SUPPLEMENTARY PAPER 2 – INFRASTRUCTURE FUNDING PRINCIPLES

Infrastructure is essential to support NSW's growth, but it is complicated in terms of how it is currently structured, coordinated and funded. UDIA NSW recommends a hybrid approach to resolve infrastructure funding in NSW. Our approach is underpinned by three key principles:

1. Infrastructure funding should be efficient, transparent, accountable, predictable, equitable
2. The infrastructure funding regime should support housing supply to support affordability
3. There must be a beneficiary pays approach to infrastructure.

INFRASTRUCTURE CHARGING IS POOR IN AUSTRALIA

In 2012 the Housing Supply and Affordability Reform (HSAR) Working Party from COAG examined charges imposed on the development industry and home owners, finding

> *Some states and local governments were imposing infrastructure charges on developers (or purchasers in some instances) in a manner that lacked consistently, transparency, and predictability.*

The Commonwealth Inquiry into The Australian housing affordability challenge, 2015, among other things, found:

> *Developer contributions are frequently opaque and unjustified in their application, and there may be no clear connection between the cost of the infrastructure provided and the contribution, to the extent that the contribution may be well in excess of the cost of the infrastructure it is supposed to pay for. Additionally, in many cases developer contributions are used to pay for infrastructure that benefits the wider community (for example trunk roads and utilities infrastructure upgrades). In this case, developers and ultimately new home buyers are being forced to subsidise the rest of the community.*

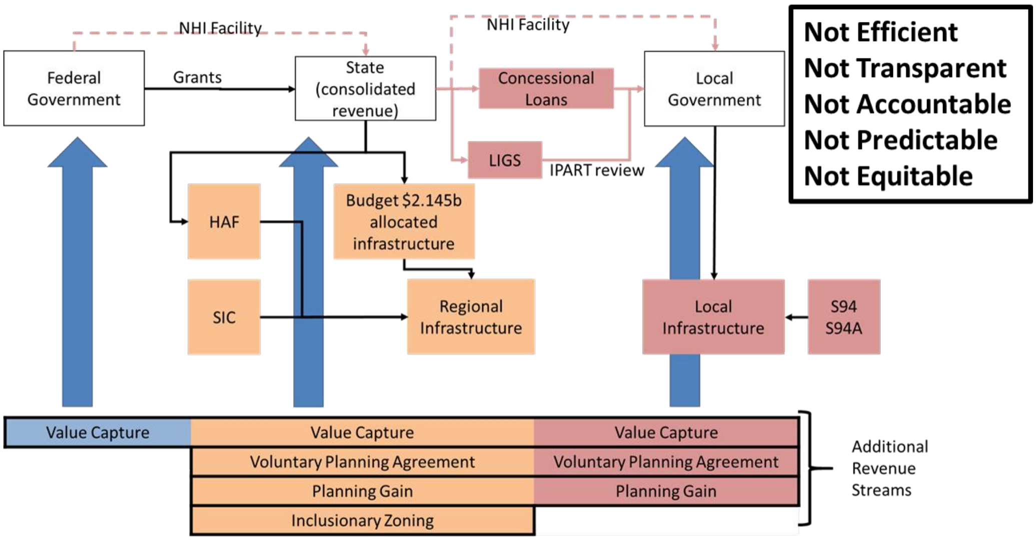
The Henry Tax Review stated

> *The use of infrastructure charges has the potential to improve the allocation of infrastructure. However, where they are not set appropriately, infrastructure charges can reduce the supply of new housing, which can increase overall house prices.*

Recommending that

> *the Council of Australian Governments should review building and land use policies and infrastructure charges to ensure they do not unnecessarily restrict the supply of housing*

This describes the infrastructure funding and coordination process in NSW, which fails to easily identify funding streams or nexus. A diagram of the revenue paths and expenditure streams are shown in the diagram below:



Infrastructure Expenditure Revenue and Relationships

PRINCIPLES DEVELOPED BY COAG AND NSW GOVERNMENT

The HSAR Working Party recommended infrastructure charges should, at least, be:

- **efficient** – charges should be for infrastructure required for the proposed development or for servicing a major development;
- **transparent and accountable** – charging regimes should be supported by publicly available information on the infrastructure subject to charges, the methodology used to determine charges and the expenditure of funds;
- **predictable** – charges should be in line with published methodologies and charging schedules (with clarity around the circumstances in which charges can be modified after agreement); and
- **equitable** – where the benefits of infrastructure provision are shared between developers (land owners), the infrastructure charges levied on the developer should be no higher than the proportional demand that their development will place on that infrastructure.

