HIA Submission to the Productivity Commission Inquiry into First Home Ownership

Executive Summary

October 2003

EXECUTIVE SUMMARY

The task of restoring housing affordability presents an enormous challenge for policy makers, the industry and the broader community. Spectacular increases in house prices have captured considerable media attention.

In previous housing cycles, housing affordability has been damaged by sharp increases in interest rates being relied upon to dampen asset price inflation. On this occasion, housing interest rates are at a 30-year low, the stock market has been, until recently, in retreat, and rampant increases in house prices have precipitated a ballooning of the deposit gap and a marked deterioration in accessibility conditions for first home seekers.

While there is a temptation to dismiss the spiral in house prices as the outcome of 'irrational effervescence' there are structural issues in land release planning and development, the taxation of new housing and the funding of urban infrastructure that are impacting severely on housing affordability.

The cost of supplying new housing has been inflated on two fronts: by a shortage of serviced land and a marked increase in the amount of indirect taxes applied to residential development. Rampant increases in the price of urban land have strangled housing affordability.

The seeds of the current housing affordability crisis were sown in the early and mid-nineties when state governments decided to shift the pattern of urban development towards consolidation away from expansion of the urban fringe. Part of the reason for the curtailment of greenfield development has been the influence of environmental interests. But the main reason has been to contain public sector outlays and borrowing for the funding of infrastructure at the urban fringe due in no small part to the public opprobrium surrounding borrowing and the following expenditure indiscretions of the 1980s. Past failures in public borrowing have caused governments to make a virtue of reducing public debt.

Increasingly, State and local governments have resorted to upfront contributions on greenfield development to finance long-lived community and social infrastructure that had been funded previously through public sector borrowing. While the rationale adopted for the escalation of development charges on greenfield development was to reduce or remove the assumed 'subsidy' received by new home buyers on the urban fringe, the 1993 report by the Industry Commission, *Taxation and Financial Policy Impacts on Urban Settlement* could not "confirm the large incentives to fringe location that it had expected to find on the basis of existing claims," (page 5). In addition, there is a suspicion that State governments have shifted greater responsibility onto local governments to fund urban infrastructure but without providing adequate revenue to meet those demands.

The curtailment of greenfield development has not been offset by an expansion in the supply of land for in-fill development precipitating an explosion in the price of raw

land at the urban fringe and a bidding up of prices for redevelopment sites in established suburbs. Endemic shortages of residential land combined with the transfer of infrastructure funding from the public sector to new home buyers have produced a staggering increase in the price of urban land.

Coupled with bottlenecks in the availability of urban land has been a relentless imposition of an increasing array of taxes and charges on residential development and home building, which have to be passed through to new home buyers. New home buyers are bearing the brunt of funding an ever expanding range of community and social infrastructure through the imposition of upfront development contributions.

There are now more than 20 indirect taxes and charges embedded in the price of a new home, which average nationally nearly $70,000 on a typical new house and land package and rake off nearly $11 billion a year from new home buyers in indirect tax revenue for governments. In Sydney, taxes and charges on new home buyers are much higher.

Recourse to a (temporary) increase in public borrowing would be the most efficient and equitable method of financing the community's demand for social infrastructure. Public borrowing for social infrastructure would spread the repayment burden further across time and across generations. Financial markets ought to be able to distinguish between productive infrastructure investment and 'monuments', particularly where governments present a transparent strategy and timetable for the repayment of public sector borrowings and establish a clear link between the borrowing for infrastructure and increases in general property rates or user charges. HIA estimates that a 10 per cent increase in general property rates, equivalent to about three dollars a week on the average property, would be sufficient to fund the annual cost of social infrastructure being borne currently by new home buyers in Sydney, representing a saving of more than $30,000 on a typical new house and land package.

The adoption of more efficient and equitable approaches to the funding of urban infrastructure presents the greatest opportunity to stimulate the supply of residential land and address the yawning housing affordability gap.

The submission argues that in addition to reform of infrastructure funding arrangements, fundamental changes are needed in planning approval systems for residential development. The political interference in the process of identifying, approving and releasing land for residential development has not only pushed the acquisition costs of 'raw' land through the roof but reduced the ability of the housing industry to deliver an affordable product to home buyers both in suburban greenfield locations and in-fill sites in established areas. The notion that a government-controlled land release and development process can best deliver housing affordability outcomes does not stand up to scrutiny. The Albury Wodonga study in the submission is a case in point.

Planning approval systems have become so complex and so open to 'community' opposition that in most States even straightforward developments in an established area require planning approval, even where the land is appropriately zoned for the type of development proposed. This system must change. Governments need support

from planning systems to allow the kind of in-fill development they are promoting to actually occur. Where land is appropriately zoned, residential development must be permitted 'as of right'. The alternative is continuing conflict between local government and its constituents and inevitably, upward pressure on house prices.

Steps to achieve a better balance in residential land markets could include the identification and disposal of surplus government land. An audit should be undertaken of Federal, State and local government property that could be surplus to requirements and made available for residential development.

One of the most inequitable and inefficient practices that the submission reveals is the cascading effects of the multiplicity of tax regimes that apply to new residential development. Not only are new home buyers inappropriately facing massive bills for upfront contributions to social and community infrastructure, they also face GST and stamp duty payments on those charges. The submission proposes a simple administrative solution to the problem of GST being levied on upfront development charges, to give proper effect to the Federal Government's attempts to make them exempt.

Stamp duty applies at least twice on every new house. Moreover, any relief that might have been available to first home owners through stamp duty concessions has been eroded by the failure of State governments to adjust the stamp duty rate scale in the face of higher housing prices. Stamp duty 'bracket creep' has seen stamp duty payments to State governments ballooning: house prices have increased on average by 28 percent over the last two years but stamp duty revenue has increased nearly twice as fast at 45 percent.

The submission proposes that stamp duty should be levied once at the final stage of a new home purchase by enabling land developers and builders to claim an exemption from stamp duty on the purchase of their 'trading stock' in the same way that motor vehicle dealers obtain an exemption from stamp duty on the purchase of their vehicle stock.

Reform of the taxation treatment of residential development and building would be one of the most effective ways in which governments could help to improve housing affordability. HIA estimates that the removal of the double taxation of new housing, combined with a fairer way to fund community infrastructure could slash the cost of a new house and land package by $45,000 or more than 8 percent in Sydney, $12,000 in Melbourne, $22,000 in Brisbane and $26,000 in Perth.

To ensure that reductions in the indirect tax burden on new housing were passed through in lower prices to new home buyers, the Australian Competition and Consumer Commission (ACCC) could be called upon to monitor the industry, similar to the role played by the ACCC during the GST transition period.

There are also many other largely hidden issues that have been impacting negatively on housing affordability. These include the uncertain regulatory environment surrounding the administration of building codes, the complexities of managing contracting arrangements in the industry for payroll tax, health and safety, taxation

and workers compensation arrangements. The submission outlines a wide range of practical solutions to these issues.

The task of restoring housing affordability cannot rest on the shoulders of any one government. Instead there needs to be a new spirit of cooperation and commitment among the three pillars of government. The Australian Government can take a lead through the Council of Australian Governments and by establishing a Federal Department of Housing. The key findings and recommendations contained in the submission are summarised below.

Summary of Key Findings and Recommendations

Chapter 1 – Introduction

Key Findings

1.1 The focus of HIA's submission is on the longer term issues impacting on access to home ownership. The submission addresses the issue of housing affordability from a whole-of-market perspective, with particular emphasis on the 'supply-side' of residential development.

Chapter 2 – Value of Home Ownership

Key Findings

2.1 Home ownership provides economic and social security and adds significantly to the quality of retirement. High levels of home ownership can mitigate the amount of government outlays on family and social security programs.

2.2 The benefits of home ownership will become more important with the aging of the population. Saving by Australians in both home ownership and superannuation have been encouraged by governments through the taxation system as a key plank of Australia's retirement incomes policy.

2.3 While increases in existing house prices have delivered a financial windfall for previous owner-occupiers, there is a growing anxiety within the community about prospects for young Australians to enter the home ownership market.

Chapter 3 – Is There A Housing Affordability Problem?

Key Findings

3.1 Much of the commentary about housing affordability has been more closely aligned to accessibility to first home ownership instead of regular costs of housing, such as mortgage interest payments or property rates.

3.2 Whether measured by the deposit gap or amount of income required to service a home loan, access to first home ownership is under threat.

Chapter 4 – Factors Affecting Housing Affordability

Key Findings

4.1 Short term drivers that influence housing affordability include housing interest rates, home buyers' incomes and the relative attractiveness of home ownership as an investment.

4.2 Some of the longer term key drivers that influence housing prices include the availability of serviced residential land, planning systems, community attitudes to housing styles and new developments, the level of taxes and charges on housing and changes in government home ownership assistance.

4.3 Recent downward trends in housing affordability are more directly related to the long term structural issues than to other factors such as overseas migration or the first home owners grant.

Chapter 5 – Planning Reform

Key Findings

5.1 The process of development approval is complex, fragmented, political and inconsistent across the country. The myriad of planning approval controls is driving up housing costs and diminishing industry confidence in the merits of planning systems.

5.2 Major planning influences on housing affordability include:

- the increase in the number of proposals requiring planning approval;
- the increased complexity of development assessment processes;
- Government's continued monopoly in development assessment work;
- a shortage of skilled planning staff in local government;
- a rigid application of development standards that discourage the development of better housing mix and wider consumer choice.

Key Recommendations

5.1 State governments should:

- ensure housing affordability is adopted as an object of State planning legislation and similarly in local and regional planning schemes;
- adopt standardised legal and administrative provisions of planning schemes, including zoning controls, definitions and development categories;
- adopt standardised 'as of right' processes for the approval of detached dwellings and medium density housing, based on community accepted design and performance standards;
- adopt plain language regulation;
- standardise notification processes;
- review appeal and referral procedures.

5.2 All State governments should review their planning legislation and their system processes and administration to allow a greater participation by private sector professionals in development assessment, in accordance with the opportunities identified by the *Development Assessment Forum*.

5.3 State governments should develop consistent minimum open space standards and a universal formula for the calculation of contributions.

5.4 Upfront development charges should not apply to social or community infrastructure. Where such charging occurs it should be managed through the respective State planning legislation and be identified through an infrastructure plan. When implemented by local government, these plans should form part of the local government's planning scheme, justify the use of contributions over alternative funding methods and should set the method of calculating the level of development contributions. Contribution plans must identify a clear nexus between the development and the planned infrastructure to be established, as well as the reasonable timing of its provision.

5.5 The ability to challenge monetary conditions of development approvals, without jeopardising the whole consent, should be prescribed in all State planning/appeal systems.

5.6 The ability of councils and other consent authorities to negotiate up from the legislated contribution baselines set in infrastructure plans should be outlawed. Contribution Plans should reflect the maximum amount that may be required as an upfront charge on development.

5.7 All State governments should establish regional planning strategies to manage the growth of their major metropolitan centres. The strategies should provide appropriate levels of land supply for both greenfield and infill housing

opportunity. These strategies must have statutory significance and must be reflected in both local planning schemes and local government actions.

5.8 The Federal Government should cooperate with State and local governments to facilitate planning reform based upon recognised best practice.

Chapter 6 – Infrastructure Supply, Charging and Funding

Key Findings

6.1 Pressures on the funding of urban infrastructure are a principal impediment to the timely release of land for residential development. Attempts to contain public sector outlays for infrastructure to greenfield development in preference to urban consolidation have caused a squeeze on the availability of serviced land at the fringe, which has not been matched by a corresponding increase in the supply of in-fill development due to local resident opposition.

6.2 The cost of providing urban infrastructure increasingly is being funded by a complex array of ad hoc taxes, fees, levies and charges applied to residential development, which tends to be passed through to new home purchasers.

6.3 Social infrastructure by nature involves services and facilities that are accessible by all members of the community. Accordingly, they should be funded more broadly rather than specifically by new home buyers through exactions on residential development.

6.4 Upfront development charges should be limited to local (physical) infrastructure – sometimes referred to as private benefit infrastructure. Such infrastructure includes roads, drainage, stormwater and land for local open space.

6.5 Rather than upfront charging, capital costs for social infrastructure should be recouped from beneficiaries through user charges or recourse to general property rates.

Key Recommendations

6.1 If new residents are to be separately charged for the cost of upgrading infrastructure, it should reflect the proportion in which they derive the benefit, and not involve a cross-subsidy to existing residents. A similar direct charge should apply to existing residents.

- Double-dipping should be avoided. For example, the rates paid by new residents should be reduced to reflect the fact that they have already made an explicit payment for incremental capital costs and should not bear the capital cost component of existing infrastructure.

- If new residents are to be explicitly charged for the capital or ongoing costs of social infrastructure (on an upfront or ongoing user-pays basis), similar charges should be levied on existing residents.
- If consumption of certain services is to be subsidised (to ensure equitable access for low income groups or account for externalities), the public subsidy should be funded by the whole community, not a narrow subset of new residents.
- To the extent possible, there should be consistent treatment of new developments within a jurisdiction and across jurisdictions, to remove bias in location decisions.

6.2 State and local governments should be encouraged to consider funding alternatives for the provision of community infrastructure, such as extending the rate base and time limited public sector borrowings.

Chapter 7 – Land Supply

Key Findings

7.1 All of the major cities potentially face land supply shortages. These shortages are more critical in Sydney but nonetheless are significant elsewhere in terms of their potential to impact upon housing affordability. It is essential to ensure that there are adequate supplies of zoned land being released that are capable of being serviced readily.

7.2 State government population projections have underestimated the rate of population growth in the major cities. The need for better coordination between the Australian and State governments in terms of population forecasting and related planning issues is paramount to the proper and responsible management of cities.

7.3 Contemporary planning studies suggest that savings can be made by accommodating households in established areas rather than on the fringes of cities. However, much depends on the capacity of existing infrastructure, which can vary from site to site.

7.4 Where physical infrastructure is provided on a user-pays basis, households should be free to choose more expensive infrastructure cost locations if they consider the benefits are worth it. Differential pricing will determine that appropriate residential densities are achieved.

7.5 A substantial proportion of major city growth will need to be accommodated in new release areas. Governments must consider and plan for the predictable and timely availability of both greenfield and infill residential opportunities.

7.6 The efficiency and responsiveness of government land release programs and rezoning processes must be improved. Current processes are cumbersome, uncoordinated and therefore ineffective in meeting supply targets. There are many constraints on the release of land and too many actual and pseudo 'planning authorities' to deal with.

Key Recommendations

7.1 Better monitoring of land and housing production is required, coupled with greater flexibility in the way that governments respond to changed circumstances.

7.2 State governments must adopt a more progressive approach to the management of urban growth, based on realistic population forecasts.

7.3 Governments should consider the re-establishment of the Indicative Planning Council (IPC), disbanded in the mid-1990s, to advise governments on prospects in housing and urban development and the ability of the industry to meet housing demand.

7.4 State governments must identify and promote opportunities for the conversion of land to its highest value use, both at the city fringe and in established areas. Government land management programs must focus on 'how to make it happen' rather than on monitoring the often slow progress toward targeted housing supplies.

7.5 There is a need for greater metropolitan or regional responsibility in terms of meeting projected housing needs. It is not sufficient for individual councils to opt out of their responsibilities in meeting regional housing needs. Regional strategies, planning and monitoring are required for both greenfield and infill opportunities.

7.6 Final decisions about land releases and housing supplies must rest with a single agency. Planning reform of individual State/Territory systems should be coordinated to ensure that state reforms are consistent.

7.7 The short-term supply of land in Sydney is at chronic levels. Vacant lot stocks are at crisis point. The NSW Government's proposal to ramp up lot production to 10,000 lots per year within 3 years is 3 years too late. Urgent action is required to alleviate today's pressures and those that will be experienced over the next 3 years.

7.8 The NSW Government must identify specific release areas for immediate lot production. It is also necessary for government to urgently identify sites in its ownership/control that can be brought on line promptly. Such sites should not be limited to greenfield locations.

7.9 Greater public awareness of housing need should be promoted by governments to help counter community resentment toward infill housing

Chapter 8 – Regional Case Study – Albury-Wodonga

Key Findings

8.1 Land supply shortages are not only being experienced in the major metropolitan centres. A case study documents the affordability impacts of a constrained land market in Albury Wodonga.

Chapter 9 – Taxation

Key Findings

9.1 State and local governments are boosting revenues from the inefficient and inequitable cascading of indirect taxes levied at different stages of the residential development and building process. Taxes on new housing have increased by more than 300 percent over the last decade whereas general inflation has been around 25 percent over the same period. The total indirect tax take on new housing is equivalent to nearly 30 percent of the final purchase price of a new house and land package.

9.2 Stamp duty bracket creep has seen stamp duty paid on an average home increase by 45 percent over the past two years, much faster than house prices, which have increased by 25 percent. The effective rate of stamp duty has increased by 1.5 percentage points of the average house price. The failure to index the scale of stamp duty rates for house price increases has rendered ineffective first home buyer stamp duty concessions.

9.3 Because stamp duty is a transactional tax, it can distort the structure of land development and building arrangements. The effect of double and triple dipping of stamp duty through intermediate stages of housing development can add almost 4 percent to the purchase price for a new home buyer.

9.4 Multiple purchases of land by developers and builders can create a significant additional stamp duty burden through the aggregation of the purchase prices of individual sites. Aggregation for stamp duty purposes can add as much as $6,000 to the cost of a greenfield block of land.

9.5 The GST is levied inappropriately on a range of social infrastructure charges and stamp duty embedded in the purchase price of blocks of land. In turn, stamp duty is charged on the GST-inclusive price of a new house and land package. The elimination of the double dipping of taxes on new housing would boost significantly housing affordability.

Key Recommendations

9.1 In relation to the imposition of GST on state and local government charges:

- an input tax credit should be available on items covered by the Federal Treasurer's Determination. This would give effect to the policy behind Division 81 – that GST should be levied on State fees for services but not on State taxes.

9.2 In relation to payroll tax:

- payroll tax must be removed from the value of plant and materials supplied on which it is currently being levied in some instances in NSW and Victoria.

9.3 In relation to stamp duty, there should be:

- indexation of the stamp duty rate schedule in line with increases in house prices, at least for first home buyers;
- a provision for land developers and builders to claim exemption from stamp duty on trading stock, similar to the operation of stamp duty for motor vehicle traders;
- removal of the requirement to aggregate multiple land contracts for the purpose of assessing stamp duty.

9.4 For all of the cost saving tax reform measures, the ACCC should be given the responsibility to monitor the passing on of these savings to new home buyers.

Chapter 10 – Government Support for First Home Buyers

Key Findings

10.1 The most appropriate way to involve the industry in the provision of affordable housing is to focus on easing the regulatory constraints that drive up new housing costs and inhibit the industry's capacity to respond in a timely and flexible way to the diversity of housing requirements.

10.2 A number of measures are available to assist first home buyers, including the First Home Owners Grant, stamp duty concessions and rental purchase schemes offered by some State housing authorities.

10.3 The value of stamp duty concessions for first home buyers has been diminished by the failure of State governments to index the stamp duty scale in the face of higher house prices.

10.4 The imposition of 'affordable housing' levies and quotas on residential development to increase the supply of housing for low-income households is inefficient, inequitable and counter-productive. Housing assistance should be delivered through budgetary allocations that are transparent and paid for by the community of taxpayers and not just new home buyers.

Chapter 11 – Building Issues

Key Findings

11.1 The shift to higher density development in major capital cities has exposed apartment and medium-density building to the unproductive workplace relations practices associated with major commercial construction projects, such as site allowances, wet weather provisions and on-site facilities. In Victoria, the imposition of commercial building work practices on high-rise residential projects increases the cost of apartments by more than 20 percent compared with single dwelling construction.

11.2 Unless the particular employment, industrial relations and training needs of the home building industry are addressed adequately, there is likely to be significant pressure on the cost of all forms of new housing. Pressures on the availability of skilled labour to the industry will continue to drive up costs and diminish housing affordability.

Key Recommendations

11.1 HIA considers that housing affordability can be enhanced by:

- Providing legal security for the status of trade contractors. This could be done by the Commonwealth and States recognising that persons who have the status of a Personal Services Business for income tax purposes are independent businesses and should not be treated as employees for any purpose whatever.
- Addressing those industrial relations issues that have the potential to increase the construction costs on medium density housing sites when compared with single dwellings.
- Dealing with the chronic skill shortages in the building industry through the provision of more flexible and accessible training options tailored to address specific areas of need.

Chapter 12 – Building Control

Key Findings

12.1 All new private building work is regulated. Changes to regulations have a direct effect on the cost of building work. There are significant inefficiencies within existing building control processes, building codes and standards.

12.2 In the past five years there have been 13 amendments to the Building Code of Australia, the effect of which has been to increase the costs of new home construction by between $5,600 and $24,600 a dwelling, a significant part of which can be linked to new energy provisions, sound insulation in attached dwellings and revised stormwater regulations.

12.3 In addition to amendments to the Building Code of Australia, State and Territory administrations have introduced local changes to building regulation that have increased construction costs by nearly $18,000 a dwelling in Victoria, $5,000 a dwelling in Queensland and by $18,000 a dwelling in the ACT.

Key Recommendations

12.1 The Australian Building Codes Board requires a statutory framework. A structural model based on the Food Standards Australia New Zealand would offer significant benefits.

12.2 State and Territory governments must ensure that building regulations operate through the Building Code of Australia and not through local planning schemes.

12.3 The restructured ABCB should develop a national administrative framework that is able to support the application of the performance based technical standards required by the BCA. This framework should include:

- an effective and cost-efficient system of product certification;
- an approvals application system that provides for both private and public approval processes;
- an efficient approval system for alternative, performance based solutions.

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1 Introduction

The HIA paper 'Restoring Housing Affordability – the housing industry's perspective', demonstrated the long term threat to housing affordability from restrictions on the availability of land for residential development coupled with a complex array of excessive taxes and charges.

Government approaches to land release and the funding of urban infrastructure need to change fundamentally if Australian's capacity for home ownership is to be restored.

The focus of the Productivity Commission's Inquiry is to investigate the difficulties faced by first home buyers in achieving home ownership. Short term improvements in access to home ownership can be achieved through initiatives such as the First Home Owners Grant, as was ably demonstrated by its doubling in 2001. However, HIA is firmly of the view that lasting improvements in the access of first home buyers to home ownership can only come from dramatic reform of the process of supplying residential land to the whole of the housing market.

It is a matter of simple economics that in an environment where the supply of a product, residential land, is constrained from coming onto the market, there will be upward pressure on prices as demand for the product continues to increase. The escalating tax burden on residential land development and purchase just adds to this pressure on prices. As can be seen from the falling proportion of first home buyers entering the owner occupier housing market, the outcome will be a long term reduction in the numbers of first home buyers able to enter the market.

The benefits of home ownership are well documented and extend beyond the financial advantages of acquiring an asset likely to experience real capital growth. **As the Australian population ages, the benefits of home ownership to the quality of retirement will become increasingly important**. Other advantages from high levels of home ownership have also been researched, including better health, education and social outcomes for the residents of owner occupied homes.

Difficulties in accessing first home ownership are subject to both shorter term cyclical problems and more deep seated long term structural issues. The rapid growth in real estate prices over the last two years will abate, but the longer term problems of shortages of residential land and its heavy and inequitable tax burden will remain.

Against this background, the focus of this submission is on addressing the longer term structural issues confronting new home buyers. In addition, some observations are made about the efficacy of different types of assistance for first home buyers.
There is a myriad of issues that impact on the affordability of home ownership. This submission seeks to address the major and direct determinants of the affordability equation. The submission also focuses on the ease of access to home ownership rather than its ongoing costs such as mortgage interest and property rates.

2 The Value of Home Ownership

2.1 The great Australian dream is fading

Owning a family home has always been the centrepiece of Australia's enviable quality of life. The great Australian dream, purchasing the family home, has always been a major commitment, a large investment in a family's future. However, over the past two to three years, accelerating cost increases have begun to price many families out of accessing home ownership in major Australian cities.

Never before has a typical Australian family earning an average income been unable to afford a typical new home. This trend could ultimately create major social dislocation as the people required to service the daily needs of our cities, cannot afford to live within these cities. Such a dramatic change has a number of other national ramifications:

- *financially* – home ownership has long been the basis for asset accumulation, wealth generation and a foundation for independent financial security in retirement;
- *economically* – not only is the industry that builds new homes a vital engine of national economic growth, but also the new homes they build are increasingly web-enabled, allowing families to learn, study and run small businesses from home;
- *socially* – home ownership engenders stable and secure neighbourhoods;
- *environmentally* – new homes are better designed and built to higher environmental standards, reducing claims on resources relative to most existing homes.

2.2 There's no place like home

The family home is profoundly important, providing economic security, independence and privacy. Home ownership provides a raft of social benefits, both as a foundation for a family's financial security and as the building block of thriving communities. Home ownership strengthens Australia's social fabric.

The role of the family home is fast evolving and becoming more important to the economy as homes become the hub for economic growth, education and enterprise. Home is where 30 per cent of small businesses operate their businesses, where children study and learn online, and where families shop over the net[1]. The family home is fast becoming the engine room of the burgeoning information technology revolution.

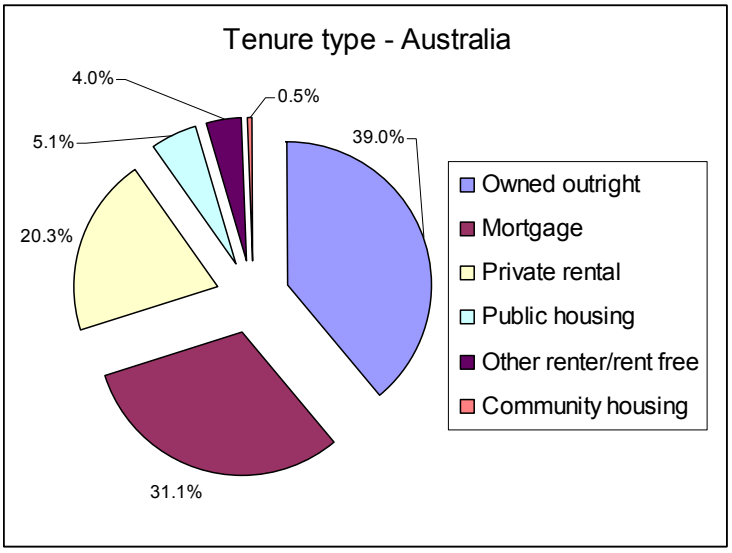
[1] *Characteristics of Home-Based Businesses*, Small Business Index, October 1999, page 2.

2.3 Home ownership in Australia

Australia once boasted one of the highest rates of home ownership in the world at almost three quarters of the population. In recent years the overall home ownership rate has been in decline, as young people wait longer to buy their first home. For example, in 2000, almost half (forty six per cent[2]) of young people (aged 20-24) were living with their parents, when in 1979 the rate was under one in three (31 percent[3]). This change reflects younger people spending longer in education and deferring their entry into the workforce but may also have been influenced by the growing housing affordability gap.

Australia has more than 7.2 million homes, with around 64 percent of these being in capital cities[4]. Australia's population is highly urbanised.

The number of people in a typical household continues to fall, from an average of 3.3 people per dwelling in 1971 to 2.7 people in 1996. This demographic change alone drives around 40 percent of the underlying demand for new housing[5].



