NSW GOVERNMENT | Treasury

Ms Cate Faehrmann MLC
Chair
Portfolio Committee No 7 – Planning and Environment
Parliament House
SYDNEY NSW 2000

PortfolioCommittee7@parliament.nsw.gov.au

Dear Chair,

Re: Environmental Planning and Assessment Amendment (Infrastructure Contributions) Bill 2021

I welcome the opportunity to make a submission to the Inquiry into the Environmental Planning and Assessment Amendment (Infrastructure Contributions) Bill 2021.

In April 2020, I was approached by the Minister for Planning and Public Spaces to undertake a holistic review of the NSW infrastructure contributions system (the Review) and report back with recommendations.

The Review found that the current system is overly complex, unpredictable, and does not adequately fund the infrastructure required for growth. This has led to an opaque system with poorer outcomes for the community such as slower development, higher costs and uncertainty for industry, and lower service levels. A package of 29 recommendations was proposed to address these challenges.

In March 2021, the NSW Government accepted all of the Review's recommendations, as outlined in my Final Report.[1] These reforms will deliver a transparent, certain, efficient, consistent, and simpler contributions system that will unlock new housing supply, deliver vital infrastructure, and boost investment in New South Wales.

As part of implementation, several recommendations of the Review require legislative and regulatory amendments. This Bill contains the enabling legislation to support execution of the reform package, including:

- establishing a regional infrastructure contributions scheme
- implementing a direct land contribution mechanism
- further provisions for existing local infrastructure contributions.

Despite there being broad support for the policy intent of the recommendations, aspects of the recommendations have been queried since exhibition of the Bill. My submission clarifies the policy intent of some of the reforms, where questions have been raised by concerned stakeholders.

[1] The NSW Productivity Commission's Final Report on the *Review of Infrastructure Contributions in New South Wales* can be accessed here: https://www.productivity.nsw.gov.au/infrastructure-contributions-review

Economic benefits from the reform package are significant, if implemented in full

Economic modelling of the reform package estimates net gains to the economy of up to $12 billion over 20 years and the creation of an additional 2,600 jobs. Benefits will be realised as better services, lower house prices, and savings for businesses.

Many of the Review's recommendations are interdependent and must be implemented together to realise the full benefits. This package of reforms has been carefully designed to maximise the economic benefits while also balancing the impacts across local government and industry.

Most importantly reforms to local government rates to allow them to increase with population growth must be treated as a central part of contributions reform, rather than as a separate measure. The overall package seeks to lower councils' financial dependency on infrastructure contributions, while allowing rates revenue to increase with population growth within a local government area.

Independent modelling by the Centre for International Economics demonstrates that, while impacts of the rate peg reform are modest initially as it takes time for additional revenues from the rate peg reform to ramp up, over 20 years councils are significantly better off overall under this package, albeit with some rebalancing between sources of revenue. Since rate revenues are untied, this package of reforms significantly improves councils' financial flexibility. In addition, increased future revenue capacity will give councils more fiscal capacity to borrow to fund infrastructure requirements.

The overall package is finely balanced and the individual recommendations have been designed with other recommendations in mind. For example, as outlined in the Final Report (Table O.1), the impacts on local government from the reform package include:

- a reduction in revenue from infrastructure contributions – of around $90 million in 2024 across all councils
- increased section 7.12 revenues will be more than offset by reduced revenue from local planning agreements and section 7.11 revenues
- the impact on gross revenues earned from section 7.11 do not take into account the reduction in costs from the efficient benchmarking of infrastructure costs and the direct land contribution
- an increase in local government rates revenue from the rate peg reform—rates revenue are expected to increase by an additional 8.9 per cent over 20 years.[2]

The additional rates revenue will more than offset the impacts on infrastructure contributions. It will also enable councils to recoup the operating and maintenance costs associated with servicing a larger population and service debt to forward fund infrastructure, improving the coordination of service delivery with development.