The April 2013 White Paper, *A New Planning System for NSW* set seven contribution principles to inform future reform:

1. **Simple and Predictable** – the contribution system should be as easy to understand and administer as possible. Everyone should have a reasonable expectation of the future amount and timing of payment of infrastructure contribution.
2. **Transparency and accountability** – everyone should be able to track the need for infrastructure, revenue collected from contributions and expenditure on infrastructure. Responsible parties should be accountable for the timely provision of infrastructure.
3. **Beneficiary pays** – parties should only pay for infrastructure that they will benefit form. When benefits are shared between groups, the distribution of costs should reflect this.
4. **Avoidable costs** – developers should not be charged for infrastructure that is not required for new development. There must be a nexus and proportionality between development and infrastructure need.

5. **Cost reflectivity** – contributions should reflect the efficient cost of providing infrastructure. It should demonstrate that the provision of infrastructure in some areas is more expensive than others, and the developer's contribution should reflect at least some of that cost.
6. **Affordability** – the contribution system should not inhibit the supply of housing.
7. **Contestability** – the private sector should be invited to compete for delivery of works where it is likely to add value. Developers should be allowed to contribute to the cost of infrastructure through flexible means including 'works in kind' in lieu of a direct contribution payment.

UDIA endorses both sets of principles as guiding principles for infrastructure funding.

BENEFICIARY PAYS MODEL FOR INFRASTRUCTURE FUNDING

UDIA NSW supports user pays models for development. User pays models typically utilise two approaches:

1. <u>Impactor Pays</u> – those that create the need for additional infrastructure contribute to the cost for the infrastructure.
2. <u>Beneficiary Pays</u> – those who benefit from additional infrastructure contribute to the cost for the infrastructure.

Infrastructure Contributions through Section 7.11, SIC, and VPAs tend to follow an *impactor pays* approach in their undiscounted form. Therefore, the entire cost of new infrastructure is apportioned to those who create the need for the new infrastructure, new residents, even though existing residents or those beyond the catchment may benefit from the infrastructure.

Endeavour Energy has followed a *beneficiary pays* approach to infrastructure contributions, whereby those who benefit from new infrastructure share the cost, hence new and existing customers both pay for new shared network infrastructure. The overall network split was a 30% contribution by existing customers, although varies on individual items.

Where an impactor or beneficiary cannot be identified or isolated, then the taxpayer pays, or the broader community pays.

UDIA NSW supports a beneficiary pays models. A beneficiary pays model would:

1. Share the cost of infrastructure items across a broader base more appropriately, and
2. Ensure homebuyers only fund infrastructure items that they benefit from, so reducing upfront costs.

This approach to infrastructure funding has also received endorsement in the 2013 White Paper, *A New Planning System for* NSW, and in the Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments,* April 2011 which has highlighted:

> *"Broadly, the appropriate allocation of capital costs hinges on the extent to which infrastructure provides services to those in a particular location relative to the community more widely.*

The Grattan Institute's paper, "Housing affordability: re-imagining the Australian dream" (March 2017) supported the Productivity Commission's principles, also highlighting the need to release more greenfield in Sydney as a key tenant to promoting housing affordability. Therefore, any reforms to infrastructure funding must result in improved housing supply to support affordability, which implies there is a need for a beneficiary pays approach.

The following supplementary paper develops an infrastructure funding mechanism that follows these principles.

SUPPLEMENTARY PAPER 3 – INFRASTRUCTURE FUNDING REFORM

HOW CAN NSW FUND LOCAL AND REGIONAL INFRASTRUCTURE WITHOUT COMPROMISING HOUSING SUPPLY AND AFFORDABILITY?