Source: Australian Bureau of Statistics, 2001 Census

Around two in five Australians own their home outright. Around one in three Australians is in the process of paying off their mortgage[6]. For the 70 percent of Australians who own or are paying off their home, increasing house prices delivers growth in home equity. Many households are now tapping into their increased household wealth to fund renovation work and other consumer spending.

Despite the financial windfall that growing house prices have delivered for existing home owners, many parents are worried about how their children will ever afford to achieve home ownership.

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2 *Housing Assistance – A Lifetime Perspective*, Anthony King, A report commissioned for AHURI, January 2002, page 6.
3 *Household and Family Trends in Australia*, Special Article – ABS Year Book 1994, Table Two.
4 *Australian Housing Policy Project: Facts Sheet 1 – Housing Snapshot*, AHURI 2001, pages 1-2.
5 *Better Living Environments*, HIA 2001, page 8.
6 *Australian Housing Policy Project: Facts Sheet 1 – Housing Snapshot*, AHURI 2001, pages 1-2.

2.4 Benefits of home ownership

The right to housing is important, not just as shelter, but live in peace, security and dignity. Consider the many benefits of good housing.

A good house provides:

- shelter;
- safety, security and stability;
- encouraging stability for education;
- a launch pad for small businesses;
- a sense of community;
- a financial nest egg;
- local access to amenities such as parks, schools and shops.

Inadequate housing can:

- exacerbate family pressures;
- harm health;
- limit educational achievements and aspirations;
- strain over-taxed family budgets; and
- enforce long commuting trips to shops, schools and work.

Clearly, access to appropriate housing is essential. But is tenure significant? Some researchers have found that across the whole Australian population changes in tenure produce little additional benefits as the situation usually involves "a move from a relatively good situation to a relatively better one"[7]. However, other research has demonstrated benefits from home ownership across areas as diverse as employment, education, health, wealth, neighbourhood engagement and even crime reduction.

Private benefits of home ownership

▪ Property values	▪ Several studies show that home ownership has modest to significant positive influence on property values[8].
▪ Wealth	▪ Home ownership is clearly linked to increased wealth, and Australians hold around 50 percent of their wealth in housing[9].
▪ Employment	▪ The probability of being unemployed is reduced if you are a home owner, and the duration of unemployment is shorter for home owners[10].

[7] *Housing and Its Association With Other Life Outcomes*", MacDonald, Peter & Merlo, Rosangela, A report commissioned for AHURI, October 2002, page 1.

[8] *Asset Based Policies – Matched Saving Accounts Exploring Options. A Report to the Chiefly Research Centre*, The Allen Consulting Group, September 2003, page 8.

[9] *Housing Assistance and Non-Shelter Outcomes*, Bridge et al, A report commissioned for AHURI, June 2003, page ix.

[10] *Housing Assistance and Non-Shelter Outcomes*, Bridge et al, A report commissioned for AHURI, June 2003, page iii.

Social benefits of home ownership

▪ Stability.	▪ Families and communities are more stable.
▪ Neighbourhood engagement (social capital).	▪ Research suggests that home owners have greater incentives to become involved in their neighbourhood. They move less frequently than renters, so can build up a greater investment in their neighbourhood. Also, physical improvements, such as the maintenance of parks, local schools and other public infrastructure benefit them, directly as consumers of these public goods, and also indirectly as their efforts are reflected in higher capital values in the area[11].
▪ Property maintenance	▪ Home ownership is associated with reinvestment and greater maintenance[12].
▪ Educational prospects	▪ Two overseas studies have shown that home ownership has a positive effect on education but these results have not been reproduced in Australia[13].
▪ Health	▪ Home ownership is linked to better health (reduced chance of illness) than renters, but this effect seems to be largely socio-economic rather than being a feature of home ownership itself[14].
▪ Budget outlays	▪ Treasury modelling shows that home owners save the Commonwealth between 6 percent and 29 percent of pension payments when compared with people who are renting their home[15].

[11] *Housing Assistance and Non-Shelter Outcomes*, Bridge et al, A report commissioned for AHURI, June 2003, page vii.

[12] *Asset Based Policies – Matched Saving Accounts Exploring Options, A report to the Chiefly Research Centre*, The Allen Consulting Group, September 2003, page 8.

[13] *Housing Assistance and Non-Shelter Outcomes*, Bridge et al, A report commissioned for AHURI, June 2003, page iii.

[14] *Housing Assistance and Non-Shelter Outcomes*, Bridge et al, A report commissioned for AHURI, June 2003, page v.

[15] *Allowing Access to Superannuation for Housing*, Department of Treasury Discussion Paper 1997, Table 1, Attachment B.

2.5 Conclusion

Home ownership is important to Australians for a whole range of reasons. For some it is a vehicle to financial security in retirement, for others it is a dream that they aspire to achieving. For most families it is the single largest purchase they will ever make. Dramatic changes in housing prices interest the whole community, and directly or indirectly, affect the whole community.

3 Is There A Housing Affordability Problem?

3.1 What is housing affordability?

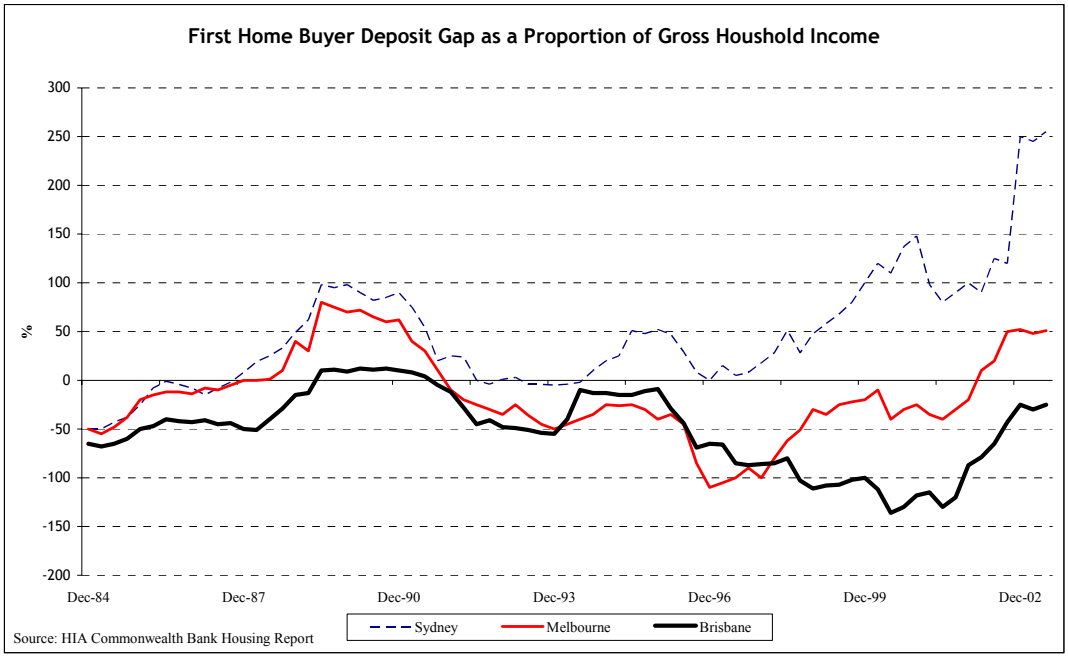
There are various ways of looking at and measuring *housing affordability*. In broad terms housing affordability relates housing costs to household income:

- for renters, housing affordability measures compare weekly or monthly rent payments to household income;
- for home owners, affordability measures relate mortgage payments to household income.

However, in light of Australians' overwhelming preference for home ownership much of the commentary about 'housing affordability' is aligned more closely to concepts of *accessibility* to home purchase than to recurrent or regular costs of housing as a proportion of household income.

3.2 How should housing affordability be measured?

Measuring the *ease of access* to home purchase can be calculated in a range of ways. Sometimes accessibility to home purchase is measured according to the *deposit gap,* which is the difference between the price of a typical house and the maximum amount of loan that can be repaid by a household on average weekly earnings or average household income (see chart below).



Another way of looking at accessibility would be to compare actual incomes against the income *required* to repay a home loan on an average house and land package with a given level of deposit. Regardless of which approach is employed to measure accessibility, all rely on a combination of house prices, interest rates and incomes.

The different measures of 'ease of access' show a similar story – housing affordability is under acute pressure in Sydney. The deposit gap in Sydney as a share of household income has blown out in comparison with the house cycle of the late 1980s. In Melbourne and Brisbane the deposit gap has widened as well, but is to date not dissimilar from the experience of the late 1980s. Whereas affordability in the late eighties sagged under the weight of double digit interest rates, the most recent decline in housing affordability has been much more influenced by increases in house prices with housing interest rates at a thirty year low.

4 The Prime Causes of Unaffordable Home Ownership

4.1 Is it just a cyclical problem?

The affordability of home ownership changes with:

- the cost of land;
- the cost of building;
- taxes on the purchase of land and housing;
- the financial circumstances of prospective home owners, including their income as it affects their capacity to make regular mortgage repayments and their wealth as it affects their capacity to provide equity in the home purchase;
- interest rates; and
- the extent of government home ownership assistance.

These affordability determinants are affected by both shorter term cyclical factors and longer term structural changes. In the short term, cyclical fluctuations in affordability are principally driven by changes in:

- housing interest rates;
- home buyers' incomes associated with labour market cycles; and
- the relative attractiveness of home ownership as an investment.

Over the last decade or so structural changes that have caused movements in housing affordability for new homes have arisen from:

- the ratcheting up of developed land prices from the continual ramping up of infrastructure charges and levies;
- government imposed constraints on the supply of greenfields residential land;
- increasingly complex and lengthy planning and approval processes for residential land development;
- increasing community opposition to residential development, especially in infill areas;
- increasing taxes on the supply of residential land and housing;
- progressive increases in the regulated standards for developed land and housing; and
- changes in the levels of government home ownership assistance.

It is these longer term structural issues on which this submission focuses.

The submission also focuses on the affordability of new homes. While the new home market represents a modest 2 percent of the total housing market in any one year, it has a major impact on the operation of the market as a whole. This is because new homes are direct competitors in the marketplace with established homes and movements in the cost of new homes can, depending on market conditions, impact on prices of established housing.

The new home market also provides a 'pressure valve' that can dampen price pressures in the established housing market as new housing supply comes on stream. If the price of new homes becomes more competitive with established homes, then additional demand for housing will shift to the new market. However, if this pressure valve is blocked by land supply shortages and escalating charges on new housing , then demand pressures in the established market will feed through to higher prices for existing and new housing.

Much of the focus of the submission will also be on the new housing market in Sydney where structural land supply and infrastructure issues present the greatest challenge to housing affordability. While Sydney is the epicentre of the housing affordability crisis, new home buyers in other cities are not quarantined from increasing upfront charges for community infrastructure. In these circumstances finding durable policy initiatives to dealing with housing affordability issues in Sydney could help to ameliorate looming affordability pressures in other cities.

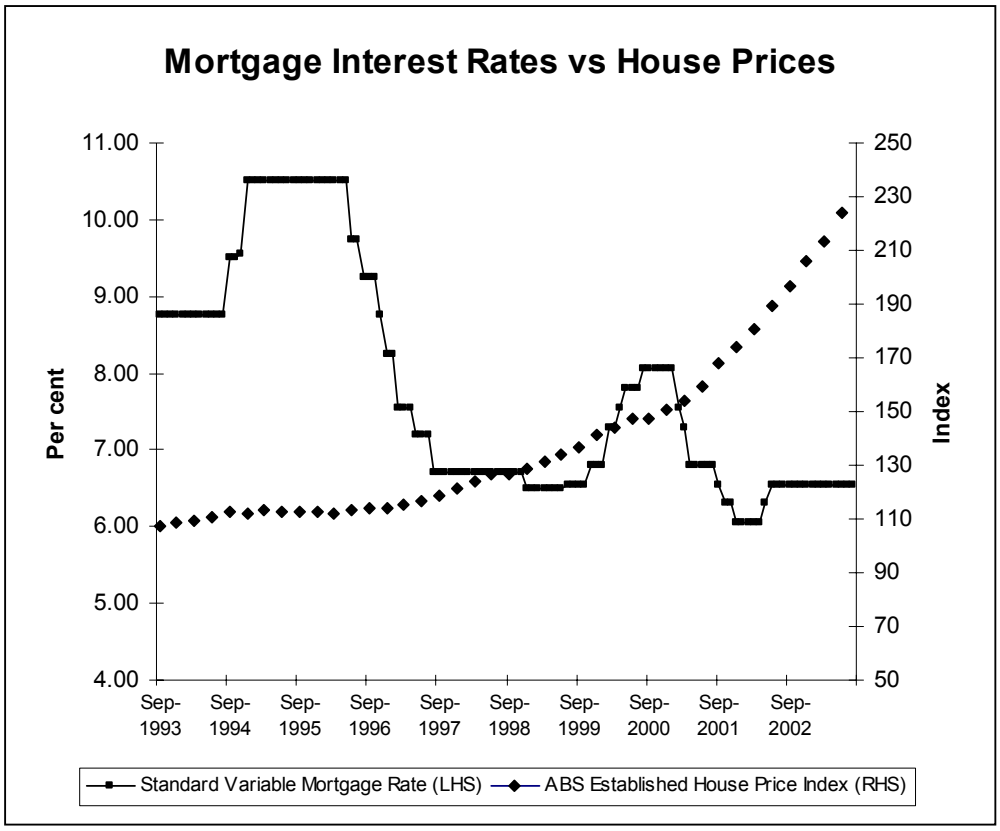
Another reason for the emphasis in the submission on the Sydney market is that price pressures from the Sydney market can be transmitted to other markets. This can occur through migration of housing demand out of Sydney and also through the activities of rental investors.

4.2 Is it a demand or a supply problem?

In recent years the long term demand for housing has not experienced dramatic and unexpected increases. The underlying requirement for new homes has grown from around 150,000 per annum to around 160,000 over the last five years due mainly to the increase in the immigration program. However, this would not be sufficient to explain the dramatic increases in the price of land that have occurred in most parts of Australia over the last two years or so.

Much has been made of the impact of lower housing interest rates on house prices. The graph below shows a relationship between falling interest rates and the climb in home prices, but the linkages are not one-to-one. Other factors have played a part in driving house prices, namely:

- the slump in returns on alternative investments and a corresponding escalation in the demand for investment property;
- land supply constraints that impeded the delivery of more housing which fuelled a rapid bidding up of prices and created expectations of continuing capital gains; and
- strong economic growth and a steady labour market added to home buyers' confidence to borrow and invest in housing.



Strong demand conditions for new housing signalled an opportunity for infrastructure suppliers, especially in NSW to ramp up the fees and charges associated with land development, compounding the pressure on prices and adding to price expectations.

Constraints on the supply of land in both new suburbs and in infill areas made it impossible for builders and developers to meet the increase in demand. That the supply of land for new residential development has continued to be constrained by State and local authorities has prolonged the period of rapid price growth most cities have experienced.

While most of the pressures on affordability can be expected to ease as returns on alternative investments, particularly equities improve relative to housing, the underlying structural problems of land availability will remain.

In the face of the restricted supply and rampant increases in land prices, the market has shifted towards smaller block sizes for detached housing and increased housing densities through more multi-unit development. But despite these changes and symptomatic of the extent of the supply pressures, the share of land cost in new house prices has increased relentlessly.

In Sydney, land has doubled its share of the average new house price over the past 25 years and now absorbs the majority of the home purchaser's dollar. In Brisbane and Perth more than 40 percent of the new house price is accounted for by the land component, doubling over the last 25 years. Since mid-2002, the cost of raw land has

risen dramatically again – as much as two-fold increases have been reported in the broad acre price of land in Sydney.

Share of Land in New House Prices

	1976-77 (a)		1992 (b)		2002 (b)	
	New House Price $	Land %	New House Price $	Land %	New House Price $	Land %
Sydney	49,010	32	189,800	44	338,150	60
Melbourne	63,200	24	169,000	24	276,200	37
Brisbane	46,280	21	164,690	39	234,300	49
Adelaide	53,970	16	125,970	26	177,430	32
Perth	57,640	22	115,730	32	163,340	42

Sources: (a) Report of the Committee of Inquiry into Housing Costs, 1978
(b) Sample of Builders and Developers

4.3 Are there other causes?

Media and other commentators have also identified many other alleged causes of deteriorating housing affordability, to which HIA does not subscribe. Unfortunately, the recent pressures on housing affordability have provided an opportunity for a range of people to gain attention for their pet subjects and prejudices. The sorts of claims that have been made include affordability problems being caused by:

- overseas migration;
- profiteering by land developers and builders;
- taxation treatment of owner occupied housing;
- availability of negative gearing for investors in rental property;
- shortages of home owners warranty insurance;
- First Home Owners Grant fuelling house prices; and
- a global problem.

4.3.1 Overseas migration

Migration represents about 20 percent of the total underlying requirement for new homes. The official migration program has grown from around 80,000 per annum to around 110,000 currently. This growth will have put some pressure on the capacity of State and local government to supply the infrastructure to support this population growth. However, compared with the other factors driving the demand for housing the impact of migration has been modest.

4.3.2 Profiteering by builders and land developers

The suburban land development process typically takes between from 5-10 years. Development companies, which increasingly are public companies, move land stocks to generate returns on funds employed. The returns that have been announced by listed land developers also suggest that they have not been making super-normal profits. Sluggishness in bringing land onto the market for sale is much more likely to be a direct result of the protracted delays developers experience with planning and other approvals, rather than a deliberate attempt to 'drip feed' the market.

In the face of record levels of building activity, the price of new houses has increased only slightly ahead of CPI, such is the level of competitiveness in the home building industry. The tens of thousands of building businesses competing for customers have ensured that there is little or no capacity to profiteer.

4.3.3 The taxation treatment of owner occupied housing

The Productivity Commission's Issues Paper questioned whether the tax treatment of owner occupation could be contributing to pressures on the housing market and affordability. On the issue of the tax exemption for the 'imputed rent' that an owner occupier 'earns' on their home, it is difficult to sustain that this represents special treatment for housing as there is no imputed rent taxation for any other consumer durable asset that someone may own eg a car. Moreover, home owners are not able to claim mortgage interest, depreciation or other tax deductions on their own home. Also, the distributional impacts of taxing imputed rent would be very serious as the aged, who typically own their homes outright would face large tax bills, while younger home owners would be likely to have mortgage and other expenses in excess of the notional rental income attaching to their home, giving rise to a tax deduction.

While the capital gains made by an owner occupier on their home are not taxed this is in recognition of the substantial benefits that flow from home ownership and the Government's commitment to its support. It is no different in principle from the tax concessions available for investment in superannuation. Saving in superannuation and home ownership are encouraged as the twin pillars of Australia's retirement incomes policy.

Over the last couple of years it has been the plunge in the returns on other investments that has made housing more attractive rather than the tax treatment of owner-occupation. This conclusion is supported by the evidence that much of the increase in housing demand has been from rental investors rather than owner occupiers.

4.3.4 The availability of negative gearing for rental property

The Productivity Commission's Issues Paper mentioned that it has been commonly suggested that the tax treatment of capital gains on housing and the availability of negative gearing on rental investments has induced "excessive investment in housing", and by inference put pressure on prices and reduced affordability.

The growth in rental investment arguably has been the result of the plummeting returns on equity markets, not the tax system. Interest is a deductible expense for any income producing asset. Hence the negative gearing of any investment is not regarded as a distortion to the tax system and does not appear as a tax expenditure in the Federal Budget. Moreover, full interest deductibility has been available for investment in any income producing asset, except for a brief period in 1985 to 1987, so it is difficult to consider why it should suddenly become a significant contributor to declining housing affordability.

The 1999 changes to the capital gains tax regime would have tended to make short term holdings of rental properties more attractive than the previous arrangements. However, any advantages are likely to be small once the effects of increasing rates of stamp duty are considered.

4.3.5 Shortages of home owners warranty insurance

Some interests have suggested that the difficulties in the home owners warranty insurance market following the failure of HIH have been a significant negative influence on affordability. While it is true that premium levels have increased from an average around $300 to around $800 currently, the effect of a $500 average increase in premiums has been swamped by the increases in land prices. Since the decline of HIH there has not been any material change in the number of residential builders operating in Australia, so the warranty insurance market has not caused any lessening of competition in the building industry.

4.3.6 First Home Owners Grant fuelling house prices

The FHOG was introduced to compensate home owners for the introduction of GST. So while in isolation a $7,000 grant to first home buyers could have put pressure on prices, it was introduced at the same time as an average GST bill on a new home of around $12,000 and at a time of very low levels of industry activity. The net result would not have added any demand pressures to the market.

4.3.7 It's a global problem

Some commentators have suggested that rapid increases in residential prices and declining housing affordability are simply part of a global trend and therefore beyond the influence of governments or industry to influence. However, the western countries with which the price comparisons are normally made have all experienced the same kinds of pressures as have been felt in the Australian market. These include increasing relative returns on investment in housing following the international share market slump, environmental and other constraints on the release of new residential land, and aversion to government borrowing pressuring infrastructure agencies into upfront charging. So rather than being a global problem beyond our control, Australia is just one of a number of countries facing similar pressures and circumstances.

While many of the issues outlined in this section may have been symptoms of our recent housing affordability history, they are not the root causes of the deterioration we have experienced. In the face of increasing demand for housing, particularly demand for investment housing, the market was unable to respond due to constraints on the supply of additional greenfield and infill sites caused by policy failures, inflexible and lengthy planning approval systems and an inability to fund infrastructure provision other than through the imposition of ever larger upfront charges on new home buyers.

5 Planning Reform

5.1 Introduction

Planning systems provide the frameworks within which the critical infrastructure and land supply issues are addressed. This section deals with these core issues purely from a planning perspective. A more detailed analysis of infrastructure provision and the land supply process is contained in following sections of this submission.

5.2 The need for planning reform

The critical role of planning reform in delivering more efficient (and affordable) outcomes has long been recognised by all players in the development process[16]. Planning reform can contribute significantly to reducing housing costs by curtailing delays and uncertainties associated with land and housing development.

Some of the key 'planning system' influences on housing affordability over the past decade include:

- a significant increase in the number of proposals that now require planning approval;
- greater opportunity for persons other than a project proponent to influence the decision making process;
- the increased complexity of assessment processes, accompanied by a plethora of planning legislation and referral or concurrence agencies;
- increased uncertainties and costs associated with diverse and layered planning systems;
- government's continued monopoly in undertaking all development assessment work, accompanied by a shortage of skilled planning and associated staff, particularly at the local government level; and
- the rigid application of development standards that generally discourage housing mix and choice and limits the ability of the market to deliver accommodation types that suit demand.

The key issues to be addressed for efficient planning systems and affordable outcomes are:

- reduced complexity and greater predictability of planning systems;
- limits to who can influence the decision process once the planning rules and strategic direction have been determined;

[16] In March 1997 the Prime Minister, in his response to the Small Business Delegation's 'Time for Business' Report (the Bell Report), endorsed the need to reform the processes of referral and concurrence in development assessment. In doing so the Prime Minister agreed that these reforms should be augmented through a broader reform of development and building approval processes. Following the building and development industry's response to the Prime Minister's initiative, the *Development Assessment Forum* (DAF) was formed to pursue a national approach to the streamlining of development assessment procedures. A major aim of DAF has been "to promote cost savings to both the building and development industry and all tiers of government" through leading practice regulatory reform.

- increased competition in the development assessment process;
- the transparency of upfront development charges;
- comprehensive regional and local planning; and
- the driving of a nationally consistent planning approach.

5.3 Planning systems are fragmented, complex and unpredictable

The process of development approval is complex, fragmented and inconsistent across the country. The myriad of planning controls is eroding housing affordability and diminishing community and industry confidence in the benefits of planning systems.

Changing demographics and lifestyle trends dictate the need for Australia's home building industry to be responsive to the diverse range of housing requirements. But the rigidity and complexity of planning approval systems discourage innovation in housing design and building form, affect the availability of serviced land and frustrate the ability of the housing industry to keep pace with the changing needs of the housing market.

HIA's report, *Better Living Environments* introduced at HIA's National Planning Conference in August 2001 highlights relevant benchmarks in achieving a responsive and cost effective planning system. *Better Living Environments* identifies and describes examples of better practice that can serve as a signpost for the reform of planning approval systems. HIA, through *Better Living Environments,* recommends the development of model planning legislation based on best practices from different States to serve as a catalyst for reform and consistency.

Land use activities are identical around the country, but there are hundreds of different zoning controls and definitions used in different council areas. The focus of standardised controls is at the State government level, but the Federal Government has a significant role to ensure that reform takes place within a harmonised and coordinated framework. HIA is committed to working on a more nationally consistent approach to planning systems.

It is noteworthy that several States are reviewing their development assessment processes, with the aim of delivering a more certain and fluent assessment system[17]. These reviews, however, are in response to identified local pressures[18] and remain largely uncoordinated, despite the obvious advantages of a nationally harmonised and coordinated approach.

[17] Victoria has recently published its 'Better Decisions Faster' consultation guideline; South Australia is poised to mandate local council approval reforms; the NSW government has initiated a series of approval related taskforces to overhaul the shortcomings of reforms commenced in the late 1990s; and Western Australia is initiating a planning reform agenda within its restructured planning and infrastructure department.

[18] The initiation of recent reform agendas has come from all users of the system including industry and professional associations, State and local government bodies, and even corporatised government land development agencies. In many cases individual reports have been prepared that analyse costs and frustrations or which document elements of best practice in the hope that regulators will be encouraged to follow suit.

Most systems are needlessly complex. The proposition that detached dwellings should run the gauntlet of a host of development approval requirements depending on the State or metropolitan centre in which a project is located is unjustified. In Queensland, Tasmania, and Victoria, separate houses located in appropriately zoned areas and on standard sized allotments need no more than a building permit or equivalent. In NSW and South Australia, planning approvals are generally required for all detached houses. In Perth, an increasing number of local governments are requiring planning approvals for separate houses in response to the introduction of revised State-wide Residential Design Codes. This is mostly due to unnecessary reliance on rigid standards rather than performance criteria to control the appearance of buildings and site layout, particularly in response to community submissions. There is obvious potential to coordinate a responsive approval system, based on universally accepted criteria for dwelling houses, but little initiative at the State or local level to drive this reform.

At the very least, detached houses and medium density units that are in appropriately zoned areas should be able to have the dwellings built 'as of right' that is, subject only to a building approval and not requiring any further community advertising or consultation. This would take most of the politics out of these smaller scale developments. To support this initiative, local councils should make the zonings in their area more transparent to local residents, so that the residents have a clearer expectation about the type of development which is permitted in their neighbourhood. For example, in Western Australia, zones are defined according to their expected density eg R40 means an expected density of 40 dwellings to the hectare.

Planning legislation has become the tool for State and local governments to attempt to solve a plethora of urban development issues. Planning regulation creep has added more layers to the complex patchwork of controls and resulted in local authorities in many States circumventing the application of the Building Code of Australia, designed to ensure that all construction is undertaken to achieve acceptable levels of health, safety and amenity.

State governments should:

- adopt standardised legal and administrative provisions of planning schemes, including zoning controls, definitions and development categories;
- adopt standardised 'as of right' processes for the approval of detached dwellings and medium density housing, based on community accepted design and performance standards;
- adopt plain language regulation;
- standardise notification processes; and
- review appeal, referral and concurrence procedures.