While stakeholders will inevitably seek to cherry-pick the upside measures, this approach will see to overall package unravel, to the detriment of everyone. Care therefore needs to be taken if specific reforms are refined to ensure there are no unintended consequences on overall outcomes and impacts on relevant stakeholders.

[2] The increase in council rates forecast by the Centre for International Economics from the rate peg reform is initially quite modest but over time the growth rate in council rates significantly grow.

Reforming the rate peg to reflect population growth is a <u>necessary condition for local contributions reform</u>

Adjusting the rate peg to population growth is critical to implement this new system.

Councils (especially high-growth councils) face pressure to deliver more and better quality services. The current rating system, however, limits their ability to maintain consistent service levels or provide the necessary infrastructure to accommodate growth.

Reforming the rate peg to reflect population growth will:

- ensure councils' general income is maintained on a per capita basis as their population grows
- remove their reliance on infrastructure contributions to fund services not related to development (i.e. general costs).

The changes will provide councils with additional rates revenue and more flexibility over how they spend their contributions. By providing greater access to the flexibility of a section 7.12 contributions plan and making pooled funds the default, councils can collect funds from new development and progressively apply them to a list of infrastructure projects.

In addition, the increase in rates will remove pressure for local councils to fund the general costs from population growth via infrastructure contributions, reducing industry costs, and improving development feasibility. Industry would only be charged for the local service costs contingent on their developments proceeding.

The new system will be more transparent for ratepayers, who will be able to clearly see where infrastructure contributions are being spent. And it creates an even playing field for all councils including in our city's growing west.

IPART is currently developing a draft methodology for the rate peg reform, with a Final Report due in September 2021. In developing the methodology to implement the rate peg reform, IPART is considering the implications for different local councils across New South Wales to ensure that there are no unintended adverse consequences for individual councils. Once accepted, the new arrangements will be in place for the 2023-24 rates year.

A principles-based approach to contributions will increase the transparency and improve the certainty of the infrastructure contributions system

The package of reforms is designed to increase the transparency of the infrastructure contributions system. Confidence in the system is maintained through public accountability and transparency through all stages of the contributions process. Examples of this include:

- A contributions digital tool within the NSW Planning Portal to make the system easier to understand and interact with. Automating the ongoing administration, tracking and reporting will reduce the administrative burden and increase transparency.
- Amendments to the Environmental Planning and Assessment Regulation 2000 to improve transparency in, accounting for, and reporting on, State and local contributions revenues.
- Exhibition of land requirements and the contribution share in the contributions plan at the time of rezoning provide landowners with certainty and transparency about the obligation.

In addition, the Review makes a range of recommendations that constrain the use of and make more transparent the use of voluntary planning agreements (VPAs).

Planning agreements (State and local) allow developers to provide innovative solutions to infrastructure delivery and enable an out-of-sequence development to proceed. Yet, unlike the other contribution mechanisms, it is often less transparent and *ad hoc* in its application This can foster uncertainty and undermine confidence in the planning system. Stakeholder feedback to the Review highlighted the potential perception by industry in using these agreements that development rights can be purchased.

Recognising that there is still a need for VPAs (i.e. in the case of out-of-sequence development or provision of in-kind infrastructure) the Review recommends the issuing of clearer guidance restricting the use of planning agreements and requiring better transparency (Recommendations 4.12, 4.13, and 5.2). This will be balanced out with new arrangements for sections 7.11 and 7.12 contributions and the introduction of a new RIC scheme.

Deferring the timing of contributions payment can unlock new housing supply

Presently, section 7.11 contributions are imposed as a condition of consent and payments are typically required prior to obtaining a construction or subdivision certificate. Allowing developers to defer upfront payment of contributions to the occupation certificate (OC) stage can better support their project financing arrangements. It will also remove barriers to small developers entering the market as it improves their access to project finance.

