SGS Economics & Planning

SUBMISSION – REVIEW OF INFRASTRUCTURE CONTRIBUTIONS IN NSW ISSUES PAPER

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FOUR FRAMES OF DEVELOPMENT CONTRIBUTIONS

Development contributions exacted through the planning system can be grouped into four mutually exclusive categories, premised on the grounds of user pays, impact mitigation, value sharing or inclusionary requirements.

The distinction between these categories is briefly described below. Understanding the distinction between these four categories is fundamental to developing a robust system for development contributions. In SGS's view the NSW Productivity Commission Review of Infrastructure Contributions should utilise and reference these four frames.

Contributions premised on user pays grounds

User pay contributions are levied to recoup the cost of planned infrastructure to meet the needs of incremental development, which are distributed across existing development and successive new development projects according to projected share of usage. This rationale underpins the original Section 94 provisions in NSW (now Section 7.11 contributions). It relies on demonstration of usage nexus.

Contributions premised on impact mitigation grounds

This rationale refers to the obligation on development proponents to make good any unanticipated adverse effects of their projects, including reduced functionality or levels of service from surrounding infrastructure. Although they have a cost to the proponent contributions for impact mitigation works should not be construed as a public benefit. These measures are required to ensure there is no net loss of amenity or functionality for the community, rather than an improvement.

Contributions premised on value sharing grounds

This refers to the requirement for proponents of development to pay a de facto licence fee for the development rights awarded to them via rezonings and/or granting of development approvals. In the absence of such a licence fee, the value of these development rights would be capitalised in residual land value and therefore fully captured by the site owner, to the exclusion of the wider community. This form of development contribution is also sometimes referred to as 'planning gain' or 'betterment charge'. These extractions should be calibrated to the actual uplift in residual land value, which is the measure of the value of the development rights, rather than construction costs or the total value of the development.

Contributions premised on inclusionary requirement grounds

Inclusionary requirements are the design provision that successive projects must incorporate to ensure that development proceeds in an orderly fashion, sustainably and within community expectations. Examples of inclusionary provisions include: car parking requirements; mandatory compliance with building form, design and density requirements; special provision in conservation areas; or incorporation of affordable housing to meet environmental requirements for social mix. In some cases, for example car parking and affordable housing, inclusionary provisions can be discharged by making cash in lieu contributions for the requisite provisions to be satisfied in off-site locations.

SGS' 10 RECOMMENDATIONS

The following suggested reform recommendations represent a comprehensive and internally consistent package directly referencing the 'four frames'.

In the discussion of issues and questions which follows – which directly follows the prompts contained in the Discussion Paper (Table S1 on pages 5-9) - we also provide recommendations for reforming elements of the contributions system as currently established, consistent with the four frames approach.

1. Contextualise the different types of development contributions within an understanding of the 'four frames' for development contributions.

Each contribution mechanism should align with the disciplines of justification and cost apportionment of the relevant frame. Contributions within each frame are mutually exclusive and additive.

'User pays' contributions

2a. Revitalise user pays (s7.11) contributions system with additional state support, endorsed 'industry standard' on-line model and guidelines for proper calibration and management, for effective and integrated local land use and infrastructure ('essential' and otherwise) planning

The discussion paper notes that 'contributions plans are complex and costly to administer'. This might imply that the effort is not worth the return. This is not the case given the millions of dollars invested in urban development and the benefits from effective and integrated infrastructure and planning. In SGS's experience with councils that have established rigorous contributions plans the discipline of the plan making process and the strategic thinking that has been required have elevated the quality of strategic, infrastructure and asset planning in the council, while supporting better and more liveable communities. The reality is that the process and practice of preparing properly calibrated and rigorous user pays based contributions plans has not been sufficiently resourced and supported as a critical element of urban management.

2b. Provide standard or 'off the shelf' but low cost (bottom quintile) option if Council does not want to prepare contribution plan - limit to approved or essential infrastructure list

Reducing complexity via the option of standard or 'smoothed out' charges risks foregoing the benefits of effective and integrated land use and infrastructure planning, as well as diluting price signals for development, leading to an inevitable degree of cross subsidisation by the community or other developers or poorer, infrastructure deficient development.

However, the option of adopting a standard charge as an alternative to preparing a contributions plan should be available, provided it is set 'low', at the lowest quintile of the range of typical contribution rates. A higher, standard charge based on an 'average' will not be appropriate and will be open to challenge in many contexts (and in SGS's view has not worked in Victoria).

3. Allow for payment at Occupation Certificate stage

Deferring payment of infrastructure contributions until prior to the issuing of an occupation certificate is an appropriate reform. This allows developers to generate income before having to pay development contributions. Requiring payment of contributions early and 'up-front', at the construction certificate stage, effectively creates a barrier to entry for smaller developers with lower capacity to tolerate risk and access development finance, so delaying the timing for payment would also represent an reform to enhance industry access and efficiency.

4. Establish contributions pooling for forward funding of infrastructure (e.g. NSW Local Government Local Infrastructure Financing Corporation)

Forward funding of infrastructure is difficult with isolated council specific contribution collections. Funds collected via contributions schemes should be pooled and drawn down by Councils as required, ensuring that infrastructure and development can be properly sequenced. A Local Government Local Infrastructure Financing Corporation could be established to centrally collect funds and provide financing as required to invest in development infrastructure, according to transparent plans and accountability measures. This could operate on a similar basis to the National Housing Finance Investment Corporation (NHFIC) which aggregates finance for community housing providers at a federal level.

5. Abolish s.7.12 contributions

Section 7.12 levies are anomalous and do not readily fit into the four frames approach. They should be abolished in favour of an enhanced user pays system (including a standard, low charge option) and more formalised system of value capture (related to the change in land value, rather than to development costs), such as a Development Licence Fee system outlined below.

Impact mitigation contributions

6. Define scope of allowable impact mitigation conditions on Development Approvals

Impact mitigation requirements are sometimes included as conditions of development approval, or sometimes negotiated as part of Voluntary Planning Agreements. This category of contributions should be more formally acknowledged and referenced in guidelines which would identify allowable and appropriate circumstances and infrastructure where they could be included as conditions.

Value sharing contributions

7. Establish Development Licence Fee based on area specific, pre-scheduled rates, set at say 80% of estimated change in land value (pre and post development approvals or rezonings/FSR changes)

SGS suggest that value capture approaches be formalised in the form of a Development Licence Fee. The rationale for this is as follows. The granting of additional development rights, and access to them for the landowner, is entirely a matter of public decision resolved on town planning merits. Through the creation of town planning controls, development rights are reserved by the State. In this sense, they are analogous to other resources which are attached to real estate but are not owned by the land titleholder, for example, minerals which may lay below the surface or the water that falls onto the land from the sky. Like these other publicly reserved resources, the State is, in principle, entitled to charge a fee for access to development rights, but where it doesn't the value of the rights defaults to the landowner creating a windfall when favourable planning approvals are achieved. Where these rights are vested in the community their value is retained or available for investment in local community infrastructure or economic development (new parks, public art, culture, affordable housing and so on). Further discussion on this approach and the rationale are included in the Attachment.