State governments should also enact legislation to clearly distinguish the boundaries and relationships between planning and building regulation.

5.4 Development assessment competition

The introduction of private certification in Victoria, Queensland, NSW, South Australia, ACT and Northern Territory has resulted in a major change in the effectiveness and efficiency of the construction approval process. Those local governments that provide certification services have had to significantly change their level of service to compete in the marketplace.

Some local governments in Victoria and Queensland have also been actively involved in encouraging greater private sector involvement in the assessment process for planning applications in response to the increased complexity of assessment required by the various State and local planning schemes. The demand for town planners and other professional people to administer the development assessment process has dramatically increased, with many local governments not able to effectively manage (or resource) their assessments systems. The more innovative local governments have either reassessed their development assessment levels or have considered other ways of managing the development process. The use of private sector planning professionals to assess and certify compliance with existing planning scheme provisions is one such option.

An analysis of opportunities for private sector involvement in the field of development assessment has recently been undertaken by the *Development Assessment Forum*. That analysis has showed that a range of benefits is possible from extending (and formalising) private sector roles. The following benefits identified by DAF have specific implications for cutting costs and reducing the uncertainty often associated with assessment processes:

- higher quality applications being submitted;
- reducing the need for additional information requests, a common source of delay in the process;
- improved information that assists councils with decision making in relation to complex or major development proposals;
- reduced application decision times (and a reduction in holding and other costs);
- better use of council resources (enabling planning staff to concentrate on the development of planning policy and strategic directions); and
- potentially faster assessment processes for minor, routine and low impact development proposals.

Various trials of private sector involvement in development assessment processes have been conducted around the country. In Victoria, trials have been conducted to allow private certifiers to 'sign off' on the completeness of an application at the time of lodgement, with State government assistance, at Glen Eira Council. In Queensland, Brisbane City Council is currently considering a broad role for private sector professionals in its assessment processes. Also, recent legislation categorises 'self-assessable' development as certifiable in its entirety (not dissimilar to 'complying development' in NSW). In NSW, compliance certificates can be privately issued to certify the compliance of an aspect of a development (including its design) with relevant standards and requirements, but is not utilised or encouraged in the NSW system. Also, throughout regional NSW, local governments have allowed individual planning applications to be assessed 'externally' by planning professionals (usually on

the basis that the costs incurred are met by the applicant). This external assessment of applications has arisen informally in response to the critical lack of local government resources to manage high application numbers[19].

Within existing legal frameworks and with council (and State government) support, it is possible to extend the role of private practitioners to 'sign off' on the following development assessment processes, whilst maintaining the role of council as the development consent authority:

- administrative (and non-discretionary) elements of the DA process (eg pre-application checks on completeness and accuracy of applications submitted;
- the notification and referral of applications;
- assessed compliance of a DA with State legislation and/or local policies; or
- compliance upon completion of elements of the development such as landscaping, car parking, signage, etc.

'Certification' aims to formalise such roles by enabling appropriately qualified certifiers to take legal responsibility for such actions.

HIA supports the work undertaken by the *Development Assessment Forum* in highlighting the benefits of increased private sector involvement in the development assessment process and urges State governments to implement DAF's recommendations.

5.5 Transparency of upfront development charges

The process of providing and funding private benefit and social infrastructure is controlled through relevant State based planning regulations. There are substantial differences between States as to the types of infrastructure required to be provided in conjunction with urban development, as well as the processes for calculating and setting development charges. Some State governments have total control over the provision of infrastructure, while in some States, local government exercises control over much of the infrastructure required in an urban development. (See Section 6 for a more detailed discussion of infrastructure funding issues.)

While HIA does not support upfront development charges for social or community infrastructure, where they exist they should be identified through an infrastructure plan. These plans should assess and justify the use of contributions over alternative funding methods like rate revenue and should set the method of calculating the level of development contributions. The plan needs to identify a clear nexus between the development and the planned infrastructure to be established and the time period within which delivery of the facility can be expected.

The process of establishing a development contributions plan needs to be linked to local government planning schemes to encourage integration of infrastructure

[19] In NSW this practice has led the Department of Local Government to issue a circular advising councils that they have no legal right to apply an additional fee for the external assessment of applications. Notwithstanding this process alleviates pressures on councils' internal systems for the processing of applications and delivers a win-win for all applicants.

programs with land use planning and development decision making. Such an approach ensures fairness and transparency in the calculation of contributions and charges and provides greater certainty for developers and the business sector about the infrastructure costs they would be liable for when undertaking a project. In particular, it is the practice of local government in many States to negotiate up from the legislated contribution baseline, utilising their role as consent authority to increase the level of contribution associated with a specific development. This process should be prevented with contribution levels set in infrastructure plans reflecting the maximum amount that may be required as an upfront charge on development.

Development charges should also be open to the same process of consultation and appeal as applies to the other provisions of the planning scheme. In particular, it is appropriate that 'funding conditions' of a development consent can be appealed separately without jeopardising the whole approval. In this way, by guaranteeing the payment of contested conditions, developers can appeal the unreasonableness of a monetary requirement whilst not bringing into question their right to undertake the approved development. The capacity to separate contested conditions from the whole consent does not apply in all State appeal systems.

In relation to designing for open space and public recreation provision there are considerable differences in the standards required in each State. (See Chapter 6 on Infrastructure). There is a need to develop appropriate minimum open space standards through a review process that would bring to the surface some of the long established and unreasonable standards that are applied.

5.6 Comprehensive regional and local planning

The supply of land for urban development is primarily a State/Territory government responsibility, although largely influenced by local government zoning and approval policies. Each State seems to have a regional approach to addressing land supply as part of an overall metropolitan strategy. However, with the exception of Western Australia where regional schemes are used to zone and 'release' land for urban development, these strategies tend to be reliant on delivery by individual local governments and tend to have limited statutory influence.

The various regional strategies address transport infrastructure, major trunk infrastructure, environmental assets, agricultural land, coastal management and overall economic development and make assumptions regarding built form and projected densities. The strategies provide strategic guidance on what outcomes might be desirable, but lack legislative force in ensuring actual outcomes are achieved at a local level. If individual local governments decide that population capping or infrastructure limits are to be imposed or impose unrealistic hurdles for infill developments to overcome, then regional planning strategies can fail dismally.

In **NSW**, the State government controls the process of greenfield land release through its Metropolitan Development Program (MDP). Notwithstanding that land is identified through the regional MDP process as suitable for urban purposes, involving consultation with local government and with industry input, the time period for gaining all the relevant approvals can take from 3 to 10 years. The system's reliance

on an unresponsive rezoning and development assessment process means that its projected rates of production and supplies are largely exposed to local influences. A more responsive system would allow utility providers to adopt proactive works programs to deliver the needed infrastructure on time and for both local and State governments to streamline their approval processes to match the timing of service delivery. This would necessarily involve a reduction in the duplication of studies and counter studies regarding environmental and urban capability issues. A responsive system would prevent local governments from using the rezoning and development assessment processes to coerce greater State government infrastructure expenditure in their local areas. State government should already be committed to increasing funding to address transport needs, schools, hospitals etc as part of its overall Metropolitan Development Program.

In **Western Australia,** the State government has both a strategic plan (Metroplan) which directs Perth's future growth, and a regional planning scheme (Metropolitan Region Scheme), which reserves land for regional infrastructure, controls the zoning of land for urban development at the metropolitan level and requires local government planning schemes to be consistent. The State government is also the consent authority for all subdivision approvals. As well, the State government manages the provision of all major urban infrastructure and thereby is effectively responsible to the development marketplace for the delivery of sufficient serviced land. The Western Australian regional planning framework provides for the timely supply of serviceable residential land to market.

All State governments should establish similarly effective regional planning strategies to manage the growth of their major metropolitan centres. The strategies should provide appropriate levels of land supply for both greenfield and infill housing opportunity. These strategies should have statutory underpinning and must be reflected in both local planning schemes and local government actions.

5.7 Towards a nationally consistent planning system

In recognition of the vast differences in State planning systems, the *Development Assessment Forum* recently commissioned the documentation of a model development assessment system. The forthcoming report could provide a framework to drive State and local government planning reform. The guiding principles are:

- a separation of policy and decision making roles under which local governments would develop and set planning policy while specialist staff or assessment panels would determine development proposals;
- technically excellent criteria based on community engagement – such criteria enable compliance to be assessed objectively and provide for the application of consistent policy across planning jurisdictions;
- a single assessment body – should determine applications at the local level, based on advice from other agencies provided they have technically excellent criteria applying to each type of proposal;
- expert assessment bodies at State and local levels – established to assess and make decisions on the more complex proposals. An underlying principle is that the

complexity of assessment procedures should match the complexity of the proposal;
- planning appeals should involve a second expert assessment – leaving the courts to determine matters of law and process infringements;
- built-in improvement mechanisms – system flaws are best addressed by revisiting the technical criteria and ensuring that policies are responsive to changing needs and circumstances.

Whilst State and local governments have demonstrated a recent commitment to improve their own planning systems, there is a role for the Federal Government to support and encourage planning reform. HIA would suggest that greater cooperation by all levels of government is required to achieve much needed planning reform.

5.8 Key findings and recommendations

Key findings and recommendations on planning reform include:

- State and local governments should ensure housing affordability is adopted as an object of State planning legislation and is incorporated as an objective in all local and regional planning schemes.
- State governments should:
    1. adopt standardised legal and administrative provisions of planning schemes, including zoning controls, definitions and development categories;
    2. adopt standardised 'as of right' processes for the approval of detached dwellings and medium density housing, based on community accepted design and performance standards;
    3. adopt plain language regulation;
    4. standardise notification processes; and
    5. review appeal, referral and concurrence procedures.
- State governments should enact legislation to distinguish the boundaries and relationships between planning and building regulation.
- State governments should be required to review their planning legislation and their system processes and administration to allow a greater participation of private sector professionals in development assessment, in accordance with the opportunities identified by the *Development Assessment Forum*.
- Whilst HIA considers that upfront development charges should not apply to social or community infrastructure, where such charging occurs it should be managed through the respective State planning legislation and be identified through an infrastructure plan. When implemented by local government, these plans should form part of the local government's planning scheme, should identify the use of contributions over alternative funding methods and should set the method of calculating the level of development contributions. The plan needs to identify a clear nexus between the development and the planned infrastructure to be established, as well as the reasonable timing of its provision.

- The ability to challenge funding conditions of development approvals, without jeopardising the whole consent, should be prescribed in all State planning/appeal systems.
- The ability of councils and other consent authorities to negotiate up from the legislated contribution baseline set in infrastructure plans should be prevented. Contribution Plans should reflect the maximum amount that may be required as an upfront charge on development.
- All State governments should establish regional planning strategies to manage the growth of their major metropolitan centres. The strategies should provide appropriate levels of land supply for both greenfield and infill housing opportunity. These strategies should have statutory significance and be reflected in both local planning schemes and local government actions.
- The Federal Government should cooperate with State and local governments to facilitate planning reform based upon recognised best practice.

6 Infrastructure Supply, Charging and Funding

6.1 Introduction

HIA's investigations into the costs of housing production have revealed that the cost of supplying infrastructure for both infill and greenfield developments is one of the largest hidden costs of new housing. Increasingly, the cost of infrastructure, in many cases traditionally met by government, is now being passed on to new homebuyers in the form of upfront charges on development.

Funding pressure on the supply of urban infrastructure is one of the main impediments to the timely release of land for development. Faced with the prospect of having to fund infrastructure to new areas, governments have opted to constrain the supply of greenfield land, hoping that infill housing potential will fill the void and that a largely unquantified infrastructure capacity within established areas will be sufficient to absorb increased demands. Increasingly, however, local communities have opposed infill development, ironically on the basis of a lack of adequate infrastructure – especially public transport, roads, open space and community facilities. The net result has been both a squeeze on greenfield land supplies and a funding neglect of the much needed infrastructure that our cities depend upon.

The relationship between infrastructure funding and land supply was recognised by the Industry Commission in its 1993 report on urban settlement[20].

> *"Government control over land release for housing has been in part intended to minimise the public costs of infrastructure by influencing the rate of development. Better pricing by infrastructure providers can perform at least part of this function."*

Infrastructure costs across Australia for greenfield and infill development are funded through a complex array of taxes, fees, levies and charges. This chapter investigates infrastructure charges on a State-by-State basis. It considers the relevant regulatory frameworks, the myriad of arrangements for provision, analyses local infrastructure charges and investigates the extent and role played by independent pricing agencies.

There is no consistency in the funding of and pricing of urban infrastructure delivery between and within the States. Essentially, the cost of housing production varies significantly, based largely on the infrastructure funding arrangements that apply. Homebuyers in NSW might legitimately question why it is that they have to make such a large investment in community facilities when buying a new home, whereas their counterparts in South Australia and Queensland have a decidedly greater buying power when making the same decisions.

A clear and universal distinction between the legitimate infrastructure needs of a new housing project (whether in a greenfield or infill situation) and the community

[20] *Taxation and Financial Policy Impacts on Urban Settlement*, Industry Commission Report, 1993, Canberra.

infrastructure elements from which a wider social benefit is derived, must be drawn if housing affordability is to be repaired.

In preparing this submission HIA commissioned Access Economics to review the efficiency and equity principles that should govern the pricing and funding of urban infrastructure and how current practice equates with those principles. Frequent references are made to the Access Economics Report in this section, so for the Commission's convenience, a copy of the report is appended to this submission.

6.2 What is infrastructure?

Urban infrastructure covers a range of 'economic' and 'social' infrastructure that produces services for individuals and the community.

Economic infrastructure directly supports the production and consumption of services and includes water supply, sewerage and drainage, roads, public transport, gas and electricity supply.

Social or community infrastructure provides services such as child care centres, open recreational space, libraries, schools and hospitals.

State and local governments are the main levels of government responsible for the provision of urban infrastructure. At the State government level, schools, hospitals and major road networks are the main areas of urban infrastructure provision. Local government is usually responsible for local roads, child care centres, community halls, recreational facilities, waste management and the provision of open space.

New infrastructure or the upgrade of existing infrastructure is required in greenfield situations and when development of higher densities occurs in established parts of a region or city. The amount or standard of infrastructure that is required in conjunction with a development will vary substantially across the country, or even between neighbouring council areas.

For the purposes of this submission infrastructure has been categorised as either:

- 'local (physical) infrastructure' (sometimes referred to as private benefit infrastructure) – the need for which is directly attributable to new housing developments and which is typically funded directly or indirectly out of revenue raised from homebuyers. Local physical infrastructure includes items such as roads, drainage, stormwater, and land for local open space;
- 'community and social infrastructure' for which governments have traditionally accepted general revenue funding responsibility in recognition of external or 'redistributive benefits. It includes the headworks components of water, sewerage and power supplies, recreational facilities (eg indoor and outdoor embellishment), landscaping and other urban improvement initiatives, local or regional community facilities (eg schools, libraries, child care), regional transport and regional open space facilities.

In most State planning and development approval systems, however, there is a 'continuum of infrastructure' items for which upfront development charges are levied.

HIA's analysis of legislation and development funding mechanisms around Australia has revealed that there are a variety of rules and principles that apply to infrastructure delivery, increasingly involving inappropriate upfront capital levies applied to new residential development. These practices are not commonly communicated to or understood by homebuyers. Indeed, they form a hidden charge on new housing.

6.3 Current legislative frameworks

Despite the fact that planning legislation in most States of Australia dictates the way in which land development takes place, there is little or no mention in any jurisdiction about the principles of infrastructure provision or the allocation of the costs associated with it, apart from the common objective that development should be 'orderly and economic'. Pricing arrangements are ad hoc and inconsistent between comparable developments.

The Victorian Planning Provisions (VPPs) for Residential Subdivision require the encouragement of subdivisions that are 'cost effective'. The NSW Environmental Planning & Assessment (EP&A) Act includes "*the provision and maintenance of affordable housing*" as an objective, but affordable housing is narrowly defined as "housing for the very low and moderate income households".

Queensland's Integrated Planning Act (IPA), on the other hand, includes a purpose "*[to supply] infrastructure in a coordinated, efficient and orderly way, including encouraging urban development in areas where adequate infrastructure exists or can be provided efficiently".*

The IPA makes no specific reference to housing affordability but mentions:

> *"a decision making process that is accountable, coordinated and efficient"* and makes reference to *"applying standards of amenity, conservation, energy, health and safety in the built environment that are* ***cost effective*** *and for the public benefit".*

Specifically, Queensland's IPA limits infrastructure charges to 3 areas – water cycle management (drainage, sewer and environmental management, including headworks), transport infrastructure (local roads, footpaths, cycle ways, parking) and community land networks (open space and the land component of other community facilities). In addition information that accompanies the IPA's infrastructure provisions States that:

> *"infrastructure charges are limited to the three urban networks because as an upfront charge usually levied at the time of development they* ***threaten housing affordability*** *and reduce opportunities for new communities to participate in choosing the nature and cost of services they wish to pay for."*

However even though these principles exist HIA members report that local councils will 'negotiate' 'voluntary' development contributions in excess of those permitted by the IPA.

6.4 Infrastructure supply and housing affordability – guiding principles as to who should pay

Unlike Queensland, all other State planning jurisdictions do not clearly define, in legislation, the type or amount of social or community infrastructure that might be linked to new housing developments. Most are happy to justify upfront charges by establishing a nebulous 'nexus' between development and need (either at the local government level, as in NSW and to a lesser extent in Victoria, or directly at the State government level, as in Western Australia) or to simply 'negotiate' additional provision as part of the development approval process (as in Tasmania and elsewhere). As a result, development contribution practices have varied significantly within and between cities – the principles governing them driven more by legal rather than economic argument[21].

Whilst the principle of 'nexus' might initially seem fair to some (usually those that are not required to pay), it needs to be assessed more broadly in the context of its impact on housing affordability. Whilst it might be 'possible' to require a new housing estate to contribute to sporting facilities or a community centre on the basis of derived demand, the nexus principle could also be extended to civic improvements, urban landscaping, bushland retention and biodiversity, water quality etc. In the absence of guiding principles on how strong the nexus needs to be to trigger contributions, 'nexus' can quickly be used to tally up what can be strikingly unreasonable demands on new housing.

The recent proposal by one Sydney Council to introduce a levy of $64,000 per lot demonstrates the danger of the uncapped nexus logic. The recent NSW State government's impost of a $15,000 per lot transport levy for certain release areas is another.

In the absence of clear regulations about reasonableness and the funding of 'baseline services' (ie services that meet basic needs, the cost of which are determined on the basis of common construction and provision standards) the nexus approach is clearly a danger to housing affordability. It simply allows governments to levy up to 'what the market will bear' without regard for the totality of the impact on the final price of the home. Moreover governments frequently believe that developers pay for these charges from reduced margins, but as the Access Economics Report concludes:

> *"the incidence of developer contributions is passed forward to consumers in most circumstances" (page 34)*

Unfortunately, in the absence of viable alternative funding opportunities or a willingness to explore them, local and State governments are becoming dependent on

[21] A more detailed comparison of each State's planning legislation and infrastructure funding provisions is provided at Appendix 1.

upfront development charges to cover the costs of 'just about everything urban'. NSW councils are leading this trend, but other States seem increasingly to be following the NSW mistakes and can expect the same deleterious effect on housing affordability.

At times developers of contemporary housing estates or infill projects would be prepared to contribute to off-site social infrastructure, depending on the strength of market demand. However, this is not universally the case, especially where the developer is striving to meet a more price conscious part of the market.

According to Access Economics, more efficient and equitable financing of social infrastructure would result from charges being levied on actual beneficiaries whether they are either existing or new residents. Instead of funding social infrastructure with upfront development charges, the capital costs of acquisition should be recouped from residents through user charges, which relate to the consumption of benefits by individual residents. User charging would not prevent government subsidising users, but would avoid arbitrary allocation of cost to new residents as a convenient revenue source.

HIA submits that in practice the pricing approach should follow the recommendation contained in the 1978 report of the Committee of Inquiry into Housing Costs, namely that:

> *"Developers should continue to be responsible for internal development works in residential land development, including reticulation of services. All other developer contributions, including headworks and area contributions, contributions for amplification of services and off-site drainage and like schemes, should be removed. The resultant capital deficiency should be made up by increases in rates and charges on all consumers so that provision of services at the time of development should not be frustrated."*

While these principles were outlined 25 years ago they remain the key to equitable and efficient delivery of infrastructure in a way that does not compromise housing affordability. There is no State or Territory that currently operates on the basis of these principles.

HIA's July 2003 paper 'Restoring Housing Affordability – the housing industry's perspective', reiterated that:

> *"As a matter of principle, charges for infrastructure should be applied to fund increments to local infrastructure which are related directly to the new development and required at the same time as the development occurs eg local roads, drainage, sewerage and local parks."*

In keeping with these principles HIA believes that there are certain 'traditional' types of infrastructure that are required within a subdivision for which it is reasonable to expect the new homebuyers to pay, including the basic services such as water, electricity, roads, stormwater and land for local open space.

These principles are consistent with the assessment made by Access Economics that:

> *...works within a development provide a clear private benefit to an individual new resident. Efficient pricing would involve households carrying the full cost of provision, with charges levied directly or through the developer. (page 16)*

Over many years, however, there has been a change towards developers and therefore homebuyers paying a number of higher 'development charges' that contribute towards the supply and installation of social and community economic infrastructure, such as arterial and district roads, transport interchanges, headworks, railway station upgrades, child care centres, fire stations, schools and more.

Increasingly, reliance on development contributions has the effect of levying new homebuyers at a time when they can least afford it. Purchasers of established homes in older localities, by comparison, do not pay for their use of community facilities, other than via local rates. Access Economics concludes that for these community infrastructure items:

> *Rather than upfront charging, capital costs should be recouped from users through user charges, which more accurately reflect the distribution of benefits. (page 19)*

or if the infrastructure is for network investment:

> *...capital costs ...should be shared equally across all users (page 20)*

Upfront charging for community infrastructure has been favoured most strongly in NSW. In Sydney this type of local government development contribution, levied under Section 94 of the Environment Planning and Assessment Act averages around $20,000-25,000 per allotment in most council areas. In Victoria a similar contribution would be in the vicinity of $4,000-$10,000, which is still considered to be an unacceptably high amount for new homebuyers to cover. Similar charges in Western Australia are $21,000 and in Queensland $17,000.

In addition the NSW State Government is also is now asking for a $15,000 transport levy for new lots within specified release areas. Combined with the $25,000 contribution above, it is taking the cost of social infrastructure to $40,000 per lot. It is likely that these upfront charges will continue to form part of the NSW State Government's approach to the opening up of new release areas. Already there is strong speculation that the transport levy will rise to $30,000 per lot in future north-west and south-west land releases.

It is noteworthy that this cost shifting for social and community infrastructure has taken place in the absence of any public debate. There has been no investigation or discussion of matters that should be covered by the homebuyers or of facilities that should be funded either by new residents or through a broader taxation base. It has occurred over time largely by stealth.

It is inequitable that varying degrees of social infrastructure costs are met by some homebuyers in certain States but not by others. It is also unfair that the owners of existing housing do not contribute to the costs of services and facilities from which they derive both direct and indirect benefits. Access Economics also notes:

> *Due to the long-lived nature of urban infrastructure, issues of inter-generational equity arise. For example, the current generation may finance the large upfront costs of new infrastructure development that benefits future, as well as current, generations of residents. (page 8)*

As a matter of principle, and in the interests of economic efficiency and equity, HIA believes that this community-wide and social infrastructure should be paid for by the whole region through general taxation measures. These types of facilities have a benefit for the whole community and are fundamental to the operation of cities. There are many beneficiaries from this infrastructure, ranging from the wider to the local community. For some of the items of infrastructure governments are able to introduce user charges to pay for the infrastructure over time. For other items where there is no effective way of having user charges, general rates or taxation should be used.

If these principles were adopted there would be significant improvements in the accessibility of home ownership, especially in Sydney where the upfront charges are so high.

Access Economics reached a similar conclusion following a review of the efficiency and equity of infrastructure funding arrangements:

> *..it is inequitable for new residents to finance social infrastructure that the whole community can access. (page 21)*

6.5 Calculating the cost of new infrastructure

In addition to the problems of principle associated with upfront charging for social and community infrastructure, HIA members report that there are substantial problems with the calculation of the cost impositions including:

- costs, which can include estimated maintenance costs, being based on unreasonably short life spans of the infrastructure;
- excessive upfront standards required for infrastructure to lower the maintenance costs for governments;
- poor transparency and accountability about how the upfront charges are calculated and spent;
- difficulty in measuring capacity of existing infrastructure for assessing charges for infill developments; and
- too many fees and charges are being established 'by negotiation' rather than transparent, rigorous assessment.

As greater responsibility is shifted to the developer to physically provide services, the standards required for this work have increased significantly.

In theory the presence of independent pricing authorities in most States should go some way towards stemming the undesirable features of up front charges for social and community infrastructure. However in practice HIA members still report of pricing irregularities. South Australia and Western Australia are yet to introduce independent pricing authorities.

6.6 Section 94 – A case study of inappropriate upfront charges

Research by the UDIA and the Property Council has pointed to the inefficiency and inequity of upfront charging for infrastructure. HIA endorses these findings. The management of Section 94 payments in NSW amply demonstrates in practice some of the inefficiencies identified in the research. Data from the NSW local government department shows that over the 4 year period to June 2002, local governments in Sydney collected $726 million in development charges but spent only $505 million providing the infrastructure the funds were meant to provide.

After allowing for interest earned on the balance in their Section 94 accounts, the total amount of charges unspent grew by over 50 percent to be over $720 million. Councils holding these collections find the cost of providing infrastructure increasing faster than the interest earned on the balances, and are therefore constantly playing 'catch up' in delivering the infrastructure for which they collected Section 94 payments. There is a basic lack of accountability as well as inefficiency in the management of these charges.

6.7 State comparison – development contributions and social infrastructure

Most States have an entrenched development contribution scheme. Although it is noteworthy that South Australia, Queensland and Tasmania have these for open space only and for headworks in Queensland. In NSW, where development contributions are legally applied to a broad range of facilities and services, there is almost a total reliance on them to finance new release areas.

The level of dependency is not as high in those States where there is greater government buy-in of infrastructure responsibility (eg Western Australia and South Australia) or where there are legislative limits to the range of development contributions that may be levied as is the case in Queensland.

The ACT is unique in that 'contributions' to ACTEW, the sole owner of all service infrastructure (except gas pipes) are typically covered in the 'reserve price' for leased land. So the amounts collected to cover infrastructure costs are not at all transparent.

There are also a variety of open space standards for which development contributions are levied – 5 percent of site value in Victoria (although some councils encourage negotiation of higher contributions, up to as much as 11 percent). In Western Australia the amount is 10 percent of gross subdivisible area and in NSW the rate is 2.83ha per 1,000 population (along with an increasing array of embellishment,

bushland, conservation or bushfire setback requirements). In South Australia, the rate is 12 percent of land area.

Queensland, Western Australia, NSW and Victoria have various guidelines that apply to and largely determine policy on development contributions, although these mostly are generalised in legislation or live outside of legislation.

In all States, except perhaps Western Australia where the State government is the consent authority for subdivisions, there is a tendency for local councils to 'push the contribution envelope' by enticing developers to contribute more either by writing additional requirements into their local planning schemes, through negotiation, by stretching the nexus basis of formal contribution plans or by consent conditions.