Risks to councils' cashflow from the delayed receipt of funds has been raised as an issue. To address this risk and improve fiscal flexibility, the NSW Productivity Commission developed Recommendation 4.9 to encourage councils to pool funds and to borrow to forward fund infrastructure. The Review recognised that growing contributions balances held by councils is a significant funding source which could be pooled and deployed for early land acquisition and prioritised infrastructure delivery.

In relation to the barrier to councils borrowing from Treasury Corporation (TCorp), the NSW Productivity Commission understands that the Department of Planning, Industry and Environment are working with TCorp to update TCorp's procedures to address this issue. A direct land contribution (see below) will also help councils to manage financial risk by ensuring that contributions reflect the actual cost of land acquisition.

Increased oversight of the payment of contributions before private certifiers can issue an OC will also help to alleviate councils' concerns. Amending the *Building and Development Certifiers Act 2018* to create an offence where OCs are issued without payment of contributions can assist with enforcement.

A direct land contribution provides an equitable and efficient funding approach to land acquisition in local contributions plans

Currently when preparing a section 7.11 contributions plan, councils determine the land required for infrastructure purposes and estimate the value of the land at that point. The costs are then shared across the developments generating infrastructure demand. The contributions are typically indexed using the Consumer Price Index.

Land acquisition costs generally represent the single largest component of local contributions plans (particularly section 7.11), with land accounting for more than half of total section 7.11 costs. Escalating land values over time (particularly following a rezoning) can see a significant surge in final acquisition costs, leading to funding shortfalls for councils.

To illustrate:

- A sample of 10 properties in the Blacktown local government area, covering 181 hectares of land acquired for drainage and open space, had a valuation at the time the contributions plan was made totalling $37 million
- The final acquisition costs to council totalled $65 million, representing a 75 per cent increase.

The consequence of this is a lack of amenity and open space provision, as roads and drainage take priority where funding is short.

Introducing a direct land contribution for landowners following rezoning can provide early and adequate funding for land. The direct land contribution addresses issues faced by councils over lags and uncertainties regarding the collection of contributions to support early acquisition.

The direct land contribution must be *in lieu* of the existing charge for land acquisition in a section 7.11 contributions plan, not additional to the existing contribution as some stakeholders have suggested. The policy intent is to see contributions align with increases in the cost of land, which are notoriously difficult to forecast. Receiving contributions via land itself provides a better way for councils to ensure sufficient provision for open space. **Attachment A** provides more detail on how the direct land contribution scheme will apply.

All landowners in a “land value contributions area” are required to contribute towards the provision of land for public purposes as identified in a section 7.11 contributions plan. The same process is used to determine how much land is needed for infrastructure purposes, but instead of converting this to a total land acquisition cost at a point in time—it is converted to a percentage of the total rezoned area. To provide landowners with certainty and transparency about their obligation, the Review also makes Recommendation 4.1 to require the public exhibition of land requirements (and corresponding contribution shares) in councils’ contributions plan at the time of rezoning.

Each landowner is required to provide their respective share (through direct dedication of land or as a monetary payment) when the land is sold, or developed, whichever occurs first. Works-in-kind cannot be used to satisfy the obligation, as the policy purpose is to specifically fund land required for development (i.e. open-space/ drainage). When satisfying their obligation, the contribution amount is calculated based on the value of land at the time it needs to be acquired. This ensures that the contribution reflects changing land values and actual land acquisition costs for councils.

Strong governance will provide accountability for investment of regional infrastructure contributions and transform the delivery of state enabling infrastructure to unlock housing supply

The existing special infrastructure contributions (SIC) program is inconsistent, unpredictable, and is limited in its application across the State. The charges apply to a narrow base but can be high, as they apply only to select areas. This has contributed to a lack of timely and aligned infrastructure delivery to support growth and development.

A broad, flat, and modest regional infrastructure contribution (RIC) will provide a transparent, consistent, and certain approach to the funding of state and regional infrastructure across New South Wales. Initial modelling completed for the Review suggests it would have a negligible impact on development feasibility. The RIC will be introduced via a new State Environmental Planning Policy (SEPP). It brings requirements currently spread across determinations, directions, and orders into one instrument.
Initial adoption is recommended for the high-growth regions of Greater Sydney, Hunter, Central Coast, and Illawarra-Shoalhaven, with potential roll-out to other areas in the future.