SGS suggest that the proceeds of the Development Licence Fee be collected by Treasury, to separate the process from the approvals system, with a share redistributed back to Councils in line with and to support planned development, with some retained for state infrastructure which might otherwise be funded through Special Infrastructure Contributions.

The comprehensive application of value sharing as a pre-scheduled Development Licence fee would effectively eliminate the impact of land price inflation and related cost escalations for development contribution schemes. This is because the change in land value from any expectation or granting of development rights will be subject to the Development Licence Fee.

8. Abolish SICs and SEPP70 AHCS

A comprehensive value capture or Development Licence Fee approach will enable SICs and SEPP 70 Contributions to be abolished. These are value capture approaches by another name. Funds collected from the Development Licence Fee would be appropriately dedicated or used for state level infrastructure and affordable housing.

Inclusionary requirement contributions

9. Allow for need justified Affordable Housing Inclusionary Zones

The current SEPP 70 Affordable Housing Contributions Scheme system, as outlined in the NSW Government Guideline[1], limit contributions to affordable housing equivalent to a nominated percentage of floorspace (i.e. 5-10% 'dependent on viability') only in areas where up-zoning occurs. They are therefore only a partial mechanism for affordable housing (not likely to be established in many regional areas where rezonings will be limited).

Inclusionary zoning which would typically require a contribution from all development in an identified precinct or local government area represents a more comprehensive approach and should be used as the primary mechanism in NSW, (complemented by funding from a value capture approach such as a Development Licence Fee). A relatively low IZ 'rate' of say 5%, gradually imposed to allow for land values to adjust, and broadly applied could generate significant funds for affordable housing (though still unlikely to be sufficient to meet the supply gap, suggesting a critical and continual role for funding and subsidies from state and federal government).

10. Replicate Victorian system for open space dedication via inclusionary provisions at land and strata subdivision

The NSW Government Architect's new standards for open space provision (and targets suggested by the NSW Premier's Priorities i.e. increase the proportion of homes in urban areas within 10 minutes' walk of quality green, open and public space by 10 per cent by 2023) establish access rather than 'per capita' provision rates for open space.

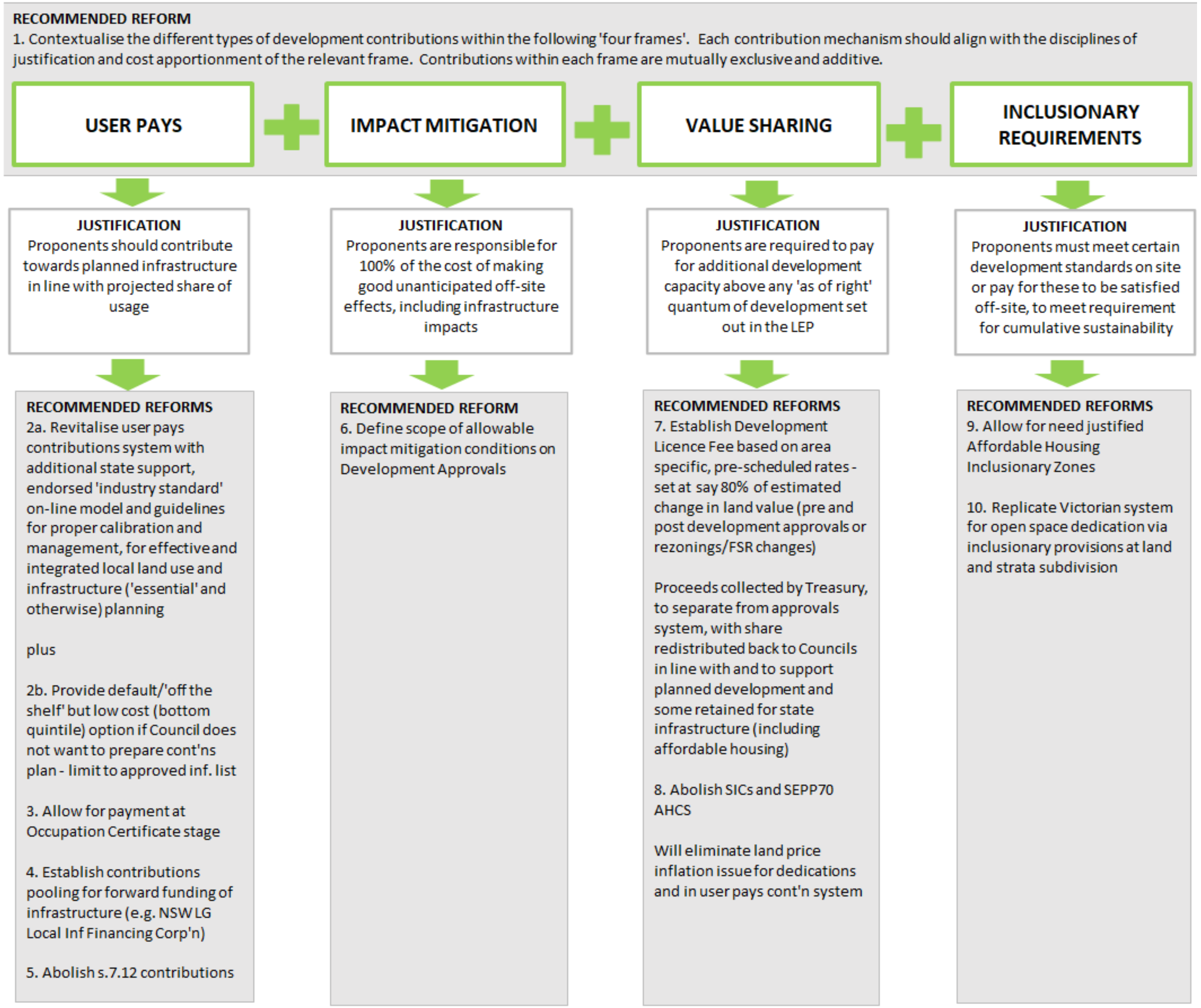
Inclusionary zoning requirements provide a means for ensuring land/funding for open space is secured. The Victorian Subdivision Act 1988 demonstrates the use of this mechanism for open space delivery, requiring a minimum 5% contribution for useable open space where sites are subdivided into three or more lots (including strata subdivisions). This is often provided as cash in lieu of land and may be used to embellish existing open space or purchase new sites. Councils may increase this inclusionary requirement based on an open space plan or strategy

A note on VPAs relevant to this suggested reform package

The role for VPAs would be significantly diminished if this reform package or something similar were implemented, creating more certainty for the development industry. However, they would still have a role in circumstances not anticipated by the reforms, and where mutually beneficial development outcomes can be achieved. They may also be established where the contribution obligations can be met in a satisfactory alternative manner, to an equivalent value or to achieve the same or similar outcomes.

[1] https://www.planning.nsw.gov.au/-/media/Files/DPE/Guidelines/guideline-sepp70-developing-affordable-housing-contribution-scheme-2019-02-28.pdf

FIGURE 1: SGS REFORM RECOMMENDATIONS BASED ON THE FOUR FRAMES OF DEVELOPMENT CONTRIBUTIONS



RECOMMENDED REFORM

1. Contextualise the different types of development contributions within the following 'four frames'. Each contribution mechanism should align with the disciplines of justification and cost apportionment of the relevant frame. Contributions within each frame are mutually exclusive and additive.

