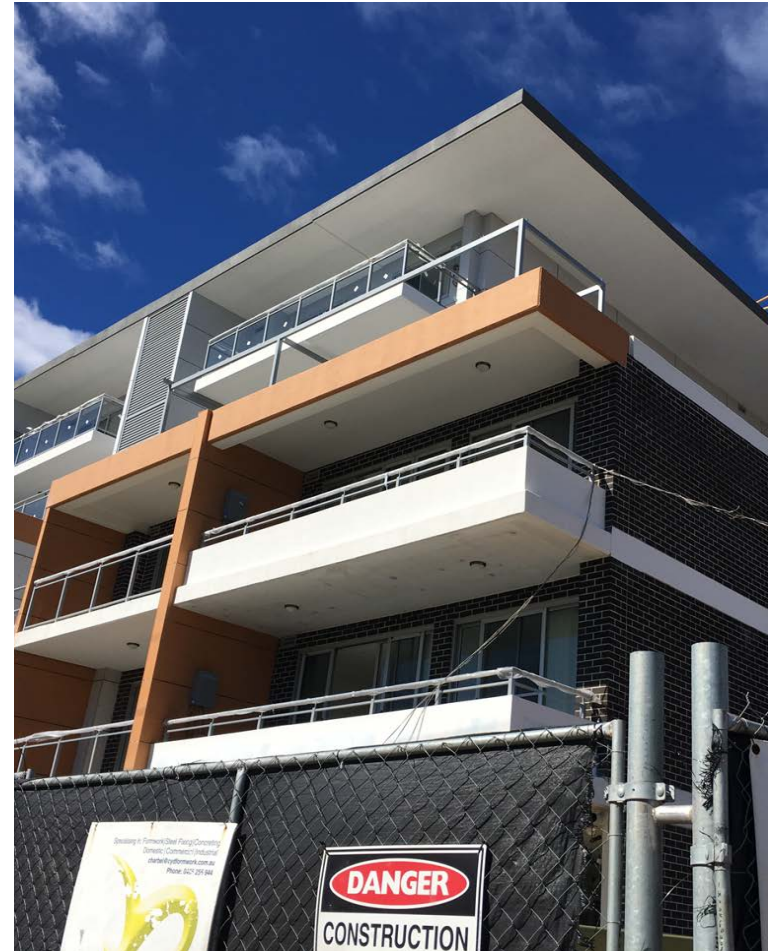


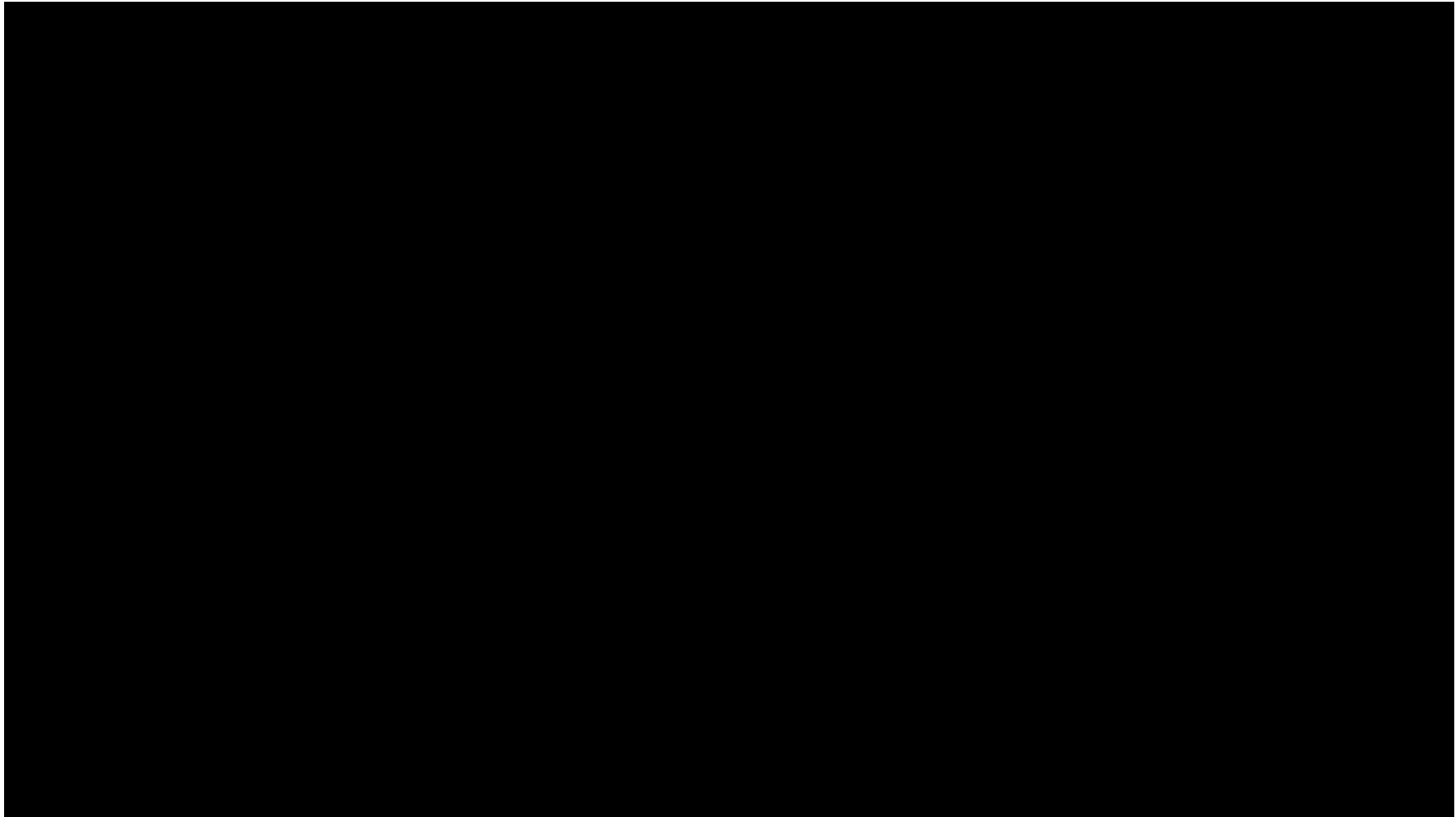
Dwelling approvals vs completions (1996-2017)

Data source: Greater Sydney Commission

Problems with the RBA approach: Apartments

The basic logic is that without zoning/land use regulation apartment land would be free





There is a solution



The thinktank

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Dropping out: the benefits and costs of trying university

REPORT

by Andrew Norton and Ittima Cherastidtham

More than 50,000 students who started university in Australia this year will drop out. Part-time students are particularly at risk. Policy makers should do more to reduce the number of young people who leave university with nothing but debt and regret.

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Higher Education

Transport and Cities

Australian Perspectives

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Daley et al, 2018

“Zoning restrictions added A \$489,000 to the price of a detached house in Sydney in 2016, according to the research by RBA economists Ross Kendall and Peter Tulip.”

This is what the RBA said

“Relative to our estimates of costs, we find that, as of 2016, zoning raised detached house prices 73% above marginal costs in Sydney”

But what's the problem?

Shouldn't we keep planning on its toes

- Yes of course. The minimum lot sizes for many Councils do appear overly generous
- But the problem is also letting decision makers think there are 489k of easy wins by reforming “zoning”.
- It takes the focus off other more important issues like taxation reform.

Conclusion

- So soon as a planning issue arises, normally intelligent people say some weird stuff
- If they are economists, it's partly because they are deeply offended by planning
- They are also pretty arrogant. A central banker writing about planning and property development? Is that really going to work?
- It's also the nature of the topic – everyone is an expert!

Conclusion – what can we do about it?

The RBA needs to hire some planners and land economists/property graduates (and the Grattan Institute)

Perhaps we need to provide a larger group of researchers/practitioners to think about housing policy. What we are doing now isn't working!

I would like to see better co-operation between the property peaks and the University sector

References

- CIE (2013), 'Reform of the NSW Planning System', Final report prepared for NSW Planning and Infrastructure, October.
- Ong, R., Dalton, T., Gurran, N., Phelps, C., Rowley, S. and Wood, G. (2017) *Housing supply responsiveness in Australia: distribution, drivers and institutional settings*, AHURI Final Report No. 281, Australian Housing and Urban Research Institute Limited, Melbourne, <http://www.ahuri.edu.au/research/final-reports/281>, doi:10.18408/ahuri-8107301.
- Sharam A, Bryant L and Alves T (2015) *Making apartments affordable: moving from speculative to deliberative development*. QUT and Swinbourne University