Even in South Australia where contributions are not legal, some councils impose a stormwater charge of approximately $600 per dwelling. In Queensland, where strong legislation specifies a clear distinction between on-site and off-site responsibilities, some local councils still seek to require additional contributions from the development process.

HIA strongly endorses the recommendations made by Access Economics that to be equitable, the financing of urban infrastructure should follow the following principles:

- *If new residents are to be separately charged the cost of upgrading infrastructure, it should reflect the proportion in which they derive the benefit, and not involve a cross subsidy to existing residents. A similar direct charge should apply to existing residents.*
- *Double dipping should be avoided. For example, the rates paid by new residents should be reduced to reflect the fact that they have already made an explicit payment for incremental capital costs and should not bear the capital cost component of existing infrastructure.*
- *If new residents are to be explicitly charged for the capital or ongoing costs of social infrastructure (on an up front or ongoing user pays basis), similar charges should be levied on existing residents.*
- *If consumption of certain services is to be subsidised (to ensure equitable access for low income groups or account for externalities), the public subsidy should be funded by the whole community, not a narrow subset of new residents.*
- *To the extent possible, there should be consistent treatment of new developments within a jurisdiction and across jurisdictions, to remove bias in location decisions. (page 25)*

Access Economics' analysis of the current Victorian, NSW and Queensland infrastructure charging systems reveals that none of these States' systems meet these criteria for equity.

Despite the switch in infrastructure costing towards more upfront development charges for social and community infrastructure, there does not appear to be a clear definition in any planning legislation of what the term 'social infrastructure' covers.

In Tasmania there are no official requirements to provide social infrastructure as part of the approval process. In South Australia it is largely limited to an open space contribution. Provision is limited by legislation in Queensland. It can be called up under State planning provisions, as in Western Australia where developers contribute to school land needs, regional roads and public transport reserves and more recently in NSW with the new transport levy and indirectly through the sterilisation of land under threatened species legislation.

Social infrastructure can also be required by local councils, as in NSW (and to a lesser extent in Victoria) where it is used for funding a variety of community facilities (eg libraries, child care centres, public art, open space embellishment, bushland reserves and indoor sport centres).

It is noted that a recently completed review of development contributions in Victoria has recommended a broader range of social infrastructure items to be required as part of the development approval process in that State. In Western Australia a new inquiry into the infrastructural costs of new development has recently been announced.

A more detailed description of the infrastructure provision frameworks in each State is contained at the end of this section.

6.8 Some funding alternatives

HIA considers that, for community and social infrastructure, greater emphasis should be placed on recouping costs through:

- the property rates base;
- local government borrowings; and
- private public partnerships.

6.8.1 Local rates

In HIA's view more emphasis needs to be placed on council annual rates as a source of revenue for social and community infrastructure provision, probably associated with an increased use of public sector borrowing to enable its timely provision.

Moreover, upfront infrastructure charges for new residents can potentially make those residents of new housing developments pay twice. As Access Economics reports:

> '*Double dipping' may also occur if new residents explicitly pay upfront capital contribution and then face the same access charge and recurrent costs as existing residents. (Page 22)*

So the new home owner effectively pays twice: once through the upfront charges and secondly through their general rates which have been used to provide the infrastructure for the existing residents. HIA views this situation as grossly inequitable, especially when the upfront charges are so high. The inequity is particularly marked as shortages of urban land are generating windfall capital gains for those already living in established areas.

Where there is a significant public good component in the social and community infrastructure, there is also the likelihood that where more broadly based funding mechanisms are used there will be less flow on into established house prices than might occur where there is a heavy reliance on upfront charging.

Compared with the level of services that are being provided, at least in most major metropolitan centres, HIA considers that council rates are too low. However the political odium from proposing rate increases has encouraged councils to opt for increasingly higher charges on the much narrower voting base of prospective new home owners.

Comparison of Property Rates – Typical Greenfield Site by State

	Typical Greenfield Rates $
NSW	1,200 – 1,400
VIC	700 – 1,000
Queensland	1,350 – 1,850
Western Australia	500 – 1,000
South Australia	800 – 1,300
TAS	400 – 1,000
ACT	600

Source : HIA members

There are no restrictions on the rate amount that a council can set in every State except NSW. Rate capping was introduced in 1977 in NSW at a time of high property inflation, and has remained since. NSW rate limits are generally in the order of 1-3 percent annually, although capping doesn't apply to garbage services which are separately itemised on rate bills and full cost recovered.

In Victoria, rate increases are typically between 4-6 percent per annum, however when combined with the revaluation of properties which now occurs every two years, the rate increase appears to be much higher to many home owners. There are also municipal charges and additional garbage charges that can apply.

In Western Australia, a council may set a minimum local rate, but it must not apply to more than 50 percent of the municipality.

Most councils are able to set special rates for specific services (new work, special garbage collection, environmental management levies etc) but are restricted in how such monies are spent and for how long a special rate may apply. There seems to be a general reluctance, however, for councils to apply special rates. In recent times in Queensland, local government has introduced hypothecated rates for special infrastructure items or catchment based levies related to specific land uses, eg tourism levies, beach replenishment levies and rural fire levies. HIA considers that the principles behind hypothecated rates could be extended readily to community and social infrastructure provision in lieu of the current reliance on upfront development contributions paid by new home buyers.

Another alternative to funding social and community infrastructure would be to increase the level of property rates across the community of ratepayers. The table below shows that a 10 percent increase in the average property rate (about $150 increase a year) would yield sufficient revenue to replace the current level of development contributions for social infrastructure. The substitution in funding for social infrastructure would achieve a much more efficient and equitable outcome.

Property Rates and Development Contributions

	Average Rates per Household*	Rates Revenue per annum** (m)	Development Contributions 2002/03 (m)	Development Contributions as a Proportion of Property Rates**
Sydney	$1,565	$2,600	$212	82.%
Melbourne	$1,519	$2,500	$134	5.4%
Brisbane	$1,451	$1,200	$115	9.6%

Notes: * 2001/02
** Includes residential and commercial property but excludes rural rates
Source: NSW, Victoria and Queensland State and local government statistics

It is apparent that local government reliance on alternative funding mechanisms (eg financial assistance grants, borrowings and special levies) has been reduced over time. Given increased responsibilities at the local level, deteriorating infrastructure and increasing environmental standards and the absence of funding alternatives, there is little wonder that there is a greater dependency on local development charges.

To shift this trend will require strong leadership, especially from State governments and their treasuries to identify and promote more efficient and equitable funding mechanisms for the social and community infrastructure that supports our cities.

6.8.2 Borrowings

Access Economics suggests that upfront payments are inappropriate for much infrastructure:

> *...for long lived capital assets, it makes sense to smooth the impact of upfront capital costs by borrowing funds and repaying the upfront capital and interest costs over time. This better reflects the extent to which the benefits from such investment are enjoyed over time. We support this principle in relation to infrastructure that bestows a broader public benefit, which may be enjoyed by both new and existing residents. (page 34)*

Moreover:

> *Economic theory and intergenerational equity considerations lend more support to the financing of public infrastructure through a temporary increase in public debt.*
> - *There is a sound economic case for applying the benefit taxation principle to infrastructure financing where it is not feasible or desirable to exclude potential recipients from the benefits of the infrastructure.*

- *In such circumstances, borrowing should be conducted by the relevant State or local government authority to fund the upfront investment, and in subsequent years, tax or ratepayers would face annual ongoing taxation liabilities consistent with the benefits or the amount of consumption of that asset that they enjoyed*. (page 32)

The Access Economics Report acknowledges that across the board there is public sector 'debt aversion', but suggests that the levels of sophistication within financial markets is such that, armed with adequate information, the markets would not punish governments engaging in prudent investment in long term infrastructure

> *They (governments) can assist in reducing the transaction costs of obtaining a quality information set upon which credit assessments can be made by ensuring that their accounts are as transparent as possible, and that any infrastructure investment and associated borrowing plans are fully explained, both in terms of their impact over time on tax or rate payers, and clearly articulating the rationale and need for the infrastructure in the first place. (page 29)*

The borrowing for social infrastructure would fund the upfront investment and repayments would be made by ratepayers or taxpayers in line with the benefits or amount of consumption of the services obtained from the social infrastructure. Reliance on general rates would provide a predictable and stable annual obligation on ratepayers, but would not necessarily capture the value of the benefits consumed by individuals over time. But in practice, general rate revenue could be used by local government to recoup the initial investment and the interest charges associated with the borrowing.

Past indiscretions have caused governments to eschew borrowing and to make a virtue of reducing public debt. However, financial markets should be able to distinguish between productive infrastructure investment and 'monuments', particularly where councils establish a clear link between borrowing for infrastructure and increases in general rates or user charges.

6.8.3 Private Public Partnerships

Private public partnerships provide a potential alternative source of funding for infrastructure for debt averse State and local governments. These partnerships deliver governments the same advantage as borrowing in that the cost of providing long lived infrastructure can be spread more equitably over a longer period of time.

The Access Economics Report suggests that with the increasing sophistication of financial markets there is ample capacity to extend private public partnerships beyond the typically large infrastructure projects into smaller scale projects. The Report suggests that infrastructure projects are best suited to private public partnerships where:

- *Private involvement offers potential gains in efficiency and/or from better allocation of risks and incentives;*

- *Clear and explicit contracts can be specified for all key aspects of performance and the outcomes readily and inexpensively monitored;*
- *Private sector operators have a track record in delivering comparable services; and*
- *Competition among potential private providers can maximise the share of benefits able to be captured by the taxpayer. (page 31)*

However, the Report also acknowledges that there are risks associated with partnerships that do not apply to direct borrowing by governments, for example if the business venture fails or if demand for the infrastructure does not meet the profitability targets of the private sector partner.

6.9 Independent pricing authorities

With a wide range of monopoly arrangements in place for urban infrastructure delivery, there has been the emergence of a number of independent pricing authorities across various State government jurisdictions.

These seem to work quite effectively where they exist, although there are no apparent price impacts in the two States that are yet to incorporate such entities (South Australia and Western Australia).

Industry is generally satisfied that these authorities operate effectively but considers that there is significant fat in the spending schedules upon which developer charges and unit prices are determined. Moreover the system will only work to the extent that industry is prepared to challenge the taxes and charges imposed. As the taxing body is frequently the same body from which a development approval is required, there is an in-built bias against mounting appeals of charging decisions.

Most pricing regimes for monopoly providers include a component of public service delivery eg guarantees for non-stop, maintenance–free supply, water quality, green power etc. These maintenance/quality guarantees are also reflected in the construction standards that are set for direct infrastructure provision and apply pressure to upfront costs as well as access and user charges.

In some States councils are also specifying increasing service provision standards eg underground provisioning, master telecommunication facilities, mandatory gas provision etc. This is often at conflict with the intentions of service providers and developers.

6.10 Key findings and recommendations

Key findings and recommendations on infrastructure supply, charging and funding include:

- Upfront development charges for social and community infrastructure have eroded housing affordability, particularly in NSW.

- Upfront development charges result in significant 'double dipping' by councils. New home buyers are paying twice for the same infrastructure: through the up front charges and through property rates.
- There is an alarming absence of any legislated requirement to consider housing affordability in State based planning systems or in the operational objectives of infrastructure agencies. Accordingly, there has been an unchecked trend toward increased upfront development charges for the provision of both social and community infrastructure in new housing projects. It is considered both necessary and appropriate to pursue housing affordability as an object of all State planning legislations**.**
- The weakness of development contribution systems as a means of funding local physical and social infrastructure is well documented. Despite this, there is an increasing dependency by local governments to use development charges to fund all types of infrastructure.
- Legislation should prescribe the principles for the setting of development contributions covering transparency, consistency, accountability, minimum and maximum standards for infrastructure and funding arrangements. The legislation should preclude State and local governments from negotiating higher development charges outside of the legislated principles.
- Queensland's managed approach is particularly useful in establishing those elements of social and community physical infrastructure that may be required as part of the development process. The Queensland approach may be directly transferable to other States. The South Australia approach to infrastructure funding also clearly distinguishes between development and State/community responsibilities.
- State and local governments should be encouraged to consider funding alternatives for the provision of community infrastructure, such as extending the rate base and recourse to public sector borrowings.
- In order to assist government borrowing programs for infrastructure projects, State governments must prepare both long and short term Infrastructure Plans, similar in scope and intent to local contribution plans. Such plans must be sufficiently transparent to address the requirements for credit assessment purposes.

7 Constraints on the Supply of Residential Land

7.1 Introduction and overview

The analysis of land supplies, housing need and planning constraints undertaken in this chapter has revealed that all of our major cities face land supply shortages. These shortages are more critical in Sydney, particularly in the immediate term, but significant elsewhere in terms of their potential to impact on housing affordability.

Other cities are better placed, however, to learn from Sydney's mistakes. Despite recent efforts to refocus government attention on lot production, new homebuyers in Sydney will suffer for some time from the fact that lot production was allowed to run so low for the last 5 years (and, as a consequence, will take another 3 years to address). The cumbersome manner of land release, rezoning and approval processes in NSW necessitates urgent government attention and remedial action to address Sydney's chronic land shortages.

Government planners responsible for managing the supply of residential land have been influenced by a myriad of studies that have examined the 'cost' of fringe development compared with development in the established parts of cities. For example the 1991 National Housing Strategy assumed that substantial subsidies were involved in fringe development. More recent reviews have pointed to the inevitability of outward growth to accommodate a substantial portion of expected population increases – at least one quarter of long term housing demand in our fastest growing cities. HIA subscribes to the view expressed by the Industry Commission's report of 1993[22] "*it is about what people want from their cities, and ensuring that decisions about where and how they live reflect the wider costs and benefits.*"

A range of problems associated with the 'management' of land supply as well as suggested mechanisms to address these, based largely on discussions with HIA's member builders and developers, are presented in the chapter.

7.2 Government management of land supply

Managing the supply of land for urban development has been made unduly complex process involving multiple agencies at the State/Territory and local government levels.

The various State/Territory approaches to the management of land supply are often expressed through their respective principal city strategies. These strategies raise concerns about the need to better manage 'urban sprawl', primarily from the viewpoint of achieving orderly and economic development and sustainable outcomes. The policy response has been to limit the supply of fringe residential land, but there has been no offsetting policies put in place to free up the supply of infill land.

[22] *Taxation and Financial Policy Impacts on Urban Settlement*, Industry Commission, 1993.

To address concerns about urban sprawl, an 'urban growth boundary' has been adopted in Adelaide and Melbourne, whilst the State government's strategy for Sydney promotes a 'compact city' without setting an official growth limit. The limitation of outward expansion in Sydney, however, has been achieved through restrictions on the amount of land released and/or allowed to be produced through the Metropolitan Development Program.

Perth and Brisbane do not have such policies. Perth's Metroplan strategy, currently being reviewed by the Greater Perth Project (to 2031), broadly directs Perth's future growth along a series of corridors, with activity favouring the two coastal stretches. Broadacre land that has the potential to be utilised for urban purposes has been identified and zoned as 'urban' or 'urban deferred' under the Metropolitan Region Scheme (and the associated Peel and Bunbury Region Schemes). Perth's Metroplan and the Region Schemes influence the extent, direction and nature of urban growth but do not specifically determine the rate of lot production.

Land supply in Queensland is managed at the regional and local planning levels. The State development infrastructure charging regime has identified 10 years as an adequate timeframe for designing infrastructure provision, so this has become a de facto planning horizon. SEQ2021 has considered growth boundaries but talks more of accommodating expected population increases through settlement strategies rather than through artificial constraints.

Land supplies in the ACT are governed through the government's land release program, which until recently allowed private companies to bid for parcels. Land subdivisions are now undertaken primarily by government.

There are no specific land supply strategies that operate in Tasmania.

7.3 Land stocks and housing affordability

The key issue is one of ensuring that there are adequate supplies of zoned land being released to the market that have the potential to be readily serviced. In most cities, with the exception of Sydney, there are adequate supplies of zoned land to meet the immediate and medium term demand for new housing (a summary of the availability of zoned land by capital city is presented in Appendix 2). But, it is the inability of the State and local government planning and infrastructure systems to deliver serviceable land that represents the greatest long term threat to housing affordability.

To have sufficient land in the development pipeline that is appropriately zoned is purely academic if there is no commitment to the timely provision of the infrastructure necessary to bring that land on to the market.

7.4 The impact of land supply on housing affordability

In the face of rampant increases in land prices most markets have shifted towards smaller block sizes for detached housing and increased housing densities where opportunity allows. Still, the share of land in new house prices has increased relentlessly.

It is the shortages of land supply and the rapid growth in development charges that have been behind the rapid increases in urban land prices in recent years, rather than increasing costs of development works.

In Sydney, land has doubled its share of the average new house price over the past 25 years and now absorbs approximately 60 percent of the home purchaser's dollar. At the city's fringe average vacant lot prices have doubled in price since 1996.

> *"You now pay twice as much for a block of land two thirds of the size, when compared with the situation 10 years ago." – Sydney developer*

Even since mid-2002 the cost of raw land has risen dramatically again – as much as two-fold increases have been reported in the past year for broad acre prices in Sydney.

Although land prices have increased markedly, the cost of building a new house has increased modestly. Over the past 12 months, the cost of a project house in Sydney (excluding the land component) has risen by 5.7 percent[23].

The impact of land costs on housing affordability, however, is not confined to Sydney. In Brisbane and Perth more than 40 percent of the new house price is accounted for by the land component. A recent Adelaide market report[24] shows that vacant land prices in the Adelaide Statistical Division have increased by 60 percent in the past 5 years. The report contends that:

> "*Since the urban fringe has traditionally provided the lowest cost house and land packages, any reduction in the availability of fringe land will increase the pressure on the most vulnerable sector of the private housing purchase market. Either the fringe market must remain well supplied or alternative forms of affordable infill housing, such as higher density smaller footprint flats and residences, must be capable of being developed. Ideally, both options should be pursued ...."*

and concludes that:

> *"The maintaining of a constant and readily accessible supply of land for residential development purposes is the most successful means by which affordability can be maintained."*

It has been commented by some that land shortages serve only to line the pockets of big developers and that industry's concern with a lack of supply is superficial. Brendan

[23] ABS Project House Price Index.

[24] *A Matter of Growth: Population, Land Supply & Policy Directions for Metropolitan Adelaide*, UDIA report, July 2003.

Crotty, Managing Director of Australand (a public company) is quick to challenge any claims of land being held back off the market:

> *"We are a public company answerable to our shareholders. We cannot afford to speculate on land purchases that might deliver development opportunity in 10-20 year's time. We must convert purchases to sales as quickly as possible to maximize returns. Unfortunately government's planning approval systems don't allow this to happen. If you don't believe me, come and have a look at our books!"*

The impact of land prices on new housing costs was presented earlier in the submission but is worth repeating here. Pressures on the availability of services land have been a major influence on the recent deterioration in housing affordability.

Share of Land in New House Prices

	1976-77 (a)		1992 (b)		2002 (b)	
	New House Price $	Land %	New House Price $	Land %	New House Price $	Land %
Sydney	$49,010	32%	$189,800	44%	$338,150	60%
Melbourne	$63,200	24%	$169,000	24%	$276,200	37%
Brisbane	$46,280	21%	$164,690	39%	$234,300	49%
Adelaide	$53,970	16%	$125,970	26%	$177,430	32%
Perth	$57,640	22%	$115,730	32%	$163,340	42%

Sources: (a) Report of the Committee of Inquiry into Housing Costs, 1978
(b) Sample of Builders and Developers

State governments increasingly are seeking to rely on land supplies from within established areas to meet the demand for residential land. The importance of proposed in-fill housing in meeting anticipated dwelling requirements and land supply in capital cities is indicated in the table below and based upon State planning strategies.

Infill Housing Need – Capital Cities

City	Year	Projected infill share of development %	Projected share for detached housing %	Current multi-unit/ detached housing mix %
Sydney	By 2008	69	31	64/36
Melbourne	By 2030	69	31	35/65
Perth (metropolitan)	By 2031	24	76	16/84
Brisbane	By 2016	40	60	36/64
Adelaide	By 2023	91	9	24/76

Sources: ABS and State planning reports

In Melbourne and Adelaide the planned reliance on in-fill housing is vastly in excess of current outcomes. There is no evidence of either State or local governments introducing policies to promote the supply of in-fill land. In the absence of these policies, these cities are destined to repeat the mistakes of the Sydney region, with similarly bad affordability outcomes.

7.5 How should land supply be delivered?

New approaches to the supply and pricing of residential infrastructure are an essential element of a strategy to improve housing affordability. However, these moves can be supported and enhanced through action to make the planning system more responsive to the shifting composition of housing demand.

In its recent paper for the Western Australian Planning Commission, SGS Economics and Planning[25] considered the most appropriate urban form for metropolitan Perth. SGS's proposals for the financing of urban settlement are summarised below:

- there must be recognition that a substantial proportion of a city's growth will be accommodated in new release areas;
- infrastructure cost savings can be achieved by lifting net residential densities in fringe locations to 15 dwellings per hectare. This more compact form of suburban development can be readily achieved through a greater mix of dwelling types rather than a uniform reduction in lot sizes, thereby not compromising traditional suburban lifestyle values;
- significant savings can be made by managing or sequencing the release of new urban land to optimise capacity in infrastructure, especially social infrastructure;
- savings might be available by accommodating households in established areas rather than on the fringes of cities. However, much depends on the capacity of existing infrastructure which can vary between locations;
- a large proportion of suggested savings can arise from the extension or augmentation of 'physical' infrastructure – water, sewer, drainage, roads, power and telecommunications. Wherever this infrastructure is provided on a user pays basis, there is little policy reason to be concerned with where development occurs – ie provided the pricing regimes for these services are appropriate, household preferences should determine location;
- pre-emptive or precautionary curtailment of outward growth is not the best way to manage the issue of hard infrastructure costs.

Combined with the initiatives outlined in the section on planning reform and infrastructure, acceptance of these conclusions by planners in managing residential land supplies could make a major contribution to restoring housing affordability. Planners need to make a paradigm shift from believing that urban fringe development is *prima facie* a bad thing, to considering it as something that is manageable and preferred by many households.

7.6 Key findings and recommendations

Key findings and recommendations on constraints on the supply of residential land include:

- State government forecasts of population projections have underestimated the rate of population growth in our major cities. Better monitoring of land and housing production is required, coupled with greater flexibility in the way that governments

[25] *Costs of Urban Form*, Discussion Paper, SGS Economics and Planning, May 2003 (prepared for Western Australia Planning Commission).

respond to changed circumstances. The need for better coordination between the Commonwealth and State governments in terms of population forecasting and related planning issues is paramount to more efficient and equitable land management. Governments should consider the reestablishment of the Indicative Planning Council (IPC), (disbanded in the mid-1990s) to advise governments on prospects in housing and urban development and the ability of the industry to meet housing demand. It is noted that the relevant State government planning ministers have recently called for a national cities summit to address the planning of State capitals. This could be coordinated through the Council of Australian Governments (COAG) and should involve local government, planning and treasury ministers.

- The continued growth of major cities is inevitable. There will continue to be strong demand for new housing, particularly from young families, in the outer regions. State governments must adopt a more progressive view to the management of urban growth, based on realistic population forecasts.
- Governments must identify and promote opportunities for the conversion of land to its highest value use, both at the city fringe and in established areas. Government land management programs must focus on 'how to make it happen' rather than on monitoring the often slow progress toward targeted housing supplies. There is a need for greater metropolitan or regional responsibility in terms of meeting projected housing needs. It is not sufficient for individual councils to opt out of their responsibilities in meeting regional housing needs. Regional strategies, planning and monitoring are required for both greenfield and infill opportunities.
- The efficiency and responsiveness of land release programs and rezoning processes must be improved. Current processes for land release are cumbersome, uncoordinated and therefore ineffective in meeting underlying demand requirements. There are many constraints to the release of land and too many actual and pseudo 'planning authorities' to deal with. Final decisions about land releases and housing supplies must rest with a single agency. Planning reform of individual State/Territory systems should be coordinated to ensure that State reforms are consistent.
- The short term supply of land in Sydney is at chronic levels. Vacant lot stocks are at crisis point. The NSW Government's proposal to ramp up lot production to 10,000 lots per year within 3 years is 3 years too late. Urgent action is required to alleviate today's pressures and those that will be experienced over the next 3 years. The NSW Government must identify specific release areas for immediate lot production. It is also necessary for government to urgently identify sites in its own ownership or control that can be brought on line promptly. Such sites should not be limited to greenfield locations.
- Greater public awareness of housing need should be promoted by governments to help to counter community resentment toward infill housing.
- A single coordinating land supply agency is necessary in order that the many competing interests associated with land and housing development can be properly managed and coordinated. Issues of infrastructure allocations, environmental management and heritage and natural conservation are not easily accommodated in the process of determining urban capabilities, particularly when there is a multitude of government agencies that have a say in the process. Western Australia's 'Bush Forever', Melbourne's 'kangaroo grass' and Sydney's Cumberland Plain Woodland

management policies are all examples of single issues that allow little compromise in the shaping of urban form. Greater coordination of these issues under a single State authority would assist in balancing a city's need for housing and environmental conservation.

- Appeal mechanisms for development determinations are costly and risky. As a matter of principle, development consent conditions that require monetary contributions (or works-in-kind) should be separately appealable to a higher authority without jeopardising the whole development consent.

8 Albury Wodonga – A Regional Case Study

8.1 Background

Albury Wodonga on the NSW/Victorian border is currently experiencing an under supply of land for residential development.

The growth of commercial development locally has cemented an exciting future for the region. The associated need for quality and affordable land for new housing is vital. Failure to meet this need will not only result in forcing potential home owners and investors to look elsewhere, but also could influence businesses that may be considering relocation to the Albury Wodonga region.

The purpose of including this case study is to highlight the issues around land supply and how land supply affects affordability in regional Australia as well as capital cities.

8.2 Land supply – Albury Wodonga Development Corporation

The Albury Wodonga Development Corporation (AWDC) was created in 1974 to develop Albury Wodonga as Australia's national growth centre. The Corporation, through its own resources and enterprise, has teamed with Federal, State and local governments to grow the two cities on the NSW/Victorian border[26].

Historically the AWDC has been responsible for developing approximately 30 percent of land in Albury Wodonga region. Their development now exceeds 80 percent of land coming on to the market[27]. HIA questions the efficiency of government bodies being established with such a marked degree of dominance in any land development market.

8.3 Affordability issues

8.3.1 Proposed land releases

The AWDC continues to be the major land holder in the region and as such offers only staged releases of land parcels. In a market experiencing chronic land shortage, this leads to the perception the AWDC is drip feeding the market. HIA does not believe the AWDC is deliberately withholding or delaying the development and sale of land in Albury Wodonga, but anecdotal evidence suggests many members of the local community would appear to think otherwise.

The AWDC is also rapidly approaching its statutory wind-up date. It is the view of HIA they should remain focused solely on disposal of current land holdings without consideration for the purchasing of any further land.

[26] Information provided from the AWDC web site.

[27] AWDC Proposed Land Releases received by correspondence from Mr Brian Scantlebury, Chief Executive Officer, AWDC. Mr Scantlebury's correspondence was a response to HIA's letter of 15 April 2003.

Any new land acquisitions made by the AWDC would only delay the inevitable move to a more efficient fully private land development market by giving other developers further cause to withhold or delay developments.