USER PAYS + **IMPACT MITIGATION** + **VALUE SHARING** + **INCLUSIONARY REQUIREMENTS**

USER PAYS

JUSTIFICATION
Proponents should contribute towards planned infrastructure in line with projected share of usage

RECOMMENDED REFORMS
2a. Revitalise user pays contributions system with additional state support, endorsed 'industry standard' on-line model and guidelines for proper calibration and management, for effective and integrated local land use and infrastructure ('essential' and otherwise) planning

plus

2b. Provide default/'off the shelf' but low cost (bottom quintile) option if Council does not want to prepare cont'ns plan - limit to approved inf. list

3. Allow for payment at Occupation Certificate stage

4. Establish contributions pooling for forward funding of infrastructure (e.g. NSW LG Local Inf Financing Corp'n)

5. Abolish s.7.12 contributions

IMPACT MITIGATION

JUSTIFICATION
Proponents are responsible for 100% of the cost of making good unanticipated off-site effects, including infrastructure impacts

RECOMMENDED REFORM
6. Define scope of allowable impact mitigation conditions on Development Approvals

VALUE SHARING

JUSTIFICATION
Proponents are required to pay for additional development capacity above any 'as of right' quantum of development set out in the LEP

RECOMMENDED REFORMS
7. Establish Development Licence Fee based on area specific, pre-scheduled rates - set at say 80% of estimated change in land value (pre and post development approvals or rezonings/FSR changes)

Proceeds collected by Treasury, to separate from approvals system, with share redistributed back to Councils in line with and to support planned development and some retained for state infrastructure (including affordable housing)

8. Abolish SICs and SEPP70 AHCS

Will eliminate land price inflation issue for dedications and in user pays cont'n system

INCLUSIONARY REQUIREMENTS

JUSTIFICATION
Proponents must meet certain development standards on site or pay for these to be satisfied off-site, to meet requirement for cumulative sustainability

RECOMMENDED REFORMS
9. Allow for need justified Affordable Housing Inclusionary Zones

10. Replicate Victorian system for open space dedication via inclusionary provisions at land and strata subdivision

Source: SGS Economics and Planning Pty Ltd

RESPONSE TO ISSUES

The following section provides SGS's detailed response to issues identified by the NSW Productivity Commission

Issue 1.1: Striking the right balance

- The four frames conceptual framework can be applied consistently across the state, although its implementation, relevance and impact will differ between jurisdictions. For example in regions without significant development activity there may be few opportunities to implement value sharing mechanisms.
- Site specificity is fundamental to a user pays approach which aims to account for site-specific development cost differentials between different areas, to establish a 'price signal'. A more standardised, average approach might provide greater simplicity and certainty, particularly for development in greenfield areas, which do not differ significantly in their infrastructure needs. However, infrastructure needs in urban infill or regional locations are largely context dependent, undermining the validity of standard-rate charges in these locations.
- NSW, Victoria and Queensland currently have the most sophisticated and entrenched development contributions systems. Opportunities to learn from other Australian contexts may be limited. Victoria's development contributions (user pays) system includes the option of a standard charge which has been based on typical or average rates but this has not been widely adopted particularly in rural or infill areas as it has not been able to sufficiently reflect bespoke and local circumstances.
- A system based on the four frames will add to certainty for the development industry. Though it should typically be avoided, public authorities should reserve the right to forego contributions depending on economic circumstances or to favour certain development outcomes (e.g. affordable housing). If development contributions are foregone, the value of the effective subsidy to be borne by the community (from the foregone contributions) should be disclosed clearly and transparently to the community. This enables the community to judge whether the cost of the foregone revenue and subsidy is merited given the outcome being sought.

Issue 2.1: Enable a broader revenue source for the funding of infrastructure

- Comprehensive application of the four frames approach will provide a suite of funding avenues which are not currently available on a regular basis (see FIGURE 1). Although VPAs are occasionally used to account for contributions based on frames 1-3 in particular, they are ad hoc and are utilised for only a relatively small share of development projects.

Issue 2.2: Integrating land use and infrastructure planning

- User-pays charges and impact mitigation measures typically relate to infrastructure provision at a local level, and may therefore providing funding to realise objectives within local plans (see FIGURE 1). Value sharing and inclusionary requirements may be utilised to address outcomes at different levels. Value sharing mechanisms (frame 3) provide a means of funding infrastructure or contributing to outcomes which might be identified in regional or district plans. For example, part of the value uplift on sites located within close proximity to new transport infrastructure could be captured via a value sharing mechanism and used as a source of funding for that infrastructure. Value sharing might also contribute to local streetscape or cycling path upgrades for example. Inclusionary zoning may also assist in achieving regional objectives, such as those for affordable housing or at a local level for open space provision.

Issue 3.1: Principles for planning agreements are non-binding

- VPAs currently serve to fill gaps in the development contributions system in the absence of a comprehensive four frames approach. However, they can undermine confidence in the planning system in situations where they are not clearly separated from the development approval process. Following the establishment of a system based on the comprehensive four frames SGS reform suggestions summarised earlier there would be a much diminished role for VPAs, thereby reducing uncertainty and increasing the efficiency of the development process. They would still be allowable in circumstances not covered by the 'four frames' system, while also enabling development proponents to meet their contribution obligations by equivalent in-kind or alternative means. This encourages innovation.
- Under the current system value capture is a wholly appropriate use of planning agreements. It is important that the infrastructure or public benefits to be funded are clearly identified, and the negotiation of agreements occurs separately from the development approval process. This can be accommodated through clear guidelines and accounting and administrative provisions at the state and local government level.
- In cases where value sharing arrangement are included VPAs do not necessarily require a nexus with the development. By definition, the value uplift is the community's, to be 'spent' on whatever community priorities are deemed worthy. Nevertheless, it is desirable that funding secured through planning agreements be linked to infrastructure needs or to the achievement of outcomes identified in a strategy endorsed by the local council (or the state government).
- The rationale for and detail of State planning agreements should be disclosed with full transparency. Once again, establishing a link between funding sourced through planning agreements and specific state infrastructure projects ensures accountability. It should be noted that for both local and state level VPAs transparency may be compromised where commercial considerations or information need to be exposed. This is yet another reason why it is preferable for value sharing rates to be 'pre-scheduled' based on the estimated change in land value associated with a consent or rezoning. These can be established as a guide for VPAs seeking value sharing (see Appendix E in Georges River Guidelines for Planning Agreements[2]) and would also be explicit in any system of development licence fees established in accordance with the SGS reform suggestions.

Issue 3.2: Transparency and accountability for planning agreements are low

- Councils should be required to provide reference to the four frames in reporting on planning agreements i.e. do contributions relate to impact mitigations, user charges or value capture.
- Planning agreements should be maintained in a centralised online register which is publicly accessible to ensure transparency and accountability is maintained.

Issue 3.3: Planning agreements are resource intensive

- In the absence of system-wide reform in line with the SGS suggestions, the practice note for VPAs should be clear about the type of contribution being extracted, and which of the four frames it sits within. This will automatically demonstrate where planning agreements are not needed/appropriate and avoid contributions being imposed or required where they are not conceptually clear.