UDIA NSW recommends a hybrid approach to resolve infrastructure funding in NSW. Our approach is underpinned by three key principles:

1. Infrastructure funding should be efficient, transparent, accountable, predictable, equitable
2. The infrastructure funding regime should support housing supply to support affordability
3. There should be a beneficiary pays approach to infrastructure.

We see three infrastructure funding pathways that would work concurrently to enable the timely supply of housing to support affordability and delivery.

PATHWAY A – PRIMARY APPROACH

Modelled on the planning reforms from the April 2013 White Paper, *A New Planning System for NSW*, we consider there should be an infrastructure funding system, structured as follows:

1. Local Infrastructure Contributions

These would recover a fair share of the efficient cost of local infrastructure relating to: local roads and traffic management, local open space and embellishment, community facilities, and the capital costs of drainage, where nexus has been established.

2. Regional Infrastructure Contributions

This would contribute a reasonable share of the cost of state infrastructure, such as state and regional roads, transport land and works, education land or work, and embellishment of regional open space, where nexus has been established.

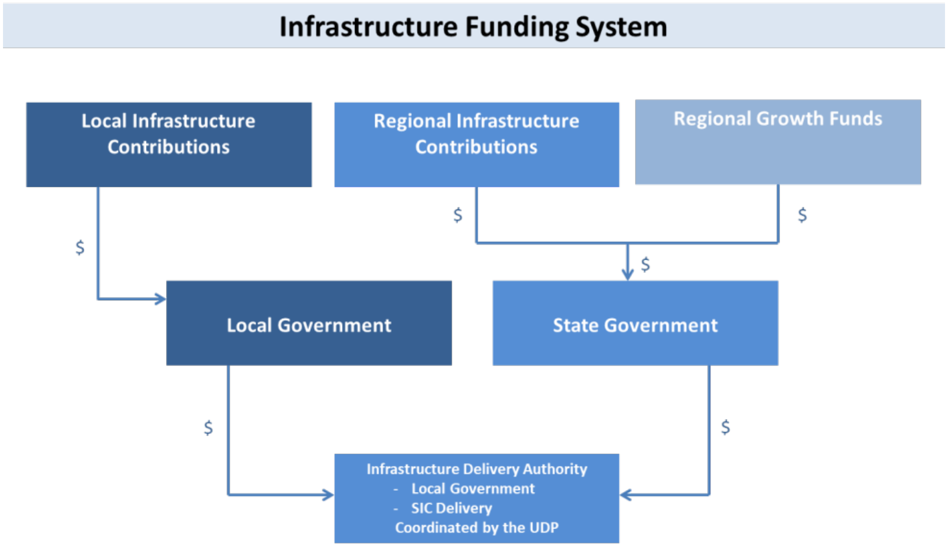
3. Regional Growth Fund

Land costs contribute over 50% of the cost of development contributions. To support a beneficiary pays approach we recommend:

- Land for drainage which improves water quality, provides recreation facilities and supports a broader catchment is funded by broader beneficiaries in the regional growth fund,
- Recreation Facilities including open space and green infrastructure that supports the broader region is included in the Regional Growth Fund.

We recommend charging this as a percentage of estimated DA and CDC value on all DAs and CDCs across the Greater Sydney Region over $100,000. The rate will be determined change depending on the Greater Sydney Commission district and its infrastructure requirements.

The chart below outlines UDIA NSW’s proposed infrastructure funding model:



INTERIM APPROACH

While the recommendations of the report are being implemented, the following interim arrangements will be critical to provide continued certainty for the industry and local government.

There must be a degree of certainty for industry, to support investment decisions over the development decision-making timeframe (7-10 years) and continue housing supply.

We consider the total cumulative local and state contributions should have a maximum charge at $60,000 for greenfield areas and $40,000 for infill areas. Depending on the location and the cost to service, we consider the following charging regime could be appropriate:

Area	S7.11	SIC	Total Cap
Sydney Greenfield	$45,000	$15,000	$60,000
Sydney Infill	$20,000	$20,000	$40,000
Sydney Other	$20,000	$5,000	$25,000

Since the announcement of section 7.11 uncapping there has been extremely limited certainty, the model UDIA NSW proposes will allow certainty, which would enable infrastructure costs to be priced into decision making. Apart from a few plans, the proposed caps would cover infrastructure costs closer to the efficient level. We support maintaining the need for an IPART assessment with the $30,000 trigger for greenfield and $20,000 trigger for infill.