Anecdotal evidence from builders and developers suggests there are many developers who wish to enter the Albury Wodonga residential development market now but are restricted through the lack of land available on the market.

8.3.2 Projected land requirements

Figures provided by the City of Wodonga demonstrate the industry concerns that projected development is unlikely to meet the projected demand for the region. It is projected that 1,000 new jobs will be created in the region per annum.

Projected demand scenarios for the three-year period 2003/06, based on anticipated new jobs growth are:

- low scenario 1,200 lots
- medium scenario 1,400 lots
- high scenario 1,800 lots

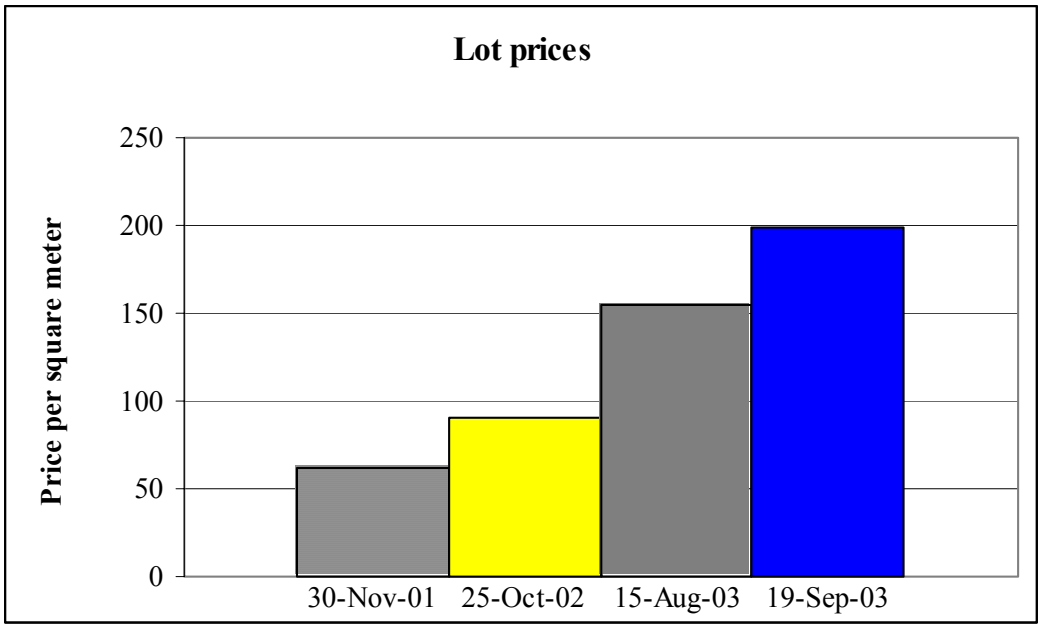
Yet total projected development for this period is 1,118 lots. The shortfalls against these scenarios are:

- low scenario 6.26%
- medium scenario 25.22%
- high scenario 61.00%

The figures also indicated that Albury's land requirements would be similar if not marginally lower than Wodonga's.

8.3.3 Price increases

The strong price increases in land seem driven by the shortages. The figures on the average lot price per square metre reflect sales of at least 20 lots of land and exhibit a startling rate of increase (see figure below).



Land has already increased from $61.85 per M^2 in November, 2001 to $199.14 per M^2 September, 2003. This staggering increase of 222 percent (or 10 percent per month) is purely a result of supply not meeting demand. Some may argue Albury Wodonga is merely following the lead of our capital cities. However, in this case Albury Wodonga has the ability to control its own destiny through its abundance of developable land and should not allow external influences to dictate its future growth[28].

8.3.4 Yield

Lower than average yields of allotments are causing fewer lots to be produced and offered to this land starved market.

In Albury Wodonga the yield can be as low as 8 lots per hectare. This is considered to be too low when the development industry believes 8-12 is a more realistic yield for residential land in the region.

AWDC's proposed land releases reveal that in 2004/2005, 83.7 hectares of land will be released and in 2005/2006 82.6 hectares will be released. Even allowing a conservative 9 lots per hectare, 1,496 lots would be created. If the land was available immediately, and sold by December 2003, allowing an 18 month time frame for development, these lots would not be available on the market until June 2005[29]

[28] Auction results were recorded by HIA staff at respective auctions over time.

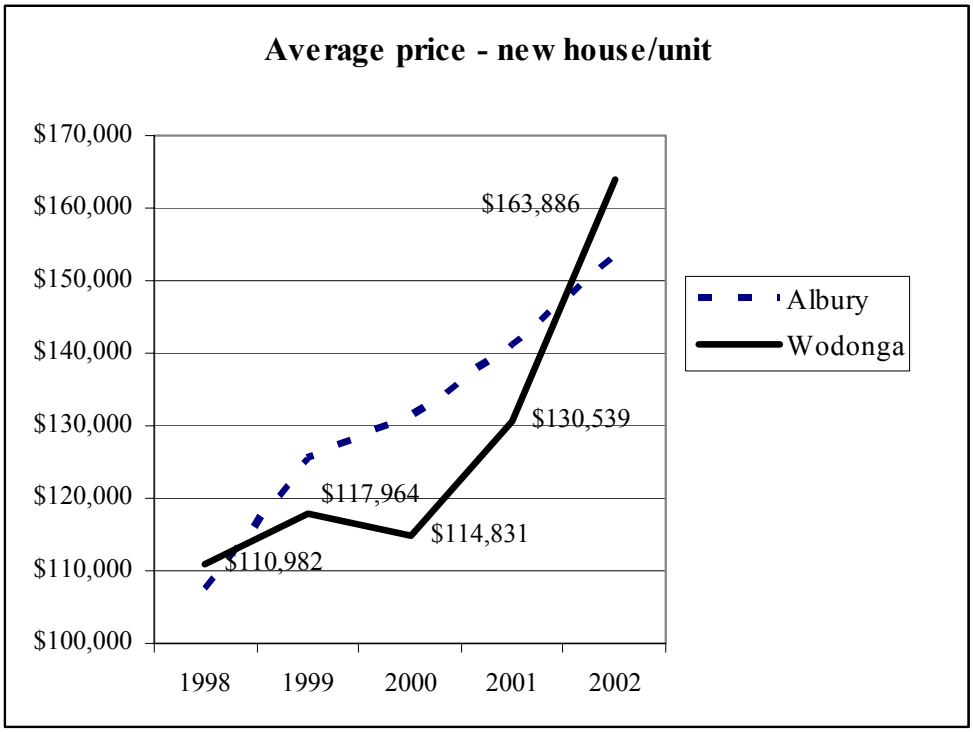
[29] AWDC Proposed Land Releases received by correspondence from Mr Brian Scantlebury, Chief Executive Officer, AWDC. Mr Scantlebury's correspondence was a response to HIA's letter of 15 April 2003.

A land supply shortage for the next 18 months therefore seems unavoidable.

8.3.5 The AWDC auction process

Due to the heated market environment that now exists in Albury Wodonga, consumers are finding at auction time they are competing against builders and developers for new release allotments.

The rapid increase in land prices not only affects the new housing market but also effects the price of the existing market. The value of existing residences is directly proportional to the cost of building a new home. Current over-inflated land prices have led to the over-valuation of existing homes making it increasingly difficult for first home buyers to purchase an affordable residence in Albury Wodonga. It will undoubtedly result in long term economic loss to the twin cities.



8.4 Points illustrated by this case study

The case study of Albury Wodonga illustrates some important issues:

- the need for strategic growth and planning in order to secure affordable housing and orderly growth trajectories for urban centres;
- the risks associated with governments acting as a land developer, rather than leaving this role to a contestable market;
- how quickly that land supply constraints can flow through to the increased cost of new housing.

9 Taxation of Housing

9.1 Introduction

Housing is exposed to a plethora of taxes, levies and charges by all levels of government, which has undermined housing affordability. For new housing there are more than 20 different taxes and charges. Although there is a widespread belief that housing is 'lightly taxed' the effective indirect tax burden on new housing is in the vicinity of 30 percent of the overall purchase price.

The interplay of Federal, State and local taxes on new housing compounds the negative impact on housing affordability through double dipping and the cascading of indirect taxes. In many cases, the indirect taxes are embedded in the price of the dwelling and thereby escape consumer scrutiny.

9.2 How is housing taxed?

The table below summarises the multitude of taxes and charges that apply to the delivery of a typical home, whether it is a new home in a greenfield development or an apartment in an inner city location.

Fees, Taxes and Charges on New Residential Development

Land Development	Building
Developer Infrastructure Contributions ▪ Major Roads ▪ Drainage ▪ Public Open Space ▪ Sewer and Water Headworks ▪ Recycled Water ▪ Community Facilities ▪ Roads and Transport Levy ▪ Stormwater Retention ▪ Land Restoration Clearance Fees ▪ Water Corporation ▪ Council ▪ Land Titles Office ▪ Electricity ▪ Development Assessment Commissioner GST on Development Costs Stamp duty on sale of the land Land tax on land holdings	Council Fees and Charges ▪ Building Permit Levy ▪ Training Levy ▪ Kerb Deposit ▪ Water Corporation ▪ Development Application Fees GST State Taxes and charges ▪ Stamp duty on the sale of a house ▪ Training levy ▪ Long Service Leave Levy ▪ Compulsory Home Warranty Insurance ▪ Infrastructure levies

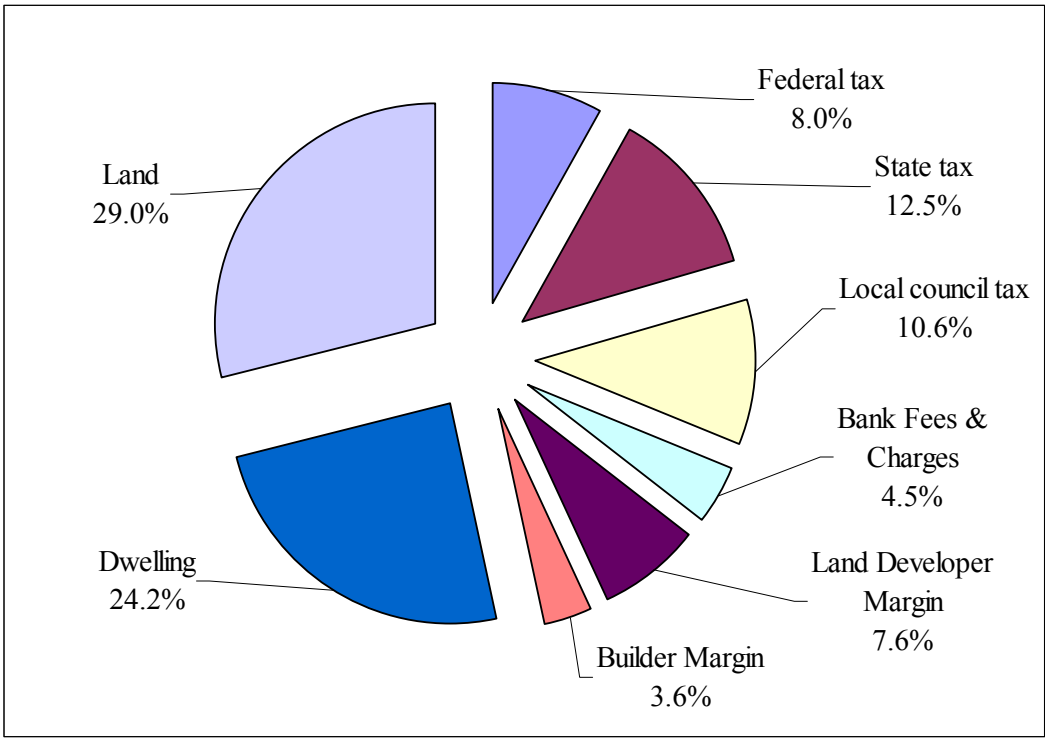
In addition to these taxes, developers and builders also pay company or income tax on their earnings and payroll taxes on their employees, and in some circumstances independent trade contractors.

Because individual taxes intersect at different stages of new residential development, the real tax burden is largely hidden from end purchasers. The chart below shows the

various components of a typical new house and land package in a large Sydney greenfield development. In this case study, indirect taxes and charges levied by Federal, State and local government amounted to $196,000 of the final sale price of $635,000 representing an effective indirect tax rate of 31 percent of the total house purchase price, which is much more than the cost attributable to the building of the house (24 percent).

The lack of visibility of most development taxes serves to dilute community opposition to them: imagine the community reaction to a proposal to introduce a 30 percent rate of GST on the purchase of new homes. Yet that is the effective rate of indirect taxation on a new house and land package in many localities.

The Great Tax Grab in Action on a Sydney Greenfield Development



Source: Sample of builders and developers

9.3 How the taxes have grown

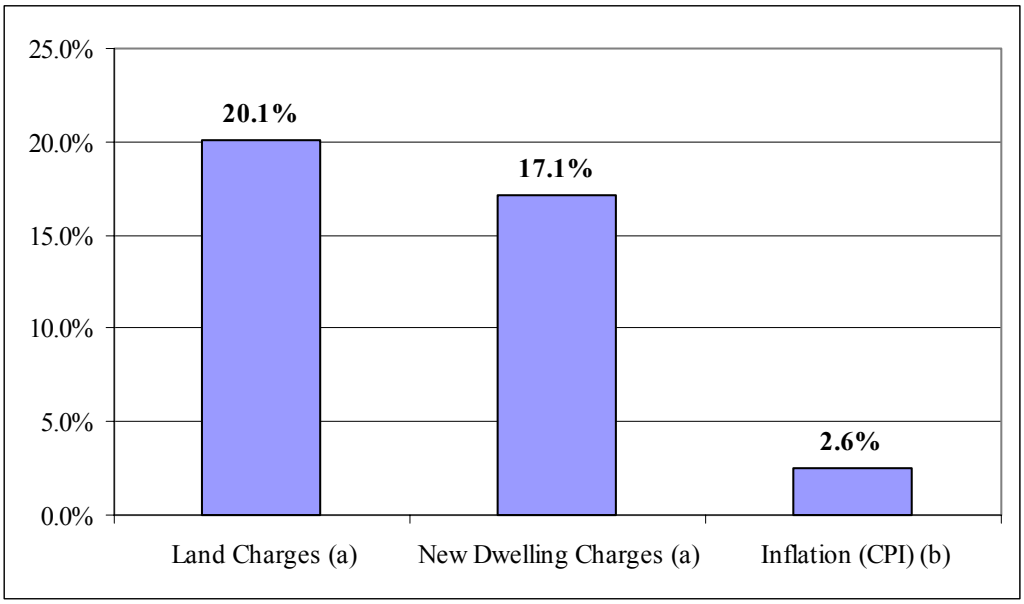
Indirect taxes on new land and housing have increased much faster than general inflation over the past decade. By way of example, whereas the consumer price index has increased by 25 percent in the past ten years, taxes on new housing and land development have increased by more than 300 percent.

Despite large increases in new house prices, there is no evidence of profiteering by builders with the typical profit margin on home building at less than 4 percent, reflecting highly competitive conditions between suppliers of new housing. While profit margins for developers tend to be higher this is understandable because of the additional capital commitments required as well as uncertainty and risk attaching to land development, which usually has long lead times. From a policy perspective, a

competitive housing market means that measures to reduce housing costs can be expected to be passed onto new home buyers in lower purchase prices.

When looking at housing affordability and in particular the level of existing house prices, it should be borne in mind that a substantial part of the increase in the 'real' price of existing real estate reflects the impact of additional indirect taxes on new housing being capitalised over time into the price of established housing.

A decade of Rampant Indirect Tax Increases: 1993 – 2003
Average Annual Rate of Increase in Indirect Taxes on New Housing



Source: (a) Sample of Builders and Developers
(b) ABS Cat No: 6401

9.4 Effect of the GST on affordability

The replacement of wholesale sales taxes with a 10 percent GST had a major impact on the total indirect tax take from the housing industry when it was introduced in July 2000. The GST lifted indirect tax receipts from new housing and renovations by more than $3.6 billion in the first year and in excess of $5 billion in the past financial year.

Indirect Taxes Collected by the Commonwealth Government on New Housing and Renovations

Year	$ Million
1998/99	140 [a]
1999/00	170 [a]
2000/01	3,830 [b]
2001/02	4,599 [b]
2002/03	5,396 [c]
2003/04	5,133 [c]

Sources: [a] HIA estimates of wholesales sales tax based on actual industry activity levels
[b] HIA estimates of GST revenues based on actual industry activity levels
[c] HIA estimates of GST revenues based on HIA's forecasts of industry activity levels

The GST will provide the States with a growth tax. The 2002/03 Federal Budget revised upwards the previous forecast of GST revenues by an additional $1.49 billion dollars for the period 2002/03 to 2004/05. In 2001/02 the Federal Government estimated that it would need to commit $1.741 million to budget balancing payments to the States for the 2002/03 year. Because of the strong growth in GST revenues, the actual expenditure by the Federal Government was $1,004 million, representing a saving of $737 million.

The housing industry has contributed about half of the expected growth in GST payments and has therefore been a major contributor to the reductions in the GST budget balancing payments that the Federal Government has had to make to the States. Put another way, the so-called GST windfall has benefited the Federal budget not State budgets. There is therefore a good case for the Federal Government to apply some of its effective GST windfall to addressing housing affordability issues, for example, through eliminating the effect of GST raisings on community and social infrastructure paid by new home buyers.

Unlike development taxes and charges, the GST was subject to extensive debate and arguably was voted upon by the Australian public in the 1998 election campaign, and is transparent to the end consumer.

HIA estimates that the net effect of the introduction of the GST was to increase the cost of a building a new home by 8 percent. This effect was offset to an extent for first home buyers through the First Home Owners Grant. The GST's effect on the price of developed land is more complex due to the availability of the 'margin scheme' which essentially removes GST from the unimproved value of residential land.

Further GST 'concessions' are meant to be available on some components of the typical house and land package through the operation of Division 81 of the GST Act. Under Division 81 of the GST Act, the payment of a tax, fee or charge levied under an Australian law is consideration for a supply and subject to GST unless it is listed in the Treasurer's *A New Tax System (Goods and Services Tax)(Exempt Taxes, Fees and Charges) Determination 2000 (No.2)* or any subsequent determinations ("he Treasurer's Determination"). The payment of a tax, fee or charge listed in the Treasurer's Determination is <u>not</u> treated as consideration for a supply and no GST will be charged.

Some examples of the items in the Treasurer's Determination upon which GST is meant to be exempt are:

- Building Construction and Complying Development Certificates;
- Building Compliance Certificate;
- Building Certificate;
- Development Application Fees;
- Application to Amend a Development Control Plan;
- Construction Zone Fees;
- Planning Certificates;
- developer charges in relation to water sewerage and drainage;
- subdivision fees;

- town planning fees.

In practice, these exemptions do not reduce the GST paid by a new home buyer where a builder or developer is undertaking the development or building work. If a householder applies for a building certificate as an 'owner builder' GST will not be charged on the certificate fee. Were the application made by the builder, the fee would be included in the price of the building contract upon which GST would be charged to the home owner.

Take the example of a land developer who pays a local council $10,000 in fees or charges of a type listed under the Treasurer's Determination. No GST would be payable to the council and the developer would add $10,000 to the cost of land development. When the land was sold to a builder (or home owner) as a building block, the $10,000 would naturally be included in the price, to which $1,000 GST would be added by the developer and paid to the ATO, to make a total price of $11,000. This result applies irrespective of whether the Margin Scheme or normal GST rules are used.

If the Margin Scheme were used the purchaser of the developed land could not claim any Input Tax Credits, so the $1,000 of GST on the development charges would become part of the builder's cost base. If the transaction was under the normal GST rules and $1,000 of input tax credits were claimed, the $10,000 charge would still become part of the builder's cost base on which the $1,000 GST would be charged to the consumer. Thus the initial GST tax exemption would be of no benefit to the consumer, and the Australian Tax Office would collect 10 percent GST on the cost of the so called GST exempt supply.

9.4.1 Recommendation

This GST exemption on a range of State and local government taxes applying to residential development could be given the intended effect if a notional or imputed input tax credit was available on those items covered by a Treasurer's Determination, even though no GST had actually been paid (and even though the margin scheme may have been used). In the example above, the developer would deduct the ITC from their costs which would be reduced to $9,090.91 upon which GST would be added on resale, making a total price to the builder (or home owner) of $10,000. The adoption of imputed input tax credits would give effect to the principle behind Division 81 that GST should not be levied on local and State government taxes.

9.5 State and local government charges

Chapter 6 on Infrastructure Supply, Charging and Funding described in some detail the iniquitous growth in taxes and charges levied by State and local governments in the name of infrastructure provision.

Not only are new home buyers shouldering a disproportionate share of the cost of social infrastructure through development charges, they are also paying inappropriately GST on those development charges and stamp duty on those charges and the GST.

Payroll tax has been extended inappropriately to building contractors in some States. Payroll tax is charged on the money paid as wages to employees of developers and home builders, subject to certain minimum thresholds.

9.5.1 Payroll tax rates and thresholds (current at 30 June 2003)

Payroll tax is payable at the following rates, when payroll exceeds the following amounts:

State	Rate percent	Threshold $	Flat or Tapered?
Queensland	4.75	850,000	Flat
NSW	6.00	600,000	Flat
Victoria	5.35	550,000	Flat
Tasmania	6.60 – 6.24	600,000 – 1.01m	Tapered
South Australia	5.67	504,000	Flat
Western Australia	3.65 – 6.00	675,000 – 5.625m	Tapered
Northern Territory	6.30	600,000	Flat
ACT	6.85	1.25m	Flat

There are essentially two approaches to Payroll Tax administration in Australia.

The Northern (Queensland, Northern Territory and Western Australia) Model
In essence payroll tax liability attaches to the employer of a person who is an employee at common law. Contractors will be included if they conform to the common law test for employees.

The Southern (ACT, Tasmania, South Australia, Victoria, NSW) Model
The Victorian and NSW models are basically identical and pick up common law employees. In addition, builders can be liable for payroll tax on payments to independent contractors where, for example, contractors are deemed to be providing 'employee-like services' or contract with the same builder for a period exceeding 90 days in a financial year. The application of payroll tax to genuine contractors has become subject to a myriad of technical and arbitrary criteria that expose builders to the prospect of adverse audits by payroll tax commissioners.

The South Australian, ACT and Tasmanian models are quite similar to the Victorian/NSW model, but in relation to the relevant contracts, each has slightly different exemptions.

The inclusion of payments to trade contractors for payroll tax purposes has in some cases pushed builders over the payroll tax threshold, with substantial tax consequences. Moreover, payroll tax is calculated on the whole of the contract price including plant and materials, thus extending it to a tax on the supply of goods. This is arguably an unconstitutional excise.

9.5.2 Recommendation

In addition to greater certainty in determining who is a contractor for a range of government purposes (see Recommendation 10.1.1), payroll tax should not be applied to payments made to trade contractors. But as a minimum, it must be removed from the value of plant and materials on which it is currently being levied in some instances in NSW and Victoria.

9.6 Stamp duty

HIA estimates that of the $10.8 billion in indirect taxes (not including land tax and property rates) levied on new housing in the 2002/03 year, State government stamp duty on new housing accounted for a staggering $1.3 billion.

Stamp duty on new housing is excessive, inequitable and a barrier to market entry.

For typical first home buyers buying on the basis of 95 percent borrowing on the value of the property, there is very little equity to support borrowing the cost of the stamp duty, which must be paid up front.

Assuming a first home buyer price of $195,000, a typical front-end loading for home buyers is as follows:

	$
▪ deposit @ 5 percent	9,750
▪ stamp duty	5,500
▪ legal costs	750
▪ other fees and charges (loan establishment fee)	500
▪ mortgage insurance	2,500
▪ total entry cost	19,000

In this example, stamp duty (excluding any duty previously paid by the developer/ builder which is included in the selling price) can be as much as 25 percent of the entry costs into homeownership, or around half of the deposit itself and can put homeownership out of reach notwithstanding the buyer's earning capacity to service the loan.

Recent acceleration in house and land prices has meant that existing concessions for first home buyers have become out of touch with current prices in virtually all State and Territory property markets. Very few people are eligible for deferment under the current criteria.

For all home buyers, the failure to adjust the various rate thresholds to reflect the increase in house prices has resulted in substantial windfall revenue gains to State governments and has pushed up effective stamp duty rates on average homes by up to 1.5 percentage points in some States and Territories. Stamp duty bracket creep has lifted the amount of stamp duty payable on a median priced house by more than 100 percent in the past eight years.

Finally, the method of levying stamp duty on intermediate stages of the sale of new housing is a major disadvantage to a community which is having increasing difficulty

in affording housing. At a time of near record lows in housing affordability, it is unacceptable to allow stamp duty paid on land purchased by the developer, paid again on the same land when purchased by the builder, and again on the house and land package (already inflated by GST and other charges) purchased by the home buyer.

Ballooning stamp duty charges on new housing need to be spiked. Early relief for new home buyers could be achieved by revisiting first home buyer concession thresholds, and removing the double taxation of new housing by excluding the GST and State and local government development charges paid on new housing from stamp duty.

9.6.1 Revenue

Stamp Duty Revenue from Residential Conveyances – by State and Territory* ($m)

	NSW	VIC	QLD	SA	WA	TAS	NT	ACT	Total
1998/99	1,709	1,121	567	194	399	34	30	52	4,106
1999/00	2,165	1,165	690	282	527	44	31	78	4,982
2000/01	1,993	1,156	630	266	562	50	25	75	4,755
2001/02	2,737	1,697	950	319	660	64	32	115	6,572
2002/03**	3,286	1,951	1,135	368	754	86	34	183	7,770

Notes: * Revenue from residential stamp duty estimated to be 90 percent of total stamp duty revenue (Source: ABS)
** Estimated based on ABS 8752 (Value of Residential Work Done)

The escalation in established house prices and the increase in the price of raw land across most States have led to substantial windfall gains in stamp duty revenue in all States. The table above shows that $7.7 billion worth of revenue was raised from new and established residential property transfers in 2002/03, up 18 percent on the previous year and a massive 63 percent on 2000/01.

9.6.2 Current stamp duty rates

The table below outlines the varying rates of stamp duty across each State and Territory. Stamp duty is applied on a sliding progressive scale in all States with rates commencing at 2 percent in some States for property transactions of $100,000 up to 5.6 percent for transactions over $1 million.