[2] http://www.georgesriver.nsw.gov.au/StGeorge/media/Documents/Council/Governance/Codes%20and%20Policies/Pol-037-01-Planning-Agreements-Policy-August-2016.pdf

Issue 3.4: Contributions plans are complex and costly to administer

- For significant development fronts or major renewal precincts, it is appropriate that detailed work go into identifying the infrastructure required given the project development, and the contributions to fund this. Calculation of these contributions should be transparent, and funds collected linked to infrastructure to ensure accountability. In contexts where infrastructure needs do not differ significantly between projects, such as greenfield areas, standard contribution rates could be applied. Amalgamating catchment areas for different pieces of infrastructure could also reduce the complexity of calculating 7.11. contributions. However, where an 'off the shelf' or standard charge is provided as an alternative to preparing a contributions plan, SGS would recommend that it be set 'low', at the smallest quintile. A standard charge based on an 'average' will be open to challenge in many contexts. In SGS's view this has not worked in Victoria.
- To say that 'contributions plans are complex and costly to administer' suggests that the effort may not be worth the return. This is not the case given the millions of dollars invested in urban development and the benefits from effective and integrated infrastructure and planning. In SGS's experience with councils that have established rigorous contributions plans the discipline of the plan making process and the strategic thinking that has been required have elevated the quality of strategic, infrastructure and asset planning in the council, not to mention generated revenue for better and more liveable communities. The reality is that the process and practice of preparing properly calibrated and rigorous user pays based contributions plans has not been sufficiently resourced and has in general remained a relatively residual activity. Reducing complexity via the option of standard or 'smoothed out' charges will forego these benefits as well as dilute price signals for individual developments, leading to a degree of cross subsidisation by the community or other developers.
- Ensuring transparency in the calculation of contribution rates and accountability by linking contributions to infrastructure projects will provide a greater degree of certainty. Development of a contributions system which broadly applies a four frames approach across an entire jurisdiction, rather than on an ad-hoc basis, will also provide greater certainty for all stakeholders.

Issue 3.5: Timing of payment of contributions and delivery of infrastructure does not align

- Deferring payment of infrastructure contributions until prior to the issuing of an occupation certificate is an appropriate reform. This allows developers to generate income before having to pay development contributions. Requiring payment of contributions early and 'up-front', at the construction certificate stage, effectively creates a barrier to entry for smaller developers with lower capacity to tolerate risk and access development finance, so delaying the timing for payment would also represent an reform to enhance industry access and efficiency.
- Forward funding of infrastructure is difficult with isolated council specific contribution collections. Funds collected via contributions schemes should be pooled and drawn down as required, ensuring that infrastructure and development can be properly sequenced. One approach would be to establish a Local Government Local Infrastructure Financing Corporation to centrally collect funds and provide financing as required, according to transparent plans and accountability measures, to invest in development infrastructure. This could operate on a similar basis to the National Housing Finance Investment Corporation (NHFIC), which aggregates finance for community housing providers at a federal level.

Issue 3.6: Infrastructure costs and contributions rates are rising

- User pays charges should be based on economic efficiency rather than on some concept of 'reasonableness' or 'feasibility'. If development is discouraged based on transparent price signalling then this is a risk, though probably appropriate. Clarity as to 'prices' (i.e. pre-scheduled notification of contributions) is important so that developers have appropriate information when making bids for and purchasing land for development. It should be noted that the comprehensive application of value sharing as a pre-scheduled Development Licence fee would effectively eliminate the impact of land price inflation and related cost escalations for development contribution schemes. This is because the change in land value from any expectation or granting of development rights will be captured. There will be no benefit in a land owner ‘bidding’ up the value of land to be contributed as part of an infrastructure plan as the land value increment will be subject to the Development Licence Fee (or an appropriate value capture alternative).

- A fully calibrated, user pays based contributions plan should be contained to necessary development infrastructure i.e. that required to allow development to occur and which contributes to a functioning neighbourhood and community where the nexus is with development occurring within that neighbourhood or community. This infrastructure may go somewhat beyond that currently on the essential works list. A narrower definition of allowable works would apply for infrastructure to be funded by a standard ‘low’ off the shelf charge. This might more closely resemble the list of essential works, constrained to the minimum level of shared infrastructure required for development to proceed.
- Infrastructure beyond the scope of works included in a user pays based contribution plan should be funded through alternative mechanisms (see FIGURE 1).

Issue 3.7: The maximum s7.12 rate is low but balanced with low need for nexus

- Section 7.12 levies are anomalous and do not readily fit into the four frames approach. They should be abolished in favour of a more formalised system of value capture (related to the change in land value, rather than to development costs), such as a Development Licence Fee system as outlined above.

Issue 3.8: Limited effectiveness of special infrastructure contributions

- Currently, special infrastructure contributions act effectively as a value-sharing mechanism though they are sometimes characterised as having user pays elements. SICs could be abolished and replaced by a comprehensive system of value sharing across all jurisdictions. SGS suggest that this be established as a Development Licence Fee with proceeds to be shared by local and state government. Value capture systems should always be separated from the process of establishing development rights or determining development consent (the latter should be decided on planning merit).
- SGS suggest that the Development Licence Fee would be based on area specific, pre-scheduled rates - set at say 80% of the estimated change in land value (pre and post development approvals or rezonings/FSR changes), to include an incentive (of 20%) to the lands seller. Proceeds Could be collected by NSW Treasury, completely separated from the approvals system, with a share redistributed back to Councils in line with and to support planned development and some retained for state infrastructure currently funded by the SICs.

Issue 3.9: Difficulty funding biodiversity through special infrastructure contributions

- The preservation of biodiversity is not related to land economics principles which provide the basis for systems of value sharing, such as special infrastructure contributions. Furthermore, biodiversity offsets do not relate to infrastructure provision, and should therefore be dealt with under a separate framework, where ecological considerations are paramount.

Issue 3.10: Affordable housing

- The provision of affordable housing though the SEPP 70 contributions system is not sufficient to address current and future unmet need for affordable housing. While it is appropriate that value sharing mechanisms should be enabled to assist in the provision of affordable housing, the current system only applies to areas where up-zoning occurs, and therefore can only act as a partial mechanism. Inclusionary zoning which would typically require a contribution from all development in an identified precinct or local government area (frame 4), is not currently enabled by SEPP 70, but represents a more comprehensive approach and should be used as the primary mechanism in NSW, supplemented by a value capture approach as implied by SEPP 70. A relatively low IZ 'rate' of say 5%, gradually imposed to allow for land values to adjust, and broadly applied would generate significant funds for affordable housing (still not sufficient to meet the supply gap which should appropriately be addressed by funding and subsidies from state and federal government).

- The currently recommended affordable housing target of 5-10% tested for 'viability' is arbitrary. SGS would argue that the contribution rate should be calculated based on the change in RLV, worked backward to a % rate of floorspace if necessary.
- If for example the Residual Land Value on any particular site was $1500/sqm for residential floorspace and the new FSR allowed (by a DA or rezoning) for an increase of 1000 sqm on a particular site then the value uplift would be $1.5m. We might say that 80% of that could be captured without affecting viability (standard profit margin still achievable, plus leaving 20% uplift for the land seller) so $1.2m. The Affordable Housing contribution rate expressed as a percentage could then be based on how much $1.2m represents of the Gross Realisable Value, or it could just be expressed as a rate per square metre (in this case $1200). By definition this is 'feasible' and actually much clearer to a developer. The RLV rate expressed on a per sqm basis is likely to vary by precinct or location.
- If restricted to a share of the uplift in value created by rezonings, affordable housing contributions should have a negligible effect on housing supply. However, this is predicated on the assumption that value sharing and inclusionary zoning provisions are pre-signalled so that they can be factored into the residual land value (RLV) equation.