We consider the total charge could be varied according to region to drive efficiencies. The maximum charges need to be stable till at least 2024, 7 years after the announced uncapping in June 2017. Although, without substantial reform of the infrastructure funding system, then it would need to be retained over a much longer period.

IMPACT OF RECOMMENDATIONS

UDIA has commissioned PwC to model the cost of the regional growth fund. The table below summarises the total budget impact from the draft report.

Table 1 – Estimated infrastructure contributions: current settings vs UDIA's interim approach, FY21 – FY24 (Nominal)

	s7.11 ($m)		SIC ($m)		Cumulative contributions ($m)	
	Total	Annual average	Total	Annual average	Total	Annual average
Current settings	$3,075	$769	$1,913	$478	$4,988	$1,247
Contribution caps maintained	$2,764	$691	$1,611	$403	$4,375	$1,094
Contributions shortfall	**($310)**	**($78)**	**($302)**	**($76)**	**($613)**	**($153)**

Table 2 –Estimated infrastructure contributions: current settings vs UDIA's proposed RGF, FY21 – FY24 (Nominal)

	s7.11 ($m)		SIC ($m)		RGF ($m)		Cumulative contributions ($m)	
	Total	Annual average	Total	Annual average	Total	Annual average	Total	Annual average
Current settings	$3,075	$769	$1,913	$478	N/A	N/A	$4,988	$1,247
Introduction of the RGF	$2,342	$586	$1,479	$370	$1,167	$292	$4,988	$1,247
Contributions (shortfall) / gain	**($733)**	**($183)**	**($434)**	**($109)**	**$1,167**	**$269**	**$0**	**$0**

Note – confidential and draft only

We have modelled the Regional Growth Fund contribution at a different rate for each district, we consider this would support housing growth in each district and revenue would be spent in the district it was collected.

District	**RGF Levy**
Central	2.90%
Eastern	0.64%
North	0.85%
South	0.93%
Western District	3.63%

This was calculated by determining the infrastructure funding required for each jurisdiction and spreading it across DPE DA and CDC value data and sharing it across each local government. PwC then calculated the portion that would be required to cover infrastructure contributions.

This resulted in savings relative to the government's position for all major developments in growth areas. Savings did not occur for single dwellings in infill growth areas. Savings did not occur in areas where a SIC was not proposed to be levied. An example of the result of the implementation on a standard dwelling in Blacktown is below:

DA Value: $300,000
RGF: 2.90%

Figure 11 - Detached dwelling: contributions under current settings and UDIA's proposed reform (RGF)

PATHWAY B – NEGOTIATED PLANNING AGREEMENTS

We recommend maintaining the existing VPA pathway as an option where circumstances dictate, such as out of sequence or a proponent led project. It is critical the integrity of the VPA system is maintained by ensuring they remain a genuinely voluntary agreement.

PATHWAY C – FUNDING MAJOR TRANSPORT INFRASTRUCTURE

For the funding of major transport infrastructure such as North-South rail or Sydney Metro projects we consider value capture approaches can be used under a set of clear conditions:

- Value capture cannot fund infrastructure on its own
- Additional value has been generated through government investment that increases the capacity for uses
- Value is captured from all land owners who benefit only when and where it is generated
- The proportion of value captured does not diminish the ability for value to be realised
- Value cannot be captured after it is already realised
- Value is not captured in full “upfront”
- There will be scenarios where value capture will not work, where beneficiaries cannot be identified or benefits spread across a city
- Planning Gain is a betterment tax not value capture and should not be levied
- Measuring and capturing the windfall gain that accrues with new infrastructure will be very difficult; therefore UDIA recommends indirect mechanisms which capture value over the long term (such as tax increment financing)

FURTHER INFORMATION

Attachment G – PwC, *UDIA Proposed changes to NSW infrastructure contributions: Assessing the financial impact to government*, October 2018 (extract) (confidential) – provides costing for UDIA’s recommendation.