NSW		Vic		QLD	
Value of Property	Rate	Value of Property	Rate	Value of Property	Rate
<$14k	$1.25 per $100 or part thereof	<$20K	1.4% of the value of the property	<$20K	$1.50
$14K<$30K	$175 + $1.50 per $100 or part thereof above $14K	$20K<$115K	$280 + 2.4% of the value above $20K	$20K<$50K	$300 + $2.25 per $100 or part thereof above $20K
$30K<$80K	$415 + $1.75 per $100 or part thereof above $30K	$115K<$870K	$2,560 + 6.0% of the value above $115K	$50K<$100K	$975 + $2.75 per $100 or part thereof above $50K
$80K<$300K	$1,290 + $3.50 per $100 or part thereof above $80K	>$870K	5.5% of the value of the property	$100K<$250K	$2,350 + $3.25 per $100 or part thereof above $100K
$300K<$1M	$8,990 + $4.50 per $100 or part thereof above $300K			$250K<$500K	$7,225 + $3.50 per $100 or part thereof above $250K
>$1M	$40,490 + $5.50 per $100 or part thereof above $1M			>$500K	$15,975 + $3.75 per $100 or part thereof above $500K

SA		WA		TAS	
Value of Property	Rate	Value of Property	Rate	Value of Property	Rate
<$12K	$1.00 for every $100 or part of $100	<$80K	$2.30 per $100 or part thereof	<$1,300	$20
$12K < $30K	$120 plus $2.00 for every $100 or part of $100 over $12K	$80K < $100K	$1,840 + $3.45 per $100 or part thereof in excess of $80K	$1.3K<$10K	$1.50 per $100 or part thereof
$30K< $50K	$480 plus $3.00 for every $100 or part of $100 over $30K	$100K < $250K	$2,530 + $4.75 per $100 or part thereof in excess of $100K	$10K<$30K	$150 plus $2.00 per $100 or part thereof
$50K < $100K	$1,080 plus $3.50 for every $100 or part of $100 over $50K	$250K <$500K	$9,655 + $5.90 per $100 or part thereof in excess of $250K	$30K<$75K	$550 plus $2.50 per $100 or part thereof
$100K <$200K	$2,830 plus $4.00 for every $100 or part of $100 over $100K	>$500K	$24,405 + $6.30 per $100 or part thereof in excess of $500K	$75K<$150K	$1,675 plus $3.00 per $100 or part thereof
$200K <$250K	$6,830 plus $4.25 for every $100 or part of $100 over $200K			$150K<$225K	$3,925 plus $3.50 per $100 or part thereof
$250K <$300K	$8,955 plus $4.75 for every $100 or part of $100 over $250K			>$225K	$6,550 plus $4.00 per $100 or part thereof
$300K <$500K	$11,330 plus $5.00 for every $100 or part of $100 over $300K				
>$500K	$21,330 plus $5.50 for every $100 or part of $100 over $500K				

NT		ACT	
Value of Property	Rate	Value of Property	Rate
<$500k	D = (0.065 x (V x V)) + 21V	<$100K	$20 or $2.00 per $100 or part thereof, whichever is greater.
	Where: D = the duty payable in dollars and	$100K<$200K	$2,000 plus $3.50 per $100 or part thereof by which the value
	V = the unencumbered value of the property, the subject of the conveyance divided by 1000.	$200K<$300K	$5,500 plus $4.00 per $100 or part thereof by which the value exceeds $200K
>$500k	5.4% applied to the unencumbered value.	$300K<$500K	$9,500 plus $5.50 per $100 or part thereof by which the value
		$500K<$1,000,000	$20,500 plus $5.75 per $100 or part thereof by which the value exceeds $500K
		>$1,000,000	$49,250 plus $6.75 per $100 or part thereof by which the value exceeds $1,000,000.

9.6.3 Existing concessions

Recent acceleration in house and land prices has meant that existing concessions for first home buyers have become too restrictive and out of touch with current values in virtually all State and Territory property markets.

With median first home buyer prices for land and house and land packages far in excess of the current exemption thresholds, very few people are eligible for deferment, or reductions in their stamp duty payments, under the current criteria.

NSW		VIC	QLD		SA	
First Home Buyers (after 1 July 2000)		**First Home Buyers - up to $150K**	**Principal Place of Residence**		**First Home Buyer**	
Metropolitan	<$200,000 exempt	Exemption for purchasers holding pension benefits entitlements.	$1.00/$100 up to $250k		<$80K	Exempt
Non-Metropolitan	<$175,000 exempt	Full exemption on properties up to $150,000, phasing out at $200,000.	**First Principal Residence**		$80K - <$130K	Reduced - Max payable $4000 for $130K - See over
Metropolitan Land	<$95,000 exempt		Based on purchase price. Uses exsiting rates but deduct:		> $130K	No exemption
Non-Metro Land	<$80,000 exempt		Below $80,000	$800		
			$80,001 - $150,000	$500		
			$150,001 -$155,000	$300		
			$155,001 - $160,000	$200		
			Over $160,000	Nil		

WA		ACT		TAS	NT
Principal Place of Residence		**Low Income Households**		**Nil**	**Nil**
<$135K	$1.50/$100 upto $100K; $5.50/$100 btwn $100K & $135K	**Property Value**			
First Home Owner	$500 or duty rebate (whichever is lesser)	< $180,000	$20 (minimum duty)		
			$10.81 for each $100 (or part) the dutiable value >$180,000		
		$180,000 - $249,000	($20 min. duty)		
		> $249,000	No concession		
		Land Value			
		<$80,000	$20 (minimum duty)		
		$80,000 to $93,000	$10.81 for each $100 (or part) the dutiable value >$180,000 ($20 min. duty)		
		>$93,000	No concession		

The stamp duty concession for first home buyers has been made redundant by increases in house prices. In NSW the median price paid by first home buyers is now nearly $80,000 higher than the cut-off point for a stamp duty concession. In Sydney, the gap would be much larger. The picture is not much better in other States.

First Home Buyer Stamp Duty Concession

State	Dwelling Price Where Nil Concession $	Concession Media First Home Price[(a)] $	Concession Limit as a Percentage of Median Price %
NSW	200,000	276,000	72
Victoria	200,000	221,000	90
Queensland	160,000	195,000	82
South Australia	130,000	163,000	80
Western Australia	135,000	179,000	75
ACT	180,000	226,000	80

Source: (a) Based on ABS loan size figures assuming a 20 percent deposit

9.6.4 Bracket creep

The failure to adjust the thresholds applying to rates of stamp duty to reflect growth in house prices has resulted in substantial windfall revenue gains to State governments and has pushed up effective stamp duty rates. The tables below show how the effective rates of stamp duty have jumped, especially for first home buyers over the last two years. In all cities, the average amounts paid to State governments in stamp duty have increased substantially.

For first home buyers in NSW, the current $200,000 concessional threshold has been so badly eroded that the effective stamp duty rate is now 93 percent higher than it was two years ago. For all of Australia, over the past two years house prices increased on average by 28 percent, while the stamp duty payable has increased by 45 percent.

Median First Home Buyer Price ($'000)

	Jun.2001	Jun.2002	Jun.2003
NSW	207	239	276
VIC	168	189	221
QLD	150	161	195
SA	122	134	163
WA	149	148	179
TAS	95	104	104
NT	148	155	186
ACT	172	198	226

Source: ABS

Notes: ABS Loan Size figures, assuming 20 per cent deposit

Median Non-First Home Buyer Price ($'000)

	Jun.2001	Jun.2002	Jun.2003
NSW	224	242	273
VIC	183	196	225
QLD	165	181	212
SA	135	133	163
WA	155	167	183
TAS	106	108	131
NT	139	133	169
ACT	183	205	255

Source: ABS

Notes: ABS Loan Size figures, assuming 20 per cent deposit

Stamp Duty Payable

	Jun.2001	Jun.2002	Jun.2003
NSW	1,535	2,655	3,950
VIC	3,640	4,900	6,640
QLD	3,975	4,333	5,438
SA	3,260	3,740	4,900
WA	4,858	4,310	5,783
TAS	4,525	4,795	4,795
NT	4,512	4,811	6,132
ACT	4,520	3,946	6,973

Stamp Duty Payable

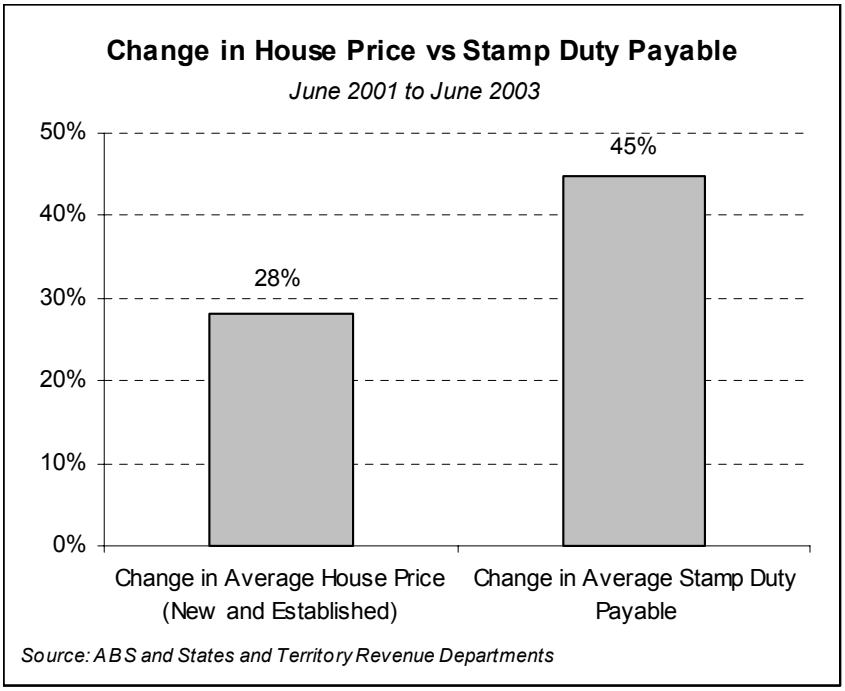
	Jun.2001	Jun.2002	Jun.2003
NSW	5,920	6,613	7,659
VIC	6,129	6,885	8,577
QLD	4,139	4,622	5,640
SA	4,000	3,932	5,089
WA	4,785	5,236	6,108
TAS	4,541	4,764	5,358
NT	4,089	3,877	5,189
ACT	4,510	5,346	7,129

Stamp Duty As a proportion of Average First Home Buyer Price

	Jun.2001	Jun.2002	Jun.2003	Increase 01-03
NSW	0.74	1.11	1.43	93%
VIC	2.16	2.59	3.00	39%
QLD	2.66	2.70	2.79	5%
SA	2.68	2.80	3.02	12%
WA	3.27	2.92	3.24	-1%
TAS	4.78	4.62	4.59	-4%
NT	3.06	3.11	3.31	8%
ACT	2.63	1.99	3.09	17%

Stamp Duty As a proportion of Non First Home Buyer Price

	Jun.2001	Jun.2002	Jun.2003	Increase 01-03
NSW	2.79	2.85	2.92	5%
VIC	3.51	3.68	3.98	13%
QLD	2.67	2.72	2.80	5%
SA	3.09	3.08	3.25	5%
WA	3.24	3.34	3.48	7%
TAS	4.75	4.63	4.36	-8%
NT	2.99	2.95	3.17	6%
ACT	2.63	2.73	2.96	13%



Rates of stamp duty should be indexed to keep pace with changing property values.

9.6.5 Stamp duty cascading on new homes

Because stamp duty is a transactional tax, stamp duty can be paid several times on the same block of land before a new house and land package is acquired by the final purchaser. Stamp duty can be paid when raw land is transferred to a developer, when the land developer sells the allotment to a builder and again when the new home buyer purchases a house and land package. The effect of stamp duty cascading on land purchases through different phases of development cannot be justified other than as a revenue raising device.

While new home buyers are acutely aware of the stamp duty impost at final purchase, they are much less likely to be aware of the cost of stamp duty embedded in the price arising from previous transactions by the developer and the builder. Worse still is the complete lack of visibility of the interaction of the stamp duty and the GST in new housing. Stamp duty is levied on the GST inclusive price of a new home, creating a tax on a tax. Moreover, where there have been intermediate payments of stamp duty, for example where a builder buys a block of land from a developer, GST is paid on the stamp duty included in the cost base of the project. The system of taxation of new housing is in a mess, with taxes on taxes on taxes and the real burden of indirect tax largely hidden from new home buyers.

Not only does the cascading of indirect taxes impact significantly on the cost of new housing, it can distort the structure of the housing development process. The amount of stamp duty paid on a new home is much higher where a builder undertakes land development and construction compared with the situation where a home owner purchases the land direct and contracts separately for the construction of the dwelling. So, one effect of the cascading of stamp duty is to disadvantage more integrated forms of housing development that State governments are seeking to promote.

The table below shows the effect of cascading stamp duty on an identical Sydney house and land package under three different arrangements for the acquisition of the land and the construction of the dwelling: first, a builder purchases a block of land from a developer and constructs a dwelling for sales; second, a builder-developer purchases raw land and undertakes all of the land development and home construction; and third, a home owner purchases a block of land direct from the developer and contracts the construction of the dwelling with a builder.

The estimated land acquisition, development, building costs and margins were based on actual case studies. In the first case study (builder constructs for sale), the total cost of the package to the home buyer was $544,990; in the second case of the integrated builder-developer, the price to the home owner dropped to $537,300; and in the third case of the owner contract building, the final price was $525,150. In these case studies, cascading stamp duty has the effect of increasing the final cost to the new home buyer by as much as $19,000, equivalent to nearly 4 percent of the house price.

Stamp Duty Cascading Distorts Home Building

	Greenfield Builder-Developer	*Greenfield* Developer-Builder-Owner	*Greenfield* Owner-occupier buys land
Raw Land Cost	$110,000	$110,000	$110,000
Stamp Duty	*$2,340*	*$2,340*	*$2,340*
Price of Raw Land to Developer	**$112,340**	**$112,340**	**$112,340**
Land Development			
Design and Land Development Costs	$60,000	$60,000	$60,000
Development Charges			
Local Infrastructure	$21,825	$21,825	$21,825
External Infrastructure	$29,090	$29,090	$29,090
Development Charges total	$50,915	$50,915	$50,915
Total land development costs	$223,255	$223,255	$223,255
GST	*na*	*$11,092*	*$11,092*
Sale Price to Builder or Home Owner	***na***	***$234,347***	***$234,347***
Stamp Duty on Sale	*na*	*$6,692*	*$6,692*
Dwelling Construction Cost			
Other Cost and Margins	$68,300	$68,300	$68,300
Building Cost	$190,000	$190,000	$190,000
Total Building Cost	**$258,300**	**$258,300**	**$258,300**
GST	*N/a*	*na*	*$25,830*
Total Land and Building Costs	$481,555	$488,247	*$525,169*
GST on sale	*$36,922*	*$37,591*	*N/a*
Final Price to the Home Buyer	**$518,477**	**$525,838**	**$525,169**
Stamp duty on sale	*$18,821*	*$19,153*	*na*
Total Cost to Home Owner	**$537,298**	**$544,990**	**$525,169**
Total GST Paid	$36,922	$37,591	$36,922
Total Stamp Duty Paid	$21,161	$28,185	$9,032

Removing Cascading Stamp Duty – the Motor Vehicle Model

The housing industry is effectively trading stock for a builder or developer. By contrast, for motor vehicle dealers, stamp duty is not levied on dealers acquiring vehicles for sale. For the motor vehicle industry stamp duty is applied as a single stage, final purchaser tax. In the same way as for motor vehicle dealers, builders and developers should have a similar ability to have their trading stock exempted from stamp duty.

Houses and cars are comparable in that they both are major consumer purchases, but car buyers are required to pay stamp duty only once.

Builders who construct display homes on land acquired from a developer are required to pay stamp duty on that land even though the house is used solely as an exhibition home. Stamp duty on the improved value is again payable when the house is eventually sold to a consumer purchaser. This is a clear instance of double dipping which would be rectified were stamp duty applied to new housing stock in the same way as occurs for motor vehicle traders.

On a $400,000 display home, exempting trading stock would save a new home buyer up to $5,000 (in Western Australia) on their purchase of the display home. There are estimated to be around 4,000 display homes sold each year Australia-wide.

9.6.6 Aggregation on land

Builder developers who purchase multiple blocks of land are required to aggregate the value of these individual contracts for the purpose of assessing the amount of stamp duty payable. The effect of aggregation can be to shift the value of land acquisitions up the scale of stamp duty. Not only does aggregation increase the amount of stamp duty payable on individual blocks of land it serves as a disincentive for builders to consolidate land holdings to provide more integrated forms of housing design and accommodation.

In the examples below, stamp duty is estimated on an infill site and a greenfiled development in Sydney involving the consolidation of separate land holdings. In the first example, three $1 million parcels of land were purchased and aggregated for a medium-density development. If each parcel of land had been purchased by separate entities, the stamp duty payable on each parcel of land would be about $2,800. But because the three parcels of land were purchased by one entity the total amount of stamp duty would increase to nearly $3,500 for each parcel of land, representing an increase of more than $670 on each parcel.

In another example, the builder acquired 10 separate blocks of land in a greenfield development to supply detached dwellings. Each block of land was purchased for $300,000. If purchased separately, the amount of stamp duty would have been nearly $9,000 but because of aggregation, the stamp duty bite would increase to $15,000 a block, a staggering increase of an extra $6,000 per allotment. In this example, the effective rate of stamp duty increased from 3 percent to 5.5 percent of purchase price due to aggregation.

Aggregation of Land Contracts into Higher Stamp Duty Brackets

Examples:

Purchase Price	Number of Contracts	Total Stamp Duty	Stamp Duty per Lot	Savings per Lot from Non-Aggregation
$3m*	(a) one $3m contract	$150,490	$3,499.77	$674.88
	(b) three $1m contracts	$121,470	$2,824.88	

Note: * 43 medium to high-density unit lots in NSW

9.7 Impact of taxes and charges on affordability

Measuring the effective indirect tax burden on new residential development is not straightforward because some of the charges fund the provision of services which otherwise would be funded by private sector providers and recouped out of the purchase price. By the same token some taxes applied to land development bear no relationship to the cost of providing direct urban infrastructure.

As detailed more fully in Chapter 6 on Infrastructure, HIA has worked closely with a number of builders and developers in each capital city to obtain estimates of development charges and levies on actual new house and multi-unit developments.

The value of indirect taxes on new housing was estimated at $10.838 billion in 2002/03, which included $3.147 billion in GST revenues, $6.382 billion in front-end levies imposed on residential development by State and local governments and $1.309 billion in State government stamp duty on the purchase of new housing**.** The estimates do not include land tax or property rates.

Apart from an inexorable increase in residential development taxes, there are wide variations in development taxes between and within States.

Pooling the case studies revealed that indirect taxes on land development for detached and multi-unit housing contributed to 30 percent or more of the land component in Sydney and Melbourne. In other cities, indirect taxes accounted for nearly 20 percent of the land cost in detached and multi-unit housing.

Indirect Tax Revenue From New Housing – Estimates for 2002/03

New Housing (ex land)

	NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust
Value of Work Done on New Housing, 2002/03 ($m) (a)	8,420	7,520	5,300	1,190	2,600	255	175	540	26,000
Proportion of Fees, Taxes Charges and GST (b)	11%	14%	13%	11%	11%	11%	11%	11%	
Total Revenue ($m)	**951**	**1,053**	**689**	**131**	**286**	**28**	**19**	**59**	**3,217**

Land for Detached Housing

	NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust
Final Land Price (b)	300,000	150,000	130,000	75,000	85,000	60,000	70,000	100,000	
Proportion of Fees, Taxes Charges and GST (b)	31%	30%	18%	19%	22%	17%	17%	17%	
Number of Blocks (a)	23,800	32,200	25,200	7,900	16,000	1,800	500	1,600	109,000
Total Revenue ($m)	**2,213**	**1,449**	**590**	**113**	**299**	**18**	**6**	**27**	**4,715**

Land for Multi-Unit Development

	NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust
Final Land Price (per Unit) (b)	150,000	75,000	65,000	37,500	42,500	30,000	35,000	50,000	
Proportion of Fees, Taxes Charges and GST (b)	31%	30%	18%	19%	22%	17%	17%	17%	
Number of Units	23,700	13,300	11,800	2,200	3,000	100	390	1,320	55,810
Total Revenue ($m)	**1,102**	**299**	**138**	**16**	**28**	**0.5**	**2**	**11**	**1,597**

Stamp duties raised from new housing developments ($m)

NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust
499	**446**	**161**	**56**	**124**	**6**	**4**	**14**	**1,309**

Total Revenue from new housing developments ($m) (including GST & stamp duty)

NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust
4,766	**3,247**	**1,578**	**315**	**737**	**52**	**31**	**112**	**10,838**

Effective rate of indirect tax on new housing developments (%)

NSW	Vic	Qld	SA	WA	Tas	NT	ACT	Aust
24.9%	**24.3%**	**16.9%**	**16.9%**	**18.0%**	**14.3%**	**14.0%**	**14.6%**	**22.1%**

Source: (a) HIA forecasts of industry activity levels
(b) Sample of Builders and Developers

As outlined at the beginning of this section, there are more than 20 different State and local government taxes and charges on a new housing development. Not only have development taxes increased much faster than general inflation, worse still, the GST is applied to the plethora of land development taxes and charges, and then stamp duty on top of that. Most of these taxes are levied as a percentage of the price, and so automatically compound in a rising market. On a new home, the total indirect tax take is over $124,000 in Sydney and more than $88,000 in Melbourne (see table below).

Total Indirect Taxes in a New House and Land Package

	Capital City $	Rest of State $
NSW	124,400	50,500
Victoria	88,700	43,900
Queensland	64,000	36,800
South Australia	54,800	28,100
Western Australia	59,100	34,500
Tasmania	33,100	-
ACT	48,700	-
Northern Territory	40,500	

Note: Comprises fees, charges, taxes, levies and the GST.

The imposition of the GST and stamp duty on development charges means that governments are effectively double dipping on new home taxes.

The State and local government tax bill on new home buyers is out of control. The table below shows that if the Federal and State governments agreed to remove the double dipping of indirect taxes on new housing the cost of a new house and land package could drop by around $12,000 in Sydney, $10,000 in Melbourne and about $5,000 in Brisbane, Adelaide and Perth.

Savings from Removal of Double Taxation On a New House and House Package

	Capital City
Sydney	11,800
Melbourne	10,400
Brisbane	4,900
Adelaide	5,000
Perth	6,000
Hobart	2,100
Canberra	3,200
Darwin	2,600

Source: Sample of Builders and Developers

Eliminating the double taxation of new housing would not put upward pressure on the price of existing housing because State and local government infrastructure taxes and the GST apply only to new housing, which is only a small part of the total housing market.

HIA is confident that highly competitive conditions in the housing industry would see cost savings passed onto to new home buyers in lower prices. However, the Association accepts that government might wish to have the Australian Competition and Consumer Commission (ACCC) monitor new house prices after the removal of the double taxation of new housing. A similar approach to the removal of wholesale sales taxes was adopted during the GST transitional period, and was very successful.

While the elimination of double dipping would provide a welcome boost to housing affordability, the overwhelming issue of the need for an equitable funding of urban infrastructure would remain.

9.7.1 Recommendations – Stamp duty

Key recommendations on the reform of stamp duty include:

- Land bought by developers and builders as part of their trading stock should be exempt from stamp duty in the same way that it is for motor vehicle dealers. Stamp duty should be levied just once on new housing when the project is sold to the home owners.
- Aggregating a builder or developers' land purchases of stamp duty is a major disincentive to the kind of integrated development State governments are promoting. It can add $6,000 to the cost of a greenfield block of land in Sydney.

- Stamp duty rates should be indexed to the changes in house values. Stamp duty should be levied once only on the final purchase by the home owners.

9.7.2 Recommendations – Tax reform

Key recommendations on tax reform include:

- For all of the cost saving tax reform measures detailed in this chapter, the ACCC should be given the responsibility to monitor the passing on of these savings to new home buyers.

10 Government Support for Home Buyers

The broad economic and social importance of home ownership means that policies to assist families to purchase a first home have long been popular with governments and their electorates. The many advantages of home ownership, both for the individual and for society at large, mean that a strong economic case can be argued for such assistance schemes. The short term budgetary cost of the assistance to home buyers pays a handsome long term dividend for the whole community.

HIA supports the goal of these home ownership policies, but notes that significant supply side reform is fundamental to addressing affordability. In the absence of initiatives to directly reduce the cost of housing by increasing the availability of land for development, proposals to boost housing demand have the potential to fuel pressures on housing prices, which could well prove counterproductive. Policies to increase access to home ownership will be more durable if they are underpinned by supply initiatives to increase the affordability of new housing, in particular the funding of urban infrastructure and the responsiveness of development approval systems to urban development. Reform of these areas has the potential to allow the market to deliver new housing at a significantly lower cost.

10.1 Overview of home ownership assistance

There are a number of different forms of support being provided to aspiring home buyers. Some of the existing schemes include:

- *First Home Owners Grant (FHOG)* – to compensate for the introduction of GST, the Commonwealth introduced a $7,000 payment for first home buyers. As the grant was payable on both new and GST-free existing homes, the number of first home buyers buying new homes plummeted. For a short period, the grant was doubled to $14,000 for new home buyers but has since reverted to $7,000. The $14,000 grant was very successful in restoring new housing's share of the first home owner market (historically around 20 percent).

  First home owner grants paid on million dollar homes seem to be a perennial talk-back radio topic. Prima facie these payments to the wealthy seem inappropriate; but the reality is the administration costs of weeding out this minority of payments may exceed the cost of continuing to pay them. In this example, the 'hand out' component may be very small – perhaps $350,000 nationally a year from a total budget of around $800 million, which is around 0.04 percent of funds.

- *Affordable housing levies/quotas* – a mechanism that has attracted some government attention is to require a proportion of new housing developments to be set aside for low income households. Another option involves collecting a levy on a development with the proceeds to be utilised to purchase housing stock.

If the support of low income housing is deemed a priority for governments then it should be funded through the budget and not through further taxes on new home purchasers.

- *Stamp duty concessions* – most of the State and Territory governments operate some system of stamp duty concessions, at least for first home buyers. As detailed in Chapter 9, the value of these concessions has been eroded by a failure to index the stamp duty scale in the face of escalating house prices.

- *Public Housing* – a number of State housing authorities have implemented 'rent to buy' type schemes, where public housing tenants can gradually purchase their home. However only a small number of households is involved, indicating a low level of demand for this type of assistance.

In addition to these existing schemes, there are numerous proposals for providing assistance to home buyers. A recent affordable housing research project identified over 120 different policy mechanisms. Some of the major proposals which are currently under consideration include:

- *Equity loans* – the Prime Minister's Home Ownership Task Force advocated the establishment of a liquid secondary market in real estate equity. The intention is to allow home owners to access both a mortgage and a passive institutional investor, meaning that they could effectively finance their home through both debt and equity. The proposal would allow the consumer to trade off a reduced share of any future capital gains for a lower threshold price for the home.

  The proposal has yet to attract significant institutional support, despite some press speculation that Wizard Home Loans was going to retail such a product with the underwriting of a merchant bank.

- *Housing lifeline* – the Prime Minister's Home Ownership Task Force recommended establishing a repayable line of credit from the Commonwealth Government, subject to an asset based means test, which would allow households to continue paying rent or mortgages when they experience short term fluctuations in income.

  HIA considers that for home owners, the market is already fairly well serviced as banks and other financial institutions can frequently accommodate these short term changes. However, the approach may deliver some benefits for private and public renters.

- *Saving Accounts* – The Federal Opposition has proposed a system of matched saving accounts, which would encourage those on low income to build up a deposit for accumulating economic assets including homeownership. Deposits into these accounts would be matched by government on a dollar for dollar basis.

Much of the skepticism which greeted this proposal has focused on the high cost of administering this scheme, which was one of the main factors that led to the demise of the savings based first home owners scheme in the 1980s.

- *Affordable housing bonds* – The Affordable Housing National Research Consortia examined 120 funding options and proposed that the preferred option was a direct government subsidy through bonds with a guaranteed minimum after tax return for private investment in affordable housing. The modeling indicated that such a bond could raise $4 in private investment for every $1 of government subsidy.