Issue 4.1: Sharing land value uplift

- Current methods of value capture (which are ad hoc, mostly via SICs and VPAs and where Affordable Housing Contribution schemes apply) should be broadened and consolidated into a single, comprehensively applied system of value capture through the implementation of Development Licence Fees (see attachment 1).

Issue 4.2: Land values that consider a future infrastructure charge

- An 'infrastructure development charge' linked to land title may be another way of describing SGS's suggested Development Licence Fee. However, 'charge' is not the appropriate wording, given that as conceived a Development Licence Fee is a means of purchasing development rights for a site (and is related to value capture), with no usage nexus. It is not a tax or charge. This should also not necessarily be limited to rezoning, but apply in the case of any changes to land title, such as the granting of additional FSR. A framework for this system is provided in attachment 1.

Issue 4.3: Land acquisition for public infrastructure purposes

- In SGS's view, where direct dedication of land for infrastructure occurs, public authorities should only be obligated to compensate landowners to the amount of the land's current Residual Land Value. Where a Development Licence Fee system is effectively implemented, the changes to RLV which would result from uplift on the site will be minimised. This would serve to reduce the need for 'equalisation', where landowners seek compensation on the basis of their land's potential RLV.

Issue 4.4: Keeping up with property escalation

- Under a system which incorporates inclusionary zoning and pre-signalled Development Licence Fees (as value capture contributions), these obligations would be factored into feasibility assessments, reducing the escalation of RLV. This provides an effective means of limiting increases to land acquisition costs.

Issue 4.5: Corridor protection

- As discussed above where a Development Licence Fee system is effectively implemented, the changes to RLV which would result from uplift on sites included in corridor identification will be minimised. This would serve to reduce the need for 'equalisation', where landowners seek compensation on the basis of their land's potential RLV and therefore reduce speculation and land value escalation.

Issue 4.6: Open space

- Where performance criteria for open space are based on access and quality rather than quantity per capita, it is more likely that less open space will be required overall. This reduces the likelihood that large parcels of land will need to be dedicated for new areas of open space.
- The NSW Government Architect's new standards for open space provision (and targets suggested by the NSW Premier's Priorities i.e. increase the proportion of homes in urban areas within 10 minutes' walk of quality green, open and public space by 10 per cent by 2023) relate to access of new development to open space and are appropriate as 'mandated' outcomes. These should be combined with guidelines for what is implied by the quality of open space. Delivery of these open space outcomes may require new mechanisms to provide clear pathways for implementation. This may consist of broadened mechanisms for development contributions and/or more interventionist systems of land assembly/dedication.
- Inclusionary zoning requirements also provide a potential means for ensuring land/funding for open space is secured. The Victorian Subdivision Act 1988 demonstrates the use of this mechanism for open space delivery, requiring a minimum 5% contribution for useable open space where sites are subdivided into three or more lots (including strata subdivisions). This is typically provided as cash in lieu of land, and may be used to embellish existing open space or purchase new sites. Councils may increase this inclusionary requirement based on an open space plan or strategy.

Issue 4.7: Metropolitan water charges

- Where costs of new and upgraded connections vary by location, a price signal should be present. This would require a user pays system, which would reduce the cost burden placed on the broader customer base and isolate it to benefitting development.
- Where broader community objectives are served through retrofit of existing systems for potable and recycled water provision, funding from the broader customer base would be appropriate. The analogy here with subsidies for domestic solar energy systems, to achieve environmental objectives, is relevant. However, where new approaches to provision are anticipated by more exacting community expectations for sustainable water management and are being delivered in major development fronts, such as greenfield growth centres or urban renewal precincts, the costs of water infrastructure should be treated as an internal cost of development wherever possible. Technological improvements and new industry norms will drive down costs (the increased energy and water standards required by BASIX have now been normalised for new development).

Issue 4.8: Improving transparency and accountability

- A central electronic platform provided by the state government should be employed to ensure full transparency and accountability in reporting on development contributions. In line with best practice principles, this should report the contributions mechanism employed, amount collected and infrastructure items funded. It is a reasonable expectation that systems of user pays based development contributions be supported by appropriate and industry standard approaches and electronic platforms. Widely varying council by council approaches to contributions management and accounting is not appropriate.

Issue 4.9: Shortage of expertise and insufficient scale

- A well-established development contributions system (based on a four frames approach) potentially provides a highly valuable source of infrastructure funding to local governments. Therefore, development contributions should be elevated to a core component of financial and asset management within councils, supported by appropriate industry standard software and state government guidelines and resource support.

Issue 4.10: Current issues with exemptions

- Exemptions should be minimised, and applied on a fully transparent basis if granted. Councils may reserve the right the grant exemptions from development contributions to facilitate certain development outcomes (such as affordable housing), provided they are fully transparent and accountable regarding this decision and the value of forgone revenue.
- Where an exemption is granted, the cost which would have been apportioned to the exempted development should not be attributed to another site or development class. The government agency granting the exemption should 'wear' the cost, to be funded from a wider revenue base.

Issue 4.11: Works-in-kind agreements and special infrastructure contributions

- Works in kind agreements or cash in lieu payments may be appropriate where land cannot be provided. However, where this has an effect of shifting timelines for infrastructure provision, the resulting cost to public authorities should be accounted for in the calculation of in lieu contributions (the difference in the Net Present Value of the changed timeline for infrastructure provision is an appropriate means of calculating this potential cost).
- A pooled system for collection of development contributions administered by the NSW Treasury would allow developers to access refunds where works-in-kind credits exceed their obligations.

ATTACHMENT 1 - SGS OCCASIONAL PAPER: VALUE CAPTURE THROUGH DEVELOPMENT LICENCE FEES

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SGS Occasional Paper

Value capture through development licence fees

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INTRODUCTION

This paper argues that the oft-cited 'windfall gains' attaching to planning approvals are simply capitalised monopoly rents arising from warranted restrictions on competition in the market for development rights. While there are many in the literature calling for taxes on 'planning gain' or 'betterment', this paper suggests an alternative policy strategy involving charging proponents for privileged access to limited development rights. For the most part, we illustrate these arguments with examples from Victoria. However, they are generally applicable across all Australian jurisdictions.

MONOPOLY RENTS ARISING FROM LIMITS COMPETITION

Restrictions on competitive access to markets inevitably create opportunities for extraction of super profits or 'monopoly rents'.

These restrictions on competition may be 'natural'. This can occur when the market in question can only support one (or a small number) of efficient suppliers, by virtue of the capital intensity of the business or simply the limited size of the market.

Restrictions on competition can also be deliberately constructed through state regulation. Historically, governments reserved, to themselves, access to trade in particular markets with a view to extracting the monopoly profits on offer. This could occur directly through state outlets or through the official sale of the trading rights[1].