The following indicative rates (subject to further development feasibility testing) are proposed:

- $10,000–$12,000 per dwelling for residential development in Greater Sydney
- $8,000–$10,000 per dwelling for residential development in the Central Coast, Hunter, and Illawarra-Shoalhaven
- $10–$40 per square metre of floor space for commercial and industrial development in the identified regions.

In comparison to the low broad-base RIC, some of the SIC rates for specific locations under the existing system are up to $55,000 per dwelling (excluding biodiversity offsets).

New transport projects confer significant local benefits through reduced travel times and expanded development capacity; these benefits are generally reflected in land value increases. Where there is the case, a transport contribution for major projects will be introduced.

In addition, a new category of contributions specific to biodiversity protection will be created. Biodiversity loss is specific to particular areas, making it inappropriate for inclusion in recommended regional contributions plans. All of these charges will be subject to feasibility testing before being introduced.

A new fund will be established for the collection of RIC, administered by NSW Treasury. Funds collected will be hypothecated for spending towards growth enabling infrastructure in priority growth areas. Spending of these contributions and the transport component will require the Treasurer's approval in consultation with the Minister for Planning and Public Spaces. Spending priorities will be decided after considering relevant strategic plans under the *Environmental Planning and Assessment Act 1979* and the *Infrastructure NSW Act 2011*.

A broad, flat, and modest RIC will improve the timing, funding, and coordination of growth supporting infrastructure, which is key to unlocking new housing supply and improving housing affordability. Economic modelling forecasts up to $9.4 billion in economic benefits will be generated through higher investment in quality, growth enabling infrastructure and greater certainty for industry from the RIC. It will also limit the unpredictable and inefficient use of planning agreements in place of a SIC.

The new approach will also transform the way agencies currently plan and deliver state and regional infrastructure across New South Wales. Presently, agencies are forced to balance funding for growth infrastructure with major new initiatives, with preference given to those capital projects with approved external funding (e.g. Commonwealth grants). This creates funding shortfalls and long delays in infrastructure delivery, further limiting development potential for a given area. The new approach would see Treasury, together with DPIE, leverage contributions funds to better align broader agency capital budgets with regional growth requirements.

As a particular example, Transport for NSW has struggled to identify sufficient capital to fund regional roads within the North West and South West growth areas. Roads that have been provided have either been delivered by developers as works-in-kind, or through external grant funding, such as the Housing Acceleration Fund.

It also encourages better infrastructure planning by accounting for the total costs of infrastructure provision (i.e. land and capital component) when prioritising infrastructure to be invested in. This reforms the way the existing SIC is applied, which is based on capturing the marginal costs of development, such as the provision of land only for schools.

By giving agencies access to a broader pool of capital, as well as a sharper prioritisation process focused on the delivery of growth-related infrastructure, agencies will be better able to prepare place-based asset management strategies, particularly in relation to ongoing operational and maintenance costs. It will also allow closer agency collaboration in infrastructure planning. For example, linking open space, recreation, and education needs to infrastructure delivery outcomes.

Savings and transitional arrangements will preserve SICs in areas where they have been determined prior to 1 July 2022. This will provide continuity and certainty where existing arrangements are already on foot. Beyond this, the new RIC arrangements will apply. To avoid confusion, developers are only liable for a RIC or SIC, not both.

Passage of this Bill is critical to ensuring the new contributions system is in place by 1 July 2022. This is the first step to delivering the broader reform package by 2023-24.

Timely adoption of these reforms will set up the foundations for more stable and sustainable infrastructure funding arrangements that will support growth during this COVID-19 recovery period and beyond.