- *Listed Housing Trust* – This model was first advocated by Brendan Crotty of Australand. Depending on cost differences, different levels of subsidy are required for different capital city markets, but $10 million in subsidy can fund between 800 houses (Sydney) and 1,400 houses (Brisbane). In return for the subsidy, the trust would own 70 percent of any capital growth. This capital growth would boost the trust's yield by around 3.5 percent per annum, which is sufficient to make investing in the trust attractive to institutional funds.

- *Concessional taxation treatment* – In Europe and the United States, both markets where high population densities make housing pressures more acute, tax credits for affordable housing have attracted institutional investment in designated affordable housing projects. These institutional funds have deepened and widened the low cost housing market, providing real choice for households on low incomes.

- *Superannuation* – There are two variations on this approach. The first, an individual approach, which has been supported by HIA suggests that to assist first home owners in the critical early years of repaying a mortgage, when the interest payments peak, the Commonwealth legislate to permit an annual transfer of after-tax superannuation fund earnings into a mortgage.

  The second, institutional approach is to encourage the wholesale channelling of superannuation investment into affordable housing. The challenge of this approach is to boost the yield from affordable housing sufficiently to make the return commercially attractive to the superannuation funds.

11 Building Issues

There are a number of building issues relating to the regulation of building as well as workplace practices that affect housing affordability adversely. This chapter examines the legislative difficulties associated with employing trade contractors, the cost of industrial relations requirements relating to higher density construction and the chronic skills shortages that exist in the building industry.

11.1 Costs of unnecessary red tape

Most housing construction is performed by trade contractors. Extra and unnecessary administrative costs are imposed on the housing sector by the unclear legal treatment of these contractors.

A plethora of law, at both State and Federal level, operates on trade contractors in a most uncertain way. This legislation extends the already uncertain common law for particular purposes, usually on the basis of further subjective tests. This includes Workers Compensation, Payroll Tax, Industrial Relations, Security of Payment, GST, Income Tax, and Superannuation Guarantee. Under different pieces of legislation, a person may be treated as a contractor for some purposes and as an employee for others, which leads to great confusion.

For example, a person may be counted with employees for Payroll tax purposes, but not for workers compensation purposes. Audits may result in contractors being included as employees for payroll tax, putting employers over the tax threshold and leading to unexpected and large payroll tax bills. Federal tax laws are themselves inconsistent, since a person may be a contractor who has an Australian Business Number, and is registered to collect GST, and yet be rejected as being a 'personal services business' for income tax purposes. All this has a high administrative cost, both for the trade contractors themselves and for those who engage them.

In HIA's view, the current legal situation in this important business area is most unsatisfactory. What business requires, but does not have, is certainty. Whether a particular person is an employee or an independent contractor is a question which arises every day in the ordinary course of business, but is one that **no one** can clearly and confidently answer. The existing plethora of legislation, both State and Federal, uses different and conflicting definitions of employees and contractors for particular purposes, while the common law tests are subjective, uncertain and for practical purposes unhelpful. Only a court of law can definitely decide a person's legal status for a particular purpose, and that decision can in the nature of things only be handed down years after the event.

There is also a constant pressure by unions and the commercial construction sector to remove the competitive advantage of trade contractors over unionised employees by extending the industrial relations system to such contractors, on the fanciful grounds that they need the 'protection' of such industrial laws. Queensland has already enacted power for the Industrial Commission to 'deem' trade contractors to be employees if it

sees fit, and the South Australia Government is considering a Report proposing the same. Quite apart from the fact that the contractors in question are violently opposed to being deemed to be employees, such a development would be disastrous for housing affordability.

11.1.1 Recommendation

HIA considers that housing affordability can be enhanced by providing legal security for the status of trade contractors. This could be done by the Commonwealth and States recognising that persons who have the status of a Personal Services Business for income tax purposes are independent businesses and should not be treated as employees for any purpose whatever. HIA has proposed this to the Federal and all State governments, with some effect. Queensland has now amended its Workers Compensation Act to exclude such persons from the status of 'workers' under that Act, and persons who engage them are excluded from being 'employers'. This is an important and sensible development which the Queensland Government saw as adding badly needed certainty to the administration of the legislation.

11.2 Higher density developments– industrial relations implications

Pressure on available land has led to increasing density of housing developments. Whatever the technical, social and planning implications of this, it also has industrial relations implications.

Studies by the Productivity Commission (1999) and Econtech (2003) have attempted to quantify the abundant anecdotal evidence that detached housing construction was significantly more cost efficient than high-rise and commercial construction. The most recent study, Econtech, found that "bringing workplace practices in the construction of commercial buildings into line with those applying in domestic residential building has the potential to increase labour productivity in the construction of commercial buildings by around 13 percent, which would reduce construction costs for commercial buildings by about 6 percent".

While it might be expected that the more highly capitalised and mechanised commercial sector would be more efficient and not less, the difference is accounted for by union mandated industrial agreements such as limits on work hours, additional overheads and rostered days off, which restrict productivity in the commercial sector. These constraints also affect the high and larger medium density housing sectors, which operate in a similar industrial environment. By contrast, there is little or no union activity in the detached housing sector. Any shift in emphasis from detached to high and medium density housing will have to face this additional cost factor, in the absence of legislative change to address needed industry reform (see below), putting further pressure on housing affordability.

The dividing line between the two sectors is ill-defined and varies from city to city, involving not only project size but also proximity to the State capital CBD. On sites claimed by unions as a 'commercial' site, they will seek to impose commercial (union) work practices, significantly increasing costs and lengthening completion

times. Whether this will occur on any particular site is a matter of commercial risk, for which allowance is sometimes made by the builder. But the outcome in an overall sense is most untidy.

HIA's investigations into construction costs on a range of building projects in Victoria have revealed that:

- the per square metre rate of construction is 23 percent higher for a 6 storey commercial building as opposed to a 6 storey residential building. This increase is attributable to industrial agreements which cover site allowances, on site facilities, wet weather provisions and Enterprise Bargaining Agreements; and
- the per square metre rate of construction for a medium density building is 28 percent higher than for a single domestic dwelling.

If the Federal Parliament were to pass the proposed Building and Construction Industry Improvement Bill, these cost differentials would be markedly reduced, as union power to act illegally to maintain their costly industrial agreements would be curtailed. The Bill would apply to all construction other than projects of less than 5 single dwelling houses. However, the fate of the Bill is currently uncertain. HIA has strongly urged all political parties to support the Bill.

11.3 Skills shortages

11.3.1 Background

Skill shortages in the residential building industry have the potential to dramatically increase the cost of construction and therefore affect housing affordability. In several previous booms in construction activity, severe skill shortages dramatically increased costs and with increasing skill shortages forecast in the next 7-10 years, it is important this issue is addressed.

Skill shortages are expected to increase in the period ahead due to the ageing of the workforce, with an increasing number of workers leaving the industry, but also because of difficulties in being able to attract new entrants.

The ageing of the workforce is a symptom of the low rate of new entrants to the industry. The ageing of the workforce also has implications for the acquisition of skills by the construction industry because the proportion of people in the younger age groups with up to date skills reduces over time. There will be skill shortages as the older workers leave the industry.

Age Profile of the Workforce

Construction industry	Age in Years %						
	15-19	20-24	25-34	35-44	45-54	Over 55	Total
	5.0	12.0	25.0	27.8	19.9	10.3	100.00

With respect to apprentices coming into the industry, the declining trend in apprenticeship enrolment in the early 1990s was reversed during the building boom experienced in the late 1990s. However, showing the cyclical nature of this industry, apprenticeship numbers declined again in 2001 as the level of activity fell in 2001 compared to the peak achieved in 2000.

The disturbing aspect is that the level of activity in 2000/01 was 54 percent higher than that of 1991/92 and the employment level in the industry in 2001 was 66 percent higher than that of 1991, but the training activity level (measured in terms of the number of apprentices in training) in 2000 remained more or less at 1990 levels. Training activity is lagging well behind the growth in building activity and employment resulting from such activity.

Apprentices in Training in Building

	Building
1990	32,727
1991	30,618
1992	28,769
1993	23,799
1994	25,518
1995	26,710
1996	26,000
1997	24,470
1998	24,270
1999	26,210
2000	30,510
2001	29,920

Apprentice Commencements

	Building
1989/90	13,356
1990/91	8,478
1991/92	7,751
1992/93	10,053
1993/94	11,481
1994/95	11,500
1995/96	8,810
1996/97	9,150
1997/98	11,150
1998/99	13,310
1999/00	14,720
2000/01	11,650

Unchecked, the availability of trade contractors will worsen. Completions of training are also showing a declining trend. Low completions are a reflection on the training system and indicate a problem with the current apprenticeship structure. This is of particular concern to the housing industry as the current training structure does not address the training needs of today's housing industry, as well as creating barriers to entry into the industry.

The current training for apprentices is in many cases too broad and does not take into account the more specialised skills required by workers in the residential building industry.

Half of the people in TAFE training in building areas are not apprentices or trainees undertaking full qualifications. Apart from those engaged in other study areas eg builder licensing, many are those seeking the skills they need for their area of specialty, but they are not seeking a formal qualification as it is not relevant to their work. This group, combined with those who do not finish an apprenticeship but stay in the industry, generally make up the specialist skills in the industry eg pavers, roof carpenters, ceiling and cornice fixers, wardrobe and bathroom installers, fascia and gutter fixers etc. They also make up the significant proportion of the skilled trades that do not have trade qualifications. The training system does not suit their needs well.

Commercial building interests dominated by unions and some trade based associations have combined to ensure the training system rigidly hangs on to the full apprenticeship as the only 'legitimate' training entry point into the industry.

In addition to those who have had some formal training there is a significant proportion of those in the industry who have acquired their skills on the job. The training system clearly has not been able to cater for their needs either.

Industrial award structures and inflexible training systems also deter mature aged people from embarking on a building career.

11.3.2 Addressing skill needs

HIA efforts to address the industry's skill needs include:

(i) developing a Career Website;
(ii) establishing HIA Group Training Schemes;
(iii) developing School Industry Partnerships to promote the industry to students, career counsellors and parents;
(iv) seeking to increase participation in Vocational Training in Schools.

Perhaps the most significant obstacle to addressing the industry's skill needs is the nature of our training systems. Much of the formal industry training is seen as outdated, irrelevant and unattractive to potential recruits to the industry. There are some new trade qualifications in the new national Training Packages, but there is still a lack of the specialist training that the industry demands and that would provide pathways into jobs in the industry. Today there are many more school-to-work pathways available in just about every industry other than building.

As well, more young people are combining work with study including in New Apprenticeships. These flexible arrangements are also available to more mature aged entrants to an industry.

Attempts to adopt some of these models have been stymied by union and trade association resistance. The main sticking point is that training qualifications are linked

to award classification, and breaking this nexus to provide flexible training outcomes therefore becomes an industrial issue.

Some in the industry also argue that shorter training periods will 'de-skill' the industry. In many States there is also a nexus between the training packages and government subsidies whereby only those packages that have been endorsed (including by the unions) can be delivered by TAFE and receive government funding.

The challenge is to gain more flexible training outcomes tailored for training the specialised workers in the residential building industry. Many currently bypass the system because of its inflexibility and if training relevant to their work were available, it would increase training participation thereby 'up-skilling' the industry. This need has been confirmed by research by the National Centre for Vocational Education Research which has shown that in the absence of relevant and appropriate training schemes:

- large numbers of trades people were working in jobs that required skills well below trade level;
- 4 in 10 workers were satisfactorily performing trade work without formal training, having acquired the necessary trade skills on the job.

The training system should offer types of training and certification such as:

- short courses in the trade area for jobs that do not require the full set of trade skills;
- training programs for older more experienced workers who require top up training;
- certification for workers who have acquired full competency but not completed training courses;
- opportunities for apprentices to continue training if their employment is discontinued or if they become contractors;
- reduced training duration where competence can be demonstrated; and
- training suitable for mature aged entrants.

The training system must respond and provide more flexible training options to meet the needs of the residential building industry and ensure the future skill needs are able to be met.

11.3.3 Conclusion

Unless the particular training needs of the home building industry are addressed, there is likely to be long term pressure on the supply of labour to the industry which will drive up costs and diminish housing affordability. The stranglehold of commercial building interests over the training arrangements in the building industry needs to be broken.

11.4 Recommendations

HIA considers that housing affordability can be enhanced by:

- providing legal security for the status of trade contractors. This could be done by the Commonwealth and States recognising that persons who have the status of a Personal Services Business for income tax purposes are independent businesses and should not be treated as employees for any purpose whatever;
- addressing those industrial relation issues that have the potential to increase the cost of higher density residential buildings; and
- addressing the chronic skill shortages in the building industry through the provision of more flexible and accessible training options tailored to address specific areas of need identified.

12 Building Control

12.1 Introduction

All new private building work in Australia is regulated and therefore changes to regulations can have a direct effect on the cost of building work. Regulations cover all activities applicable to the life cycle of a building such as:

- the design of new buildings;
- gaining approval for building work;
- construction processes;
- approval of completed buildings;
- maintenance of buildings; and
- the demolition of existing buildings.

Building control regulation has changed significantly over the past years and in most instances, building owners have had to bear the brunt of consequential cost increases. Additionally, there are significant inefficiencies within existing building control processes and these inefficiencies can have significant cost implications to the building industry and a consequential influence on housing affordability.

12.2 Australia's building control system

The regulation of building work is the constitutional responsibility of respective State and Territory governments and consequently, Australia has eight separate building control systems. These systems comprise two basic forms of regulatory provisions being; technical provisions and administrative provisions.

In 1964, Commonwealth, State and Territory governments agreed to a coordinated approach to the development of a nationally consistent suite of regulatory provisions for building work. It was agreed that uniform technical regulations would be developed initially, followed by a suite of administrative provisions, and that the project would be supervised by a new body called the Interstate Standing Committee for Uniform Building Regulations (ISCUBR). This body was responsible for the subsequent development of a suite of technical provisions titled the Australian Model Uniform Building Code (AMUBC), which became a reference document used by States and Territories when preparing their respective regulatory provisions.

In the 1980s the Australian Uniform Building Regulations Coordinating Council (AUBRCC) was established to continue the development of the AMUBC and to facilitate national consistency. In 1984, an Intergovernmental Agreement (IGA) was signed by the Commonwealth, State and Territory governments, formalising AUBRCC, establishing a shared funding arrangement and facilitating the future adoption of a common suite of technical regulations. AUBRCC subsequently produced the Building Code of Australia in 1990, which became Australia's first uniform suite of technical building regulations.

In 1994, a new Intergovernmental Agreement was signed to establish the Australian Building Code Board (ABCB). The IGA increased Commonwealth, State and Territory funding to the ABCB with the Commonwealth providing around $1m per annum, ie 50 percent of funds. The new funding arrangement provided the ABCB with sufficient resources to undertake the majority of work required to further develop the 1990 version of the BCA, and to convert it from a prescriptive based document to a performance based document. The completion of this task in 1996 was probably the most substantial reform of technical building regulations in Australia last century.

The regulatory requirements of the BCA have been developed to enable the achievement and maintenance of acceptable standards of structural sufficiency, safety, health and amenity. These requirements have been developed to ensure they are cost effective and extend no further than is necessary in the public interest. In essence, they are considered to be minimum standards.

12.2.1 Technical provisions – the Building Code of Australia

Between 1990 and early 1993, the Building Code of Australia (BCA) was adopted by all States and Territories through their respective legislative systems as the technical standard for the design and construction of buildings. In essence, this process should have facilitated national consistency of basic technical requirements. However, the 1984 and 1994 IGA included a provision for individual States and Territories to vary the content of the BCA at their discretion. This provision has since proven to be the most significant obstacle to the implementation of genuine national consistency in regulatory requirements. Major problems arising from the application of this provision are addressed below.

12.2.2 Administrative provisions

All eight States and Territories have administrative provisions for building control contained with their respective legislative systems. Administrative provisions can be varied in nature and some requirements may not be of national interest. However, several administrative support systems are required for the effective operation of the BCA and these should be uniform in content in order to achieve the efficiencies available from the application of a performance based regulatory regime. Two particular support systems are discussed later in this section.

Administrative provisions generally cover the 'paper work' processes associated with building control, including the simple task of lodging an application for building approval, a process undertaken regularly by building companies. At present, a building company that operated throughout Australia would be required to undertake this task in at least eight different ways, ie one for each State or Territory. However, it is highly likely that this number is significantly larger because many local government authorities, of whom there are approximately 700 in Australia, are allowed to impose requirements additional to the general requirements of the State system. This outcome produces substantial inefficiencies for all building companies, especially the interstate operators.

In 2002, the ABCB commissioned a study on the rationale, both economic and non-economic, for adopting a national administrative framework to improve the regulatory environment for BCA delivery. The Allen Consulting Group conducted the study and subsequently reported[30] that estimated savings to industry arising from the implementation of a national framework would be in the vicinity of $400 million a year.

The report stated in part that:

> "*Harmonising reform of building control administration provides benefits in two interrelated ways:*
> - *it provides a framework for all jurisdictions to move towards agreed best practice arrangements; and*
> - *it reduces the costs associated with excessive inconsistent regulation which hinders cross-jurisdictional operations – the current differences between jurisdictions' regulatory systems have been described by industry sources as causing confusion, with resultant time delays and cost penalties when obtaining approvals. This level of complexity results in inefficiencies and creates uncertainty for stakeholders. With many sectors of the industry, including private practitioner regulatory authorities, operating across jurisdictional borders the differences in building regulatory systems have become more noticeable and less tolerable*."

HIA strongly supports the development of a national administrative framework that is able to support the application of performance based technical standards and streamline administrative regulatory process.

12.3 Structural reform of the building regulation system

12.3.1 State & Territory governments' ability to vary the BCA

The specific purpose of developing the BCA was to facilitate national consistency. However, over the past 10 years only one State, Western Australia, reached a position where it had no variations to the national code. All other States and Territories have substantial Appendices to the BCA that contain their respective additions or deletions.

In January 2003, this persistent breakdown of national consistency reached a climax when energy efficiency provisions for housing were incorporated within the BCA.

At that time, both Victoria and the ACT had their own provisions applying throughout their jurisdictions, and around 50 local councils in NSW were applying provisions through their individual planning schemes. In consideration of this diverse regulation of energy efficiency and the evident need for national consistency, the inclusion of energy efficiency provisions in the BCA was seen as a logical means of replacing the existing fragmented approach and achieving national consistency.

[30] *Harmonisation of Building Control Administration, Costs and Benefits of the National Administrative Framework*, The Allen Consulting Group, December 2002, page vii.

However, when the new provisions were incorporated in the BCA, Victoria, the ACT and NSW decided to retain their existing systems, even though they had been directly involved in the development of the BCA provisions, and only South Australia, Tasmania and the Northern Territory adopted the new requirements. Since then, Queensland has adopted a variation of the BCA provisions and Western Australia has also adopted the provisions. To date, NSW continues to persist with its piecemeal approach to regulation by allowing local governments to set their own standards and continues to develop its own suite of energy standards for possible future inclusion in the BCA. The effect of this divergent approach is that the building industry will have to design and construct buildings in NSW in a different way to other States and Territories in order to achieve the same general outcome. If a builder elects to comply with the NSW Deemed-to-Satisfy provisions of the BCA there will be a need to use differing methods of construction, differing materials and a differing selection of components such as windows. If a builder attempted to build in the same manner as allowed in other States and Territories, it would not be possible to comply with the NSW variations and the builder would need to demonstrate that the proposed design complied with the BCA, probably by paying for an independent computer based assessment, which would increase the cost of the approval process.

The actions of jurisdictions intent on developing variations and additions to the BCA introduce significant inefficiencies to their regulatory regimes through the duplication of scarce and valuable resources. By way of example, the activities of the NSW Government in developing an individual suite of energy provisions have been ongoing during the past year. These activities have utilised a vast amount of time of government officers, consultants and industry representatives who sit on various committees and councils in an endeavour to provide advice or offer comment on the propriety of the governments' proposals. The duplication of effort between the ABCB in the development of their original BCA provisions and a State jurisdiction in the development of its individual variation package cannot be justified and should not be allowed to be repeated.

The issue that makes this duplication of effort more frustrating for industry is that notwithstanding that the States are all represented on the ABCB, they have developed State variations when it has suited political needs.

In essence, the past position of some States and Territories on the ABCB's endeavours to introduce national consistency in energy efficiency provisions has demonstrated an unacceptable lack of commitment to consistency in building regulations, and demands an urgent review of the current IGA and a restructuring of the ABCB.

The consequences of these interstate inconsistencies are costly to industry. Nationally operating building business need to tailor designs, construction techniques and approval systems for every jurisdiction's peculiarities. There are also difficulties created for manufacturers of building materials. They potentially face having to modify their product to suit the regulatory environment in each State. Not only does this add to the manufacturer's costs, it also limits the size of the market for each of the modified products. For an industry increasingly exposed to import competition, this contraction of the size of their markets is potentially damaging.

12.3.2 Australian Building Codes Board

As mentioned previously, the 1984 and 1994 IGA included a provision for States and Territories to exercise discretion in regard to the adoption of all, or parts of the BCA. While the ABCB and its State and Territory constituents have successfully delivered a nationally consistent and robust set of technical building provisions, the ongoing regulatory debacle related to the introduction of energy efficiency provisions has exposed the inadequacies of the current structure of the ABCB and its inability to implement national consistency.

Irrespective of the structural shortcomings of the ABCB, HIA considers that it remains the most appropriate mechanism to effect the development of a nationally consistent regulatory system. However, it is essential that it be provided with a substantial legislative framework and be restructured to enable it to produce the outcomes for which it was originally established.

The ABCB needs to be given pre-eminent status in building regulation matters. It also needs to be given a charter that encompasses all technical issues and administrative issues of national importance. State, Territory and local jurisdictions need to be legislatively excluded from introducing building regulations that are inconsistent with, or additional to, the requirements of the BCA. The ABCB also needs to be sufficiently resourced to enable it to deliver regulatory solutions to technical issues in a much timelier manner. It is only in this kind of framework that regulatory mayhem can be avoided in the building industry.

One way of achieving genuine national consistency would be to have the development of building regulations addressed in a similar manner to other regulatory issues, such as company supervision through the Australian Securities and Investments Commission (ASIC), or the prudential control over banks and insurers through the Australian Prudential Regulatory Authority (APRA)

A noted national model that may be more suited for the effective operation of the ABCB could be that utilised by Food Standards Australia New Zealand (FSANZ). This organisation is a statutory authority operating under the Food Standards Australia New Zealand Act 1991. This Act provides a focus for cooperation between governments, industry and the community to establish and maintain uniform food regulation in Australia and New Zealand. Under a 1991 agreement between the Commonwealth of Australia and the States and Territories, the States and Territories adopt, without variation, food standards that FSANZ has recommended and which a ministerial council representing all jurisdictions, including the Commonwealth, has approved.

The purpose of the 1991 FSANZ agreement was to consolidate responsibility for developing food standards in one specialist agency and to ensure the consistency of food standards across all States and Territories, which continue to have primary responsibility for enforcing food laws. It is understood that these arrangements continue to apply successfully.

Some of the major benefits of this model are that the States and Territories agreed to adopt regulations produced by the national body, without variation, while the States

and Territories retain the responsibility for the administration and enforcement of national regulations. Another benefit of the FSANZ model is that has been acceptable to New Zealand, which may have long term benefits for Australia in the development of international consistency between the two nations.

In line with the above model, the development of building regulation policy should be undertaken through the establishment of a high level council or Board representing all jurisdictions, including the Commonwealth. To ensure the effective operation of the council/Board, State and Territory representatives must be independent but have a direct affiliation with the building industry. This fundamental requirement arises from industry concerns with the composition of the current ABC Board which contains several members with planning industry affiliations. The influence of State and Territory inconsistencies in legislation has not been as devastating to the planning industry as it has been to the building industry and many of the industry's frustrations would be foreign to these members.

Consequently, the need of the building industry to have national consistency as a fundamental goal of the current Board is not reflected and the high level of State and Territory cooperation that is necessary to achieve that goal is not evident. Accordingly, it is essential that the council/Board that heads a future restructured ABCB must comprise representatives with the enthusiasm and commitment to ensure that the goals of the organisation are achieved. In addition to the ongoing development of the BCA, this specialist agency would be able to develop and implement administrative systems that are essential to the effective operation of the BCA, such as product certification. Additionally, the agency could develop nationally consistent processes for building approval, certification of design and construction, occupancy approval, mandatory maintenance of buildings, appeals and dispute resolution.

HIA is a strong supporter of national consistency in building regulation and considers that a restructured and resourced ABCB is the key to the successful achievement of this fundamental goal.

12.3.3 Local governments requiring a higher standard

State and Territory governments establish minimum standards for building control through adoption of the BCA. However, there has been a growing trend for local governments to impose requirements on the design and construction of buildings that are in excess of those of the BCA. A recent example relates to the regulation of sound insulation between attached dwellings whereby some local councils have been requiring higher levels of insulation than the minimum requirements of the BCA. This trend has the potential for the development of over 700 sets of building requirements throughout Australia and must be stopped. State governments must legislate to prevent local governments from establishing their own building control requirements for all issues that are regulated through the BCA. HIA understands that this is presently the case in some jurisdictions; however the level of enforcement of the legislation appears to vary significantly.

12.3.4 All building regulations must be in the BCA

HIA recognises that the administrative and consultative processes applied by the ABCB to the development of the BCA are inefficient and in some instances, the ABCB has been slow to respond to the needs of State, Territory and local governments and the community in general. Over time, these prolonged processes have become a disincentive to regulatory cooperation and in some instances jurisdictions have decided not to wait for the introduction of nationally consistent regulations to issues that require short term solutions. Consequently, governments are inclined to facilitate regulatory initiatives through State wide planning policies or the development of model provisions for inclusion in local government planning schemes. If this trend continues, the ABCB will become irrelevant to governments and the overall quest for national consistency in building regulations will be lost.

Local government jurisdictions are often responsible for spawning innovative regulations that can be readily implemented through planning schemes because they have a reasonably unvetted power to control development within their own area. An example of such activity is the current outbreak of uncoordinated regulation of sustainable construction, particularly for new housing. However, while the ABCB may be slow to respond to change, there is a regulatory process that can be applied whenever State or local governments consider that a specific issue should be regulated through the BCA. This process merely requires individuals or industry organisations seeking regulatory reform, to present their case to the ABCB for consideration and local government should be required to do the same. At present, when new issues arise, local government can simply implement regulations through planning schemes; however this sort of independent action quickly defeats the efforts of all organisations working toward genuine national consistency.

12.3.5 Regulatory impact assessment

The current trend for local governments to include building regulations within planning schemes creates another significant problem for industry. Specifically, planning legislation is not subjected to the same degree of regulatory scrutiny as the Building Code of Australia, particularly in regard to the fundamental need to justify the imposition of regulation on the local community. In the case of the BCA, the 1994 IGA requires new regulation to be subjected to a regulatory impact assessment in order to ensure that governments do not introduce regulation for regulation sake and that regulations are cost beneficial. Without this safeguard the cost of buildings can rise significantly without commensurate benefit being achieved. The potential spiralling effect of consequential layers of regulation can easily become significant hurdles to the affordability of housing and prevent many members of the community from achieving home ownership.

Consequently, it is essential that the design and construction of buildings is regulated through the Building Code of Australia and that planning schemes are not used as a vehicle to bypass the regulatory scrutiny of the BCA.