This revenue objective aside, regulation of competition may be warranted in the interests of economic efficiency. While open competition and market access can generally be relied upon to produce a welfare-boosting outcome for the community, this is not always true, principally because of market externalities. Transactions among freely competing suppliers and their customers may cause unwanted side effects for third parties. These external welfare losses could outweigh or significantly dent the welfare gains made by market transactors.

WARRANTED RESTRICTIONS ON COMPETITION

Regulation of land use and development through planning schemes in Victoria and other Australian jurisdictions represents a restriction on competition warranted by this economic efficiency objective. A 'free for all' in, say, the development of traffic generating shops, noise emitting warehouses or sunlight robbing towers is likely to create inferior streets, neighbourhoods and cities in terms of overall community welfare.

The Harper Competition Policy Review[2] acknowledged that regulation of land use and development is needed, notwithstanding the implicit or explicit erection of barriers to entry in planning schemes.

> *Land can be used for a variety of purposes, including residential, industrial, commercial and conservation, which can include national parks. However, the unfettered market may not deliver an outcome across these various uses that is considered optimal for society as a whole. Hence, governments allocate land to particular uses through planning, zoning and development assessment.*
> *p: 122*

[1] In some international jurisdictions, for example Norway and Sweden, Governments hold a monopoly over liquor retailing and directly own and operate a network of stores to address this market demand. Australian jurisdictions exploit this monopoly through liquor licencing fees. http://competitionpolicyreview.gov.au/files/2015/03/Competition-policy-review-report_online.pdf

[2] Harper, I., Anderson, P., McCluskey, S. and O'Bryan, M. (2015) **Competition Policy Review Final Report**, commissioned and published by the Australian Government

The Harper Report goes on to critique the way in which planning regulations constrain competition, particularly in the development of shopping centres. But, as might be expected in a policy review focused on economic efficiency, the Report fully accepts the requirement for regulation of where, when and how much and by what design proponents can develop land in the process of building the city.

The Harper committee further acknowledged that, where undertaken, past reviews have confirmed that planning regulation passes the net community benefit (i.e. economic efficiency) test, albeit that there is always room to better calibrate the restrictions on competition.

VALUE CAPTURE IN THE PLANNING SYSTEM

We therefore have deliberate and systematic restrictions on competition in planning regulations. Governments and communities sanction these because these restrictions are expected to generate a net community benefit compared to allowing urban development to proceed on a 'laissez faire' basis. However, by definition, they are also routinely creating opportunities for monopoly rent.

These opportunities for extraction of monopoly returns are attached to particular sites. Accordingly, they are capitalized into the value of the land. Other things equal, a piece of land which has latent or realised approval for the construction of a major shopping centre will be more valuable than land without this privileged access to retail centre development rights. Similarly, land approved for a multi-storey apartment building will be worth more than otherwise equivalent land designated for a single household dwelling.

This occurs because developers value candidate sites on a 'residual' basis. They will deduct from the gross proceeds of the sale of their finished products on a site all their delivery costs (approvals, site preparation, construction, marketing etc) plus a margin for profit and risk to arrive at the maximum price they would be prepared to pay for the land in question. Planning approvals which enable an expansion of gross proceeds will typically result in higher residual land values. This increase in land value is, in fact, a measure of the value of the additional development rights conferred by the planning approval (see figure 1).

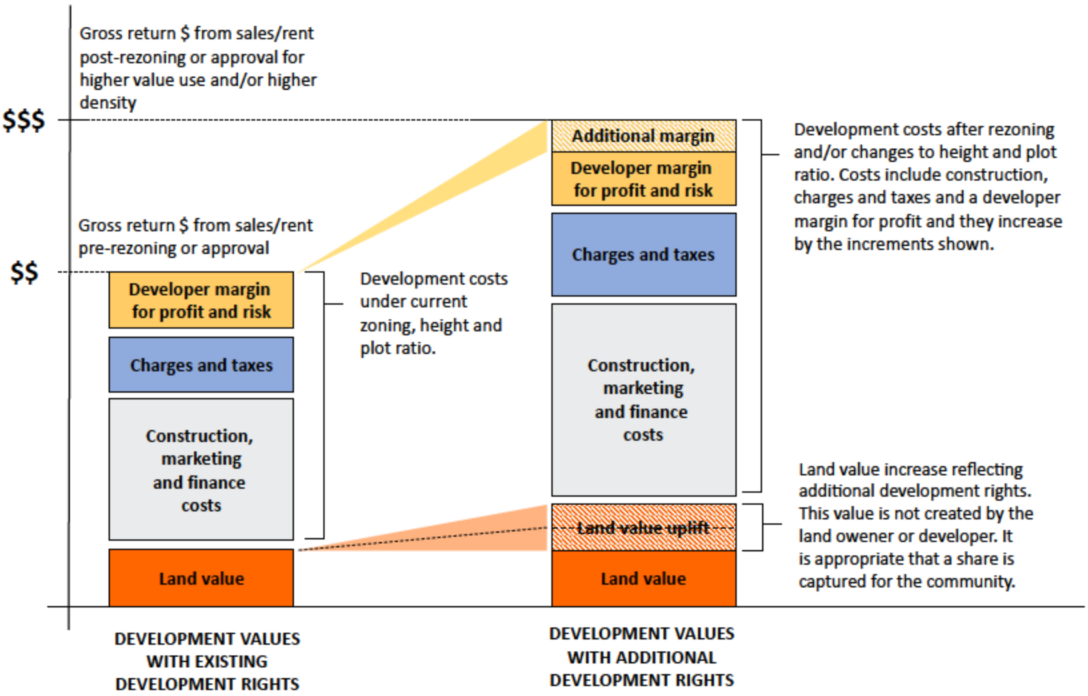
This boost to property value occasioned by variations in the competitive restrictions applying to different areas of land across the city has been recognized since the inception of planning schemes in Victoria and elsewhere. It has gone by many names including 'planning gain', 'betterment' and the rather pejorative 'windfall gains'.

Early versions of Victoria's planning legislation explicitly recognised the creation of betterment through the regulatory process and made provision for its partial capture. For example, the Town and Country Planning Act (1961) which was repealed in 1985 to make way for the current Planning and Environment Act included a specific head of power for taxation of value uplift brought about by planning scheme changes.

Even in Victoria's current planning legislation, the Growth Area Infrastructure Charge (GAIC) is, in effect, a betterment levy on the conversion of rural land for urban purposes on Melbourne's fringe.

From time to time, other jurisdictions have sought to capture part of the value uplift from planning regulations through various forms of taxation. Generally, these have been unsuccessful in no small part because of the difficulty of measuring betterment in relation to a particular transaction event. Taxing the value margin as measured 'before and after' (a planning approval or rezoning) has been problematic because of speculated pre-approval increases in value.