Yours sincerely,

Peter Achterstraat AM

15 July 2021

ATTACHMENT A – Examples of how direct land contribution mechanism will apply

If I own a $3 million property, and as part of a rezoned precinct, two thirds of the property is identified for a road corridor, would I be liable for a $2 million land value contribution if I were to sell the property tomorrow?

No.

The amount of land value contribution will be determined in reference to how much land is needed for local infrastructure purposes across the whole precinct being rezoned.

Hypothetical example - if the precinct has a total area of 100 hectares and the local infrastructure land needed (for parks, drainage) is 10 hectares – this is 10 per cent of the precinct area.

All landowners within the precinct would have an obligation to provide the equivalent of 10 per cent of their site for this infrastructure purpose. Note: the rate will vary from precinct to precinct as it is directly related to the infrastructure needs of that precinct.

In real life, however the land needed is unlikely to be evenly distributed across the precinct. For example, where two-thirds of a particular landowner's site is identified as being needed for a local infrastructure purpose. The council can only require landowners to make a contribution equivalent to 10 per cent (taking the above hypothetical example). Where landowners are selling the property, they would be required to make a contribution equivalent to 10 per cent of the property value = $300,000.

By collecting the relevant percentage amount across all landowners, council will have the funds required to purchase the land needed from the landowner where two-thirds of the site is required for a road corridor. The cost of any section 7.11 contributions plan is reduced as the cost of the land does not have to be incorporated as currently occurs.

Taking the hypothetical example - if landowners are developing the site (**not selling first**), then other options become available.

In this first instance, 10 per cent of your site could be dedicated to the council to satisfy the obligation. You could then either agree with council to dedicate the remaining 56 per cent needed in exchange for credit (assuming you had other sites that would also have land value contributions to satisfy); sale to the council for agreed value or council could compulsorily acquire at just terms.

Is it possible that in some cases, 30 per cent, 40 per cent, 50 per cent or more of a private landholding may have to be handed over to the local council free-of-cost?

No.

This is not the policy intention of the direct land contribution. No new pathway is being introduced by which councils can force land to be handed over for free.

There will be some sites where, because of the nature of the infrastructure (such as drainage), larger portions of their site may be identified as being required for an infrastructure purpose, as is the case currently. Importantly, the land needed is averaged out across the whole precinct (as they all benefit from the infrastructure being provided).

There will be some landowners who do not have any land identified for an infrastructure purpose on their site. They still need to chip-in, as these contributions will fund the acquisition of land from others.

The argument for the section 7.11 *status quo* would be that land acquisition is apportioned across all development in a precinct, and therefore enables all development to support acquisition of the same corridor. I'm aware of how the status quo fails to keep pace with the cost of land over the life of a contributions plan.

This mechanism is the same methodology. The land is identified and the obligation is shared across the precinct.

What's different between the proposed direct land contribution mechanism relative to the existing section 7.11 mechanism for land acquisition?

For section 7.11 a cost estimate for the total land acquisition is prepared. For example, 10 hectares at $200/sqm = $20 million. This cost is then divided by the total number of expected lots. From the date that the plan is prepared, the $20 million cost estimate is indexed using the Consumer Price Index (typically 2-3 per cent). When council has collected the contributions and is ready to purchase land, the land prices have risen well above CPI (sometimes 20 per cent or more) – leaving council with a funding shortfall that is currently borne by general rate payers.

In the proposed system, we determined (using the hypothetical above) that 10 hectares of the 100-hectare precinct is needed for local infrastructure. Instead of valuing this at a point in time, an obligation of 10 per cent of the land value (to be satisfied when the land is developed or sold, whichever occurs first) is identified at rezoning. This land **is not** also added to the section 7.11 contributions – but is an alternative approach (i.e. no "double dipping").

If all the contributions were being satisfied by money – then the payments will be made with reference to the land value at the time of payment. This will overcome the problem of cost estimates not keeping up with rising land values. Ideally though, it will also facilitate more direct dedication of the land that the council needs, which should reduce costs all round.