FIGURE 1. ESTIMATING THE VALUE OF PLANNING APPROVAL


Gross return $ from sales/rent post-rezoning or approval for higher value use and/or higher density
$$$
Gross return $ from sales/rent pre-rezoning or approval
$$
Developer margin for profit and risk
Charges and taxes
Construction, marketing and finance costs
Land value
Development costs under current zoning, height and plot ratio.
Additional margin
Developer margin for profit and risk
Charges and taxes
Construction, marketing and finance costs
~~Land value uplift~~
Land value
Development costs after rezoning and/or changes to height and plot ratio. Costs include construction, charges and taxes and a developer margin for profit and they increase by the increments shown.
Land value increase reflecting additional development rights. This value is not created by the land owener or developer. It is appropriate that a share is captured for the community.
DEVELOPMENT VALUES WITH EXISTING DEVELOPMENT RIGHTS
DEVELOPMENT VALUES WITH ADDITIONAL DEVELOPMENT RIGHTS

Source: SGS Economics & Planning Pty Ltd

In the absence of taxation mechanisms, approval authorities have devised less transparent ways of capturing a share of the betterment created through their planning schemes. This can include protracted negotiations to extract commitments to invest in the public domain, provide affordable housing or otherwise deliver a benefit to the local community. Some authorities have sought to regularise the extraction of community benefit by making access to additional development rights contingent on a 'bonus' system. Unfortunately, many of these innovations have had the damaging side effect of adding to a complex, inefficient and risk laden development assessment system that acts as a drag on worthwhile investment. Moreover, the granting of a bonus can connote that approval authorities are compromising environmental and design standards in order to achieve an unrelated public benefit.

LICENSING RATHER THAN TAXATION

Rather than conceptualising betterment as a negative taxation issue – that is, the government *taking away* part of the wealth of a property owner – it can be seen as the *sale of development rights* to proponents granted privileged access to markets that must be regulated for the sake of economic efficiency. That is, the government is providing a positive asset to the proponent for a reasonable price linked to the monopoly rent on offer.

This perspective may be novel within the confines of the planning system, but it is conventional in other regulatory regimes where market access is necessarily restricted in the interests of efficiency. Access to commercial fisheries, broadcasting bands, logging in native forests and, as noted, liquor distribution are but some examples of where regulation is essential to manage natural monopolies and externalities in a sustainable and equitable way, and where those granted access to the limited trading rights must pay a licence fee to government for the privilege.

AUSTRALIAN PRECEDENTS

Development proponents in the ACT are already required to pay a fee linked to the value of the land-use rights granted via the planning system. Since 1971, the Territory Government has imposed some form of licence fee where there is betterment as a result of a change in land use, additional floor space or both.

That this licence payment is straightforward and generally accepted in the national capital stems from the fact that the Territory has a leasehold rather than freehold land tenure system. Once proponents for more intense or higher value land uses have secured planning approval for the sites in question, the terms of their lease on the land must be varied to accommodate this approval. As the varied lease will be of higher value than the pre-planning approval lease, the Government extracts a proportional lease adjustment fee.

Originally, this lease variation charge was estimated on a case-by-case basis, using before and after valuations. The system is now being reformed to use codified or pre-notified standard per unit values for different types of development in the different suburbs of Canberra[3].

The development licensing fee system in the ACT is made transparent by the leasehold arrangements unique to that jurisdiction. However, it is not *dependent* on that system of land tenure. A codified system of development licensing system identical to that of the ACT could be applied across Australia.

AN OPERATIONAL MODEL FOR DEVELOPMENT LICENCE FEES

A development licensing system of general applicability would compare the current use of a lot with the proposed use and apply a fee geared to the implied uplift enabled by the planning approval.

The before and after *site valuations* would not be estimated for this purpose. As noted, such valuations are likely to have been subject to pre-approval speculation. To circumvent this problem and to simplify administration, the uplift in land use value would be established using generalised residual land value figures for the suburb or precinct in question. These generalized figures would be empirically based in the sense that they would be derived from recent sales records.

This approach has been applied in the recently approved Amendment C270 to the Melbourne Planning Scheme. Proponents of developments in the central city with a floor area ratio (FAR) greater than the adopted benchmark of 18:1 are required to pay an in kind licence fee geared to the generalised residual land value for each square metre of floorspace above the benchmark. These generalised residual land values are calculated as 10% of the gross realization value, which itself, is a generalized or typical figure for each precinct in the central city (see table 1 and figure 2).

The gross realisation values adopted in Am C270 are shown in the following table. On this basis, a proponent of development for an additional 10,000 square metres of residential floorspace above the 18:1 FAR in, say, the ‘Eastern Core’ precinct must, firstly, meet all relevant design standards and, secondly, make a public benefit dedication on site to the value of 10,000 x $9,000 x 10% = $9 million.

[3] See Macroeconomics.com.au (2010) **Final Report on the Review of the Change of Use Charges System in the ACT**, commissioned by the ACT Treasury http://www.treasury.act.gov.au/Change%20of%20Use%20Charge/CUC%20-%20Macroeconomics%20Nicholls%20report.pdf

This dedication must be made 'in kind' as agreed with the approval authority, and take the form of any of the items listed below:

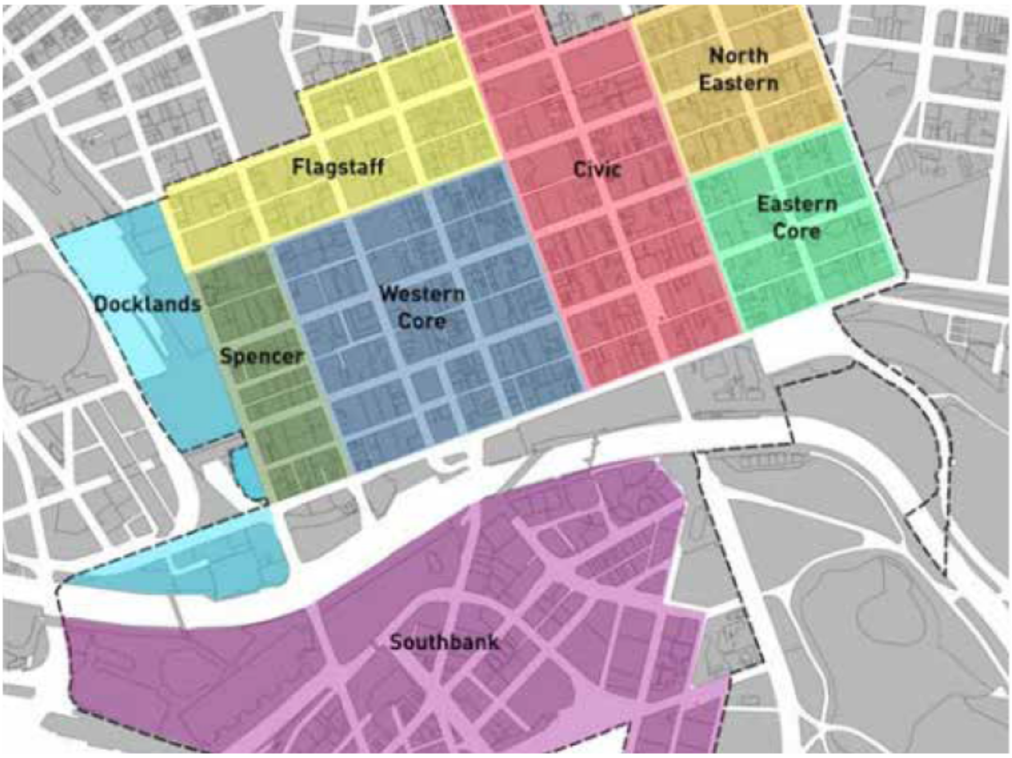
- publicly accessible open areas on site
- publicly accessible enclosed areas within the proposed building
- affordable housing within the proposed building
- competitive design process for the design of proposed building, and
- strategically justified uses including office on site or within the proposed building.

TABLE 1. GROSS REALISATION VALUES PER SQUARE METRE BY USE AND PRECINCT

	Eastern Core	North Eastern	Civic	Flagstaff	Western Core	Spencer	Southbank	Docklands
Retail	$17,000	$14,000	$16,000	$15,000	$17,000	$14,000	$12,000	$14,000
Hospitality	$9,000	$8,000	$8,000	$7,000	$7,500	$6,500	$6,500	$6,500
Commercial	$9,000	$6,000	$7,000	$5,500	$7,000	$5,000	$5,000	$5,000
Residential	$9,000	$8,000	$8,000	$7,000	$7,500	$6,500	$6,500	$6,500

Source: SGS using EY data

FIGURE 2. GRV PRECINCTS MAP



Source: DELWP (2016), How to Calculate Floor Area Uplifts and Public Benefits

The 'value sharing' or development licensing principle established in the Melbourne Planning Scheme could be readily applied to all development across the State, although several refinements would assist in efficient administration. These include making allowance for cash instead of in-kind payments for development licences and establishing a standardized base line for the calculation of fees. The value of the additional development rights would be taken as the difference between the (standardized) residual land value of the proposed development and the (standardized) residual land value of existing use rights.

It would also be useful to separate collection of the licence fee from the planning assessment process, as occurs in the ACT. That is, a proponent would secure a development approval purely on the planning merits and then purchase the relevant licences at the scheduled fee from a separate agency of government. This would mitigate perceptions that planning outcomes are being compromised in pursuit of greater revenues.

As an illustration of how this expanded and codified development licensing system might work, refer to the table of nominal residual land values by hypothetical suburb below. Assume a proponent wants permission to replace four single family houses on four lots in Suburb 3 with a residential tower of 100 dwellings comprising a total of 10,500 square metres of floorspace. In this case, the value of existing use rights will be $450,000 x 4 = $1,800,000. The gross value of the development rights after the approval will be 10,500/100 x $80,000 = $8,400,000. The value uplift enabled by the development approval will therefore be $6,600,000.

The percentage of this uplift taken as a licence fee is a matter for policy. In the ACT, it has ranged up to 75%. In a recently adopted de-facto licensing scheme, the Georges River Council in NSW seeks to recover 50% of the value of additional development rights granted through planning approvals[4].

It is important to leave 'something on the table' in striking the fee rate. Too high a percentage could act as a disincentive to development.

A rate of up to 50% might be seen as reasonable, particularly if phased in over a long period (say 5 to 10 years) to allow currently embedded price expectations to work their way through the market. At 50%, our Suburb 3 proponent would be required to pay $3.2 million for a development licence fee. This amounts to around 40% of the gross value of the development rights.

A development licence fee of this nature would generate significant revenues. If, for the purposes of illustration, we assume a residual land value of around $50,000 per apartment in Victoria and approvals of around 30,000 such dwellings each year, revenue yield would be $600 million per annum for that state. Development licence fees for commercial, retail, hospitality and other land uses would be in addition to this. So revenues could exceed $1 billion per year in Victoria.

TABLE 2. NOMINAL RESIDUAL LAND VALUES

	Typical residual land values			
Land Use/Development	Unit	Suburb 1	Suburb 2	Suburb 3
Low density residential	dwelling	$380,000	$500,000	$450,000
Medium density residential	100 sq m NLA	$62,500	$70,500	$65,000
High density residential	100 sq m NLA	$75,000	$85,000	$80,000
Commercial - low rise	100 sq m NLA	$70,000	$79,000	$74,000
Commercial - high rise	100 sq m NLA	$63,000	$71,100	$66,600
Retail / Hospitality	100 sq m NLA	$82,500	$93,500	$88,000
Industrial - intensive	100 sq m NLA	$35,000	$39,500	$37,000
Industrial - low density	100 sq m NLA	$23,100	$26,070	$24,420

[4] The value of these additional rights are also estimated on a codified, pre-notified basis along the lines of AmC270 in Melbourne. See http://www.georgesriver.nsw.gov.au/GeorgesRiver/media/Documents/Building/Planning%20Agreements/Georges-River-Council-Policy-on-Planning-Agreements-effective-10-August-2016.PDF

COLLATERAL BENEFITS

Capturing land value through development licence fees would bring a number of collateral benefits.

Revenues from licence fees could be shared between State and local government. This would give local communities and Councils an incentive to facilitate housing and other warranted development. This structural change in the way value created by development is shared could pave the way for liberalization of the land supply chain for housing construction, particularly in well serviced areas. This would work towards improved housing affordability.

Moreover, better data would be generated about the value (or loss of value) implied by proposed planning scheme changes. This would enable more efficient and accurate assessment of whether these changes will give rise to a net community benefit. It might also be expected that speculative bidding up of land values ahead of approvals may be dampened, leading to more rapid and efficient adjustments in local land markets.

Importantly, a development licence fee will be non-distortive if calibrated correctly. That is, a development licence fee would not deter development that would have occurred in the absence of such a scheme. Proponents will be indifferent as to whether they pay the full value of the development rights secured through a planning approval to the private owner of the site, or whether this amount is shared between the private owner and government. On the land owners' part, they can be expected to continue to release the sites in question for redevelopment for as long as there is a sufficient price premium on offer compared to the value of the sites in their current use.

COVERAGE OF VALUE UPLIFT

This paper has focused on land value uplift arising from the granting of development rights via the planning system. There are two other sources of value uplift. One relates to the unpriced, off-site benefits generated by public investment in infrastructure, such as parks, public transport and other services provided in whole or part at the taxpayer's expense. Properties will enjoy this lift in value regardless of whether additional development rights are secured.

A further source of value uplift relates to the general health of the city economy which is a reflection of sound urban management as well as historic and natural resource endowments. Property values in healthy, growing, well managed cities will be higher, other things equal, compared to a poorly managed declining city. Again, this would hold regardless of the granting of development rights or investment in new infrastructure.

These three 'engines' of value uplift are conceptually separate and should be kept so for policy making purposes (see SGS Economics & Planning Pty Ltd, 2016)[5]. Different tools for value sharing will be appropriate for the different engines. For example, the Land Tax regimes operated by most State Governments would be suitable for the third of the sources described above. Meanwhile, special purpose 'benefitted area levies' or the like might be suitable to capture part of the uplift associated with infrastructure investments that have a localized catchment of prime beneficiaries.

Licence fees could then be secured from recipients of ad hoc development approvals. To the extent that land taxes and/or benefitted area levies affect gross realisation values and/or development costs, the size of the required licence fee would adjust automatically.

[5] SGS Economics & Planning Pty Ltd (2016) **Technical paper on value capture; Final report**, prepared for, and published by, Infrastructure Australia http://infrastructureaustralia.gov.au/policy-publications/publications/files/SGS_Technical_paper_on_value_capture-September_2016.pdf

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