The Federal Office of Regulation Review, the organisation responsible for monitoring legislation requiring cost impact assessments, is aware of the different standards of

scrutiny between building and planning regulations and it is understood that regulatory processes applying to planning schemes are to be reviewed.

A further issue relating to regulatory impact assessment is the obvious need to assess all issues associated with building regulations, including the cost of compliance with administrative processes and the cost of compliance with new BCA provisions. In many instances, new requirements of the BCA will impose additional costs directly attributed to design and construction issues. However, some regulatory changes also impose additional costs for assessment of compliance. The recent introduction of energy efficiency provisions in the BCA provides a good example. Due to the complexity of the requirements, some local authorities are not undertaking a technical assessment of designs and instead are requiring the applicant to obtain an independent computer based assessment, which can cost in the vicinity $300.00. In these instances, if the local authority was to decrease their building application fees by the same amount, there would be no additional cost, however this outcome is not usually the case and the additional cost of demonstrating compliance is likely to be passed onto the home occupant.

Additionally, arising from the application of performance based designs, the ABCB have introduced Verification Methods into the BCA which are a means of demonstrating that alternative solutions comply with performance requirements. However, the use of these methods is meant to be optional to the applicant as the cost of demonstrating compliance using these methods can be significant. It is reported that some local councils do not consider these methods as optional and are requiring applicants to substantiate alternative solutions by using Verification methods, thereby saving the time and cost of their own technical assessments.

12.3.6 Approval processes

Approval processes within States and Territories form an integral component of their respective administrative systems and have not yet been the subject of a concerted ABCB drive to achieve national consistency. The importance of these processes was significantly enhanced with the introduction of performance based technical regulations, which allow any proposed design, or method of construction, to be approved provided it could be demonstrated that the proposal will achieve the required standards of performance.

The ability of industry to incorporate flexible and innovative concepts in the design and construction buildings is the fundamental difference between the previous 'must follow this recipe' approach of prescriptive regulations and the current 'must achieve this result' approach of the BCA.

However, there are some industry practitioners who do not wish to be innovative and who prefer to use historically acceptable methods. Therefore, the BCA incorporates deemed-to-satisfy provisions that the ABCB has accepted as meeting the performance requirements of the code. For industry practitioners who do wish to take the opportunity to be innovative, the BCA allows alternative solutions to be offered for approval.

When an alternative solution is proposed, it is the responsibility of the applicant for approval to demonstrate to the relevant authority that the alternative solution complies with the performance requirements of the BCA. In this context, when performance based regulations were introduced through the BCA, it was also necessary to introduce a range of administrative systems to facilitate a new approvals process. Without appropriate processes for the assessment and approval alternative solutions, the benefits of a performance based BCA cannot be fully realised.

12.3.6.1 Approval of alternative solutions

In order to assist the approval of alternative solutions, the Building Code of Australia includes Clause A2.2 Evidence of Suitability, which lists several acceptable means of demonstrating to an approval authority that a product or design complies with the BCA. In essence, the clause allows for any suitable means of documentation to be provided, as long as the approval authority is satisfied that compliance has been achieved. Forms of documentation include product certification by accredited bodies and compliance certification by accredited practitioners. As these processes are administrative in nature it is necessary for the States and Territories to provide a legislative basis for their operation through their respective building control systems.

Most States and Territories have administrative systems that facilitate professional certification of compliance with the BCA, or the issue of building approvals. However, these systems are varied in nature particularly in regard to experience and qualifications of practitioners, roles and responsibilities of practitioners and professional indemnity insurance. The development of administrative processes that facilitate national consistency in certification process is essential and it is envisaged that a revamped ABCB would be an appropriate organisation to develop these processes.

12.3.6.2 Scope of building approval documentation

In order for an approval authority to consider an application there is a need for specific documentation to be provided and the scope of documentation required has generally related to the complexity of the specific project. Over the past several years there has been a growing trend for local governments to require extensive documentation for relatively simple buildings. This has occurred through increased interest in addressing urban design issues and from considerations of matters such as stormwater runoff.

In some jurisdictions, this trend has resulted from legislative reforms to the issue of planning approvals and building approvals. For most building projects, planning approval is required before building approval can be granted and applications for these approvals are often separate.

Planning approvals are generally required to be issued by local government authorities and in many jurisdictions private certifiers are now able to issue building approvals. Prior to this structure being introduced, local councils were generally content with receiving basic schematic documentation at planning approval stage and knowing that they would eventually see all relevant documentation because they were also

responsible for issuing the building approval. However, the introduction of private certification of building approval means that for many projects, local government will not be provided with copies of building approval documentation until after the building approval has been granted.

Consequently, some local government authorities now feel that they are not provided with sufficient information at planning approval stage and have been requiring applicants to lodge a range of documentation that is really only relevant to building approval. This process can impose significant costs to industry, particularly when a developer lodges complete project documentation with a planning approval application and then decides not to proceed with a project because of changes in economic climate, changes to design to accommodate neighbour objections or excessive conditions of consent.

For most housing projects, the cost of preparing documentation for building approval will far exceed the cost of preparing documentation for planning approval and therefore, the funds expended on lodging documentation that is not relevant to the process are wasted.

It is regrettable that some States/Territories have planning regimes that condone planning approvals for dwelling houses, notwithstanding that they are located in appropriately zoned areas and meet all the building and planning code requirements. Local government approval processes in these instances add little or no value to the development outcome.

Accordingly, State and Territory governments should be required to introduce, and enforce, legislation that prohibits local councils from requiring planning applications for dwelling houses located in appropriately zoned areas. In circumstances where a planning application is warranted the documentation required to be lodged with a planning application should be limited to the material relevant to the matter that triggers the planning application in the first instance.

12.3.6.3 Product certification

Product certification is a process whereby an expert assessment body certifies that a product, material, method or system of construction, design or component relating to building work, complies with nominated requirements of the BCA.

Product certification is one method of satisfying an approval authority that compliance with the BCA has been achieved. Product certification is optional to an applicant for approval. However, some approval authorities may require applicants to obtain product certificates as a means of risk management, albeit a costly exercise for the applicant. Product certification was originally introduced as a means of attesting the qualities of new or innovative products, materials, etc. for which there were no Australian Standards or standardised testing regimes. However, some organisations, such as Standards Australia International Global Assurance Services, presently certify compliance of standardised products with Australian and international standards and provide a means of readily demonstrating compliance with regulations such as the BCA.

Consequently, product certification is an essential administrative support system for the effective operation of the BCA as it enables manufacturers to have products certified and approval authorities do not need to make a decision on the propriety of a particular product because the decision has been made for them.

In order to allow a system of product certification to operate nationally, State and Territory building control legislation must include provisions which acknowledge that the submission of a certificate by an accredited product certification body must be accepted by approval authorities as evidence of compliance with the BCA.

Currently, the ABCB is reviewing the operation of its existing product certification system and proposes to adopt a new system whereby third party accredited bodies will act as certifiers and issue Certificates of Conformity to products, materials etc that have been identified as complying with the BCA. HIA has expressed concerns with the proposal as it is founded on requirements of international standards that may be too severe to attract interest from current certifying bodies. HIA considers it is essential that Australia has an effective and cost efficient product certification system to assist the approval of alternative solutions, new and innovative products and the needs of product manufacturers, in order to operate within a performance based regulatory system. Therefore, a restructured ABCB must drive the development and operation of an effective and cost-efficient product certification system as part of its fundamental goal to implement genuine national consistency in building regulations.

12.3.6.4 Role of the fire brigades in the approval process

The approval of certain *alternative solutions*, particularly those relating to issues of fire safety, may require an assessment by officers of the fire brigade. The requirement is generally contained in the administrative provisions of State and Territory legislation and for the most part is considered to be reasonable for alternative solutions relating to equipment used by the brigades for fire fighting purposes. However, the scope of approvals in which the brigades are involved is more extensive and this creates significant problems for building designers and approval authorities.

The source of these problems is found in legislation that regulates the activities of fire brigades, simply because it conflicts with the objectives of the BCA. By way of explanation, legislation under which most State or Territory fire brigades operate requires, in part, that fire fighting activities must be directed toward the protection of life **and** the protection of property. These principles are reasonably sound for fire fighting purposes, but conflict with those applied to the development of the BCA. BCA fire safety regulations fundamentally relate to the protection of building occupants, and the protection of any property adjoining the building on fire, rather than the building itself. In essence, if all building occupants were safely evacuated and the building was destroyed without damaging adjoining property, the objectives of the regulations would have been achieved. However, this outcome would not be consistent with the objectives of fire brigades' legislation.

Therefore, a significant problem arises when the fire brigades are required to be involved in the approval of certain alternative solutions. Because of the wording of

their legislation the brigades are not comfortable with approving designs in which compliance with the BCA has been achieved, yet it is obvious that the building could be destroyed in the event of fire. Consequently, the brigades are not accepting certain alternative solutions and the design flexibility allowed by the performance based BCA is being stifled by the requirements of a regulatory approval system.

This issue has been evident for many years and there is an obvious unwillingness for it to be addressed by regulatory authorities, although the reasons for this 'head in the sand' approach are unclear.

While the contribution of the fire brigades to life safety is recognised by the HIA, the operation of an approval process that stifles flexible design and innovation without compromise to the objectives of building regulations can have significant cost implications to housing developments, particularly high rise apartment accommodation.

Accordingly, the approval of all alternative solutions must be undertaken in recognition of the need for compliance with the BCA, not ancillary legislation related to property protection or other external objectives.

12.4 Cost impact of regulatory change

Over the past several years, changes to regulations have influenced the cost of compliance with the regulations applying to the design and construction of housing. As discussed previously, regulatory provisions can be technically based and contained within the BCA, or administratively based and contained within each State and Territory legislative system. An assessment of some of these changes has been undertaken and outcomes are presented below.

12.4.1 Cost of changes to the Building Code of Australia

Since its initial adoption in 1997, the BCA has been amended on 13 occasions. The following information relates to the scope of amendments that are considered to have increased the cost of housing and the estimated impact of those increases.

Amend No.	Brief Description	Estimated Additional Cost per Dwelling $
3	The construction of toilet doors	10 – 1,100
3	AS 3500 3.2 changed to coincide with revised stormwater regulations	900 – 5,000
3	Clause 3.1.3 amended to include stairs and ramps as *Primary Building Elements* for the purpose of termite management	100
3	Figure 3.3.1.2 – piers to garage walls changed from 230 mm × 110 mm to 350 mm × 230 mm @ 3.0 m c/c for W33 wind regions only	0 – 800
3	Clause 3.4.2.2 – corrosion protection amended to identify the various locations and distances applicable to corrosion resistance	100 – 120

Amend No.	Brief Description	Estimated Additional Cost per Dwelling $
4	Consolidation of the ACT and Victorian energy regulations to be more closely aligned with each other.	400
5	AS 2047 introduced. This led to the mandatory testing, tagging and waterproofing of windows.	0 – 500
5	Performance Clause 2.2.1 (a) and (b); and AS/NZS 3500-3.2, were harmonised. This meant the recurring average rainfall was amended from a 10-year return period to a 20 year timeframe and similarly from 50 to 100 years	300 – 5,000
5	Part 3.4.1 was amended to clarify the extent of subfloor clearances for ventilation	Negligible
6	Airborne Sound Insulation introduced –assume $200,000 construction costs – attached dwellings	2,000 townhouses/terraces 4,000 apartments (Note 1)
6	AS 3959 - "Construction in Bushfire Prone Areas" introduced to require 600 mm floor clearance.	500
6	The requirement for corrosion coating of wall ties was increased	100 to 120
7	AS 3959 was amended to become more stringent	Low Hazard - Nil Med Hazard - 907 High Hazard - 1157 (Note 2)
8	AS 1288 - Glass in buildings, was amended to require a greater level of Safety glazing to residential construction.	100 to 500
9	AS 1684 - National timber framing code parts 2, 3 and 4 introduced.	Up to 1000 depending on site wind classification
9	AS 3600 - Concrete structures revised and introduced.	Negligible to Class 1 and 10 Class 2 unknown
9	AS 3959 - Construction in Bushfire Prone Areas, Amendment 2 introduced; this included fire retard timber for zones designated as a high risk zones	Cost unknown – cannot comply
10	Revised AS 3700 referenced	5 to 10
10	Table 3.7.4.1 Extreme Bushfire zone added	Cost unknown – cannot comply
11	As 1170 Parts 1 & 2 revised and introduced; now limit State design	Cost increase not yet identified
12	Energy efficiency provisions introduced	1,100 – 5,700 (Note 3)
12	AS 1170 – 1989 reintroduced to eliminate confusion and problems arising from the introduction of the latest version	No costs incurred where industry continues to use existing standard
13	AS 2050 rewritten and introduced: changes to fixing requirements for hips, ridges and gable ends as well as changed fixing requirements to the main area of the roof.	0 – 600 depending on existing practice
	Total average cost increase is approximately	**$5,600 - $24,600**

Note 1. Extracted from *Proposal to Change the Sound Insulation Provisions of the Building Code of Australia (ABCB – RD2002/02)*

Note 2. Extracted from *Comparative Costing for the Proposed Bushfire Provisions of the Building Code of Australia (Page 25 of August 1999 ABCB RIS)*

Note 3. Extracted from *Energy Efficiency Measures BCA Volume Two (Housing Provisions) (Final ABCB RIS 2002/04)*

12.4.2 Cost of changes to State or Territory administrative systems

Set out below are some examples of individual State and Territory changes to regulatory regimes that have had a significant cost impact on housing affordability.

ACT

Brief Description of Change	Estimated Cost Increase per Dwelling
High Quality Sustainable Design (HQSD) is a design policy that was introduced early this year and applies to the design of majority of houses in the ACT. The policy has increased the time required to produce a complying house design. Consequently, architects and designers have increased their fees by an average of 1 percent to cover the associated cost.	1 percent of the estimated cost of construction
Holding Charges This issue is the biggest single workface time/cost issue in the ACT building industry. The introduction of HQSD fuelled the issue further. Currently, an average approval will take 10 days for the approval of HQSD, this takes place prior to the submission of the DA. A home in the inner city area will take an average of 45 days. By example the proposed small development at our own National HIA headquarters was submitted for approval in May 2003. It is still not approved to date 4 months later. *Example:* A derelict home in the inner city suitable for demolition currently costs $500,000 to $600,000 including stamp duty of $20,000 to $25,000. At 10 percent pa holding charges apply to the approval phase of home development. This of course does not take into consideration other overheads, cash flow and preliminary costs incurred by the builder.	10 percent per annum *Example*: 1,200 per week – estimated at $15,000
Energy Efficiency Assessments. These assessments are mandatory and are currently costing per home for an approved practitioner to provide the assessment. ACT Building Control is currently considering the introduction of a five star rating.	$250 – 300
Training levy. A training levy is applied in the ACT 0.2 percent of the project for a Building Permit or Construction Certificate	0.2 percent the cost of construction
Private Certification. The introduction of a private certification process added to the cost of assessing compliance with the BCA, however ACT Building Control has reduced its fees. Overall, the new process added to the cost of approvals and inspections.	$250 – $300
Total average cost increase is approximately	**$18,000**

Tasmania

Brief Description of Change	Estimated Cost Increase Per Dwelling $
Documentation. There is a trend for local councils to increase documentary requirements and including the copy quantities. More information required on plans and specifications – onus clearly on the developer/builder to provide all information to the council. This is largely due to decreasing resources within councils and liability issues. Approximate cost increase	300
Local council fees and charges are increasing for both plumbing and building approvals. Local council fees and charges are not regulated by State government in Tasmania – no maximum fees are set. Councils have the ability to determine their own scale of charges and this is increasingly based on a cost recovery approach. Approximate cost increase based on estimated cost of construction	150 – plumbing approvals 200 – building approvals
Introduction of private certification. This was introduced by regulation however the supporting provisions are contained in the Building Act 2000 which is yet to be implemented. As a result, councils have been very wary of certification and have raised liability issues. Some councils are still charging the same fees for assessment even though the plans have been certified and inspected by the private certifier. Therefore certification sometimes reduces the timeframes for approval but fees have not been reduced accordingly. In instances where a private certifier is engaged	Approximate 900
Implementation of the Building Act 2000. This is yet to be implemented but will include the payment of a building levy at building approval stage. The amount of this levy has not yet been determined.	
Working at heights legislation introduced in 1998. This requires ground based scaffolding where the drop height exceeds 2.4 metres (affects most construction sites due to Tasmania's topography).	Up to 2,000
Sedimentation control. Some councils have introduced the requirement for soil and water management plans for house sites and condition the building approvals accordingly.	Approximate 500
Ineffective building appeal process. This leads to substantial delays. However it is hard to quantify the costs as this would vary substantially depending on holding costs etc.	
Energy efficiency assessments - the cost of a computer assessment.	250 – 300
Total average cost increase is approximately	**$4,300**

Victoria

Brief Description of Change	Estimated Cost Increase Per Dwelling $
HIH levy of 0.032 percent introduced June 2001 - adds on an average house of $150,000	48
BACV levy (Building Advice & Conciliation Victoria) of 0.064 percent introduced July 2002 to fund the new dispute process, adds an average house of $150,000	96
5 Star Energy requirements (Victorian BCA variation) From July 2004 this will add $3300 to a house of $150,000. These figures were determined by the Victorian Government and published in their Regulatory Information Bulletin. Whilst houses can achieve 4 Star from this date this option involves the addition of water savings devices in lieu of the 5th star. Plumbing Industry Commission estimates the cost to supply and install a water tank to be $2,500, so the average figure of $3,300 may hold for the 4 star option and water saving devices. No definitive costs are available as the specifics of the water saving devices are yet to be formalised.	3,300 2,500
Mandatory water saving devices. Government intends, subject to a RIS, to introduce mandatory water saving devices from July 2005, hence if the PIC cost is valid, then this will add $2,500 to the average of $3,300 equating to an overall cost increase of $5,800. **Note:** These are average home costs on level sites with a concrete slab and applicable for first home buyers, order homes/architectural homes would be expected to be higher.	2,500
Temperature control valves for hot water systems (this was introduced into Victoria on 199). Valve and installation costs approx $150 with further costs for separate reticulation system.	150
Insulation of ductwork; Insulation and fire rating to ductwork of approx $450 plus GST plus builders margin - equates to $544 for 10 percent margin and 10 percent for GST.	450
Local councils requirements - (i) Temporary site fencing (as mandated by local laws in several councils located in the fringe growth areas where first home buyers purchase) equates to $900 for full site. Infill development cost for front temp fence only $450.	900 450
(ii) Provision of rubbish containers - /house (iii) Sediment control rock beds (driveways) - /house (iv) Increased tipping fees due to the need to empty containers on a regular basis and inability to stockpile on site – approx. (v) Costs on local laws from one project home builder across a number of council areas vary per house - this includes individual requirements of temporary vehicle crossings, additional rubbish removal, permit fees, temporary fencing and GST, hence would encapsulate all of the above estimates.	150 300 – 500 200 – 300 Range between 82.50 – 2,570

Brief Description of Change	Estimated Cost Increase Per Dwelling $
OH&S requirements i) Perimeter scaffolding - per two storey house ii) Electrical tagging for leads, tools etc - average cost per house Assessed on $8/item with average of 20 items per trade tagged 4 times a year, with average tradesperson undertaking 2 projects per month and 10 trades per house. iii) Stationery, JSA's, administration associated with OH&S requirements estimated 1 hour per week per supervisor. Assessed on average annual salary of $80,000 with 48 weeks/year = $42/hour hence $1680/year. On average of 40 houses per supervisor/year this equates to 1.2 hours /house = $50	 10 – 12,000 260 50 per house
Victorian ResCode; Average costs per house for additional site surveys, assessment, drawings, checking	450
Certificates of compliance from plumbers per house cost average Assessed at $20/certificate x 3 per house	60
Certificates of electrical safety from electricians per house cost average Assessed as above	60
Lockable Meter boxes; Cost per house to provide lockable meter boxes and power industry locks	250
Electrical safety switch	80
Council property information; fees varies depending on the council	0 – 300
Total average cost increase is approximately	**$17,700**

Queensland

Brief Description of Change	Estimated Cost Increase Per Dwelling $
WorkCover Insurance increase for clerical staff from 3 percent to 8 percent	450
BSA licensing	300
Working at Heights	2,000
Sedimentation Control	500
Portable Long Service leaves levy	140
WPH&S Costs	300
Domestic Contracts Act.	750
Local government charges and fees	600
Temperature control devices	200
Total average cost increase is approximately	**$5,240**

12.5 Key findings and recommendations

Key findings and recommendations on building control include:

- As a matter of priority, the Australian Building Codes Board must be restructured in order to place the coordinating responsibility for developing national regulatory provisions within a single specialist agency. This agency must also ensure national consistency in the application of these standards across all States and Territories, which would maintain responsibility for enforcing regulation. A structural model based on the Food Standards Australia New Zealand would offer significant benefits over the current structure of the Board, particularly as States and Territories would agree to adopt developed standards without variation.
- State and Territory governments must exercise their power to regulate consistently within their respective jurisdictions and ensure that building regulations are imposed through the Building Code of Australia and not through local planning schemes on the impulse of individual local authorities.
- The restructured ABCB should develop a national administrative framework that is able to support the application of the performance based technical standards required by the BCA. This framework should include:
    a. A effective and cost efficient system of product certification;
    b. An approvals application system that incorporates both private and public approval processes;
    c. An efficient approval system for alternative solutions.
- Regulatory impact assessments must address the cost of compliance with administrative provisions of regulatory regimes and also the cost of demonstrating compliance with technical regulations.

13 Conclusions

The submission has detailed a sizeable list of issues that are impacting negatively on the affordability of housing and home ownership. While the problems are most acute in the larger cities there are pressures in all the State capitals and in regional areas.

The submission has focussed on longer term issues to be addressed if the structural decline in housing affordability is to be reversed. But, there are short term actions that governments can take. The breadth of the issues and recommendations made in the submission poses challenges to all levels of government. The 'blameshift' that has characterised the housing affordability debate to date needs to be replaced with coordination, commitment and above all else some genuine leadership from all levels of government.

In the short term, the most effective impacts that governments can have on affordability are to:

- remove the iniquitous cascading and doubling dipping of taxation on home purchases; and
- replace inefficient and inequitable upfront infrastructure charges on new home buyers with rational, long term funding options that better relate the funding arrangements to the stream of benefits and scope of users of the infrastructure.

The restructuring of funding arrangements for the provision of social urban infrastructure simply represents a better way of managing infrastructure supply businesses.

The first measure will have the effect of reducing revenues for the Federal and State governments but provides a significant improvement in affordability. The extent of the improvements is demonstrated in the following summary table. It has been derived from representative project case studies provided by HIA members of the cost structures for a typical home in each capital city. More complete detail of the cost structures in these projects is contained in Appendix 3.

Final Price to the Home Buyer (including stamp duty)

	Sydney		Melbourne		Brisbane	Perth	
	Greenfield $	Infill $	Greenfield $	Infill $	Greenfield $	Greenfield $	Infill $
Current arrangements	544,115	549,340	419,660	419,660	386,600	291,425	339,080
After removal of the cascading of stamp duty and the GST on development charges	529,517	535,103	414,239	414,073	378,689	284,641	331,457
After removal of the cascading of stamp duty and the GST on development charges and social infrastructure charges	499,116	519,942	408,048	412,865	364,490	264,877	316,771

The following table then summarises the lower prices from adoption of these reform measures. The savings are significant, up to $45,000 on a new home in a greenfield development in Sydney. Over time, these cost savings would also flow through to the pricing of established homes in these centres. So the long term affordability benefits would be available not just to the purchasers of new homes but to all home buyers.

Summary of Savings

	Sydney		Melbourne		Brisbane	Perth	
	Greenfield $	Infill $	Greenfield $	Infill $	Greenfield $	Greenfield $	Infill $
Removal of cascading stamp duty and GST on development charges	14,598	14,237	5,421	5,587	7,911	6,784	7,623
Removal of cascading stamp duty, GST on development charges and social infrastructure charges	44,999	29,398	11,612	6,795	22,110	26,548	22,309

It is clear that the biggest impact on affordability is from introducing alternative means of funding upfront development charges for social and community infrastructure. Given that these changes will take some time to implement there need be no concern about these savings not flowing through to new home buyers. With the highly competitive nature of the residential building industry the savings would flow through to both new home buyers, and consequently to the prices of established homes.

The submission also has outlined a comprehensive reform agenda for other areas that will have long term benefits for the home buying community. Each section of the submission has concluded with recommendations in each of these areas.

Although the land supply and infrastructure issues have the most direct impact on affordability, these other areas such as workplace practices, standardising definitions of contractors and employees and management of the building regulatory environment are all core issues for the cost structures of the building industry and ultimately, the home buying public.

The potential savings to home buyers and the community more broadly from the implementation of this substantial reform agenda are enormous.

What is needed to begin the process of dealing with these issues is a focal point in government that is accountable for sustained and measurable improvements in affordability.

To be effective and given the costs imposed by interstate inconsistencies of approach, this focus must be at the Federal Government level. Over the last ten years or so, various Federal Governments have retreated from an involvement with urban issues generally, and housing policy in particular. To build on the momentum generated by the Productivity Commission's Inquiry, HIA will be recommending that the Prime Minister establish a Federal Department of Housing to address the broad sweep of issues that ultimately affect the cost of housing. Industry should also be represented

on this group because ultimately it is the cost of producing a new home that will determine the long run prices faced across the market by all home buyers.

Without a conscious commitment to breaking the mould for delivering housing and its associated infrastructure, housing affordability is destined to continue to lurch from one cyclical crisis to the next with each trough in affordability being deeper than the last.

APPENDIX 1

Infrastructure Funding – State By State Comparison

NSW

In NSW new development is regulated through the Environmental Planning and Assessment Act 1979 (EP&A Act).

A user-pays philosophy has generally existed for some time in relation to the provision of infrastructure for new development. Developers are expected to pay for most infrastructure required in association with new development.

Development charges for social infrastructure such as libraries and community buildings are levied by local government under Section 94 of the EP&A Act. State government is also able to impose contribution requirements for a range of social infrastructure items via specific State government powers[31].

Physical Infrastructure Provision
Generally the developer provides all services associated with new development. Water is provided either by Sydney Water or other regionalised authorities on a monopoly basis. Electricity and gas are now provided on a competitive basis. Telecommunication services are provided on a monopoly basis.

Development Contributions and Social Infrastructure Provision
Section 94 charges are the only legal mechanism for levying what are typically known as 'development contributions'. The requirements for Section 94 charges are addressed by State government guidelines but are not written into legislation. These are inconsistently interpreted and applied by local governments across the State.

The S94 Guidelines require that a nexus must be established between the infrastructure and the funding, ie contribution charged. A direct relationship to the development and reasonableness are required to be applied. Typically charges are levied for open space (both the land component for passive and active open space, indoor facilities, swimming pools and embellishment costs), community facilities (including libraries, community or neighbourhood centres, urban improvements and child care centres), district roads and trunk drainage.

The local application of the Section 94 Guidelines means that fees and charges vary from one municipality to another. Whilst it is estimated that most Section 94 plans levy between $20,000 and $25,000 per allotment, one Sydney council proposes to charge $64,000 per new allotment.

[31] The recent proposal to levy a $15,000 per lot transport levy in certain release areas required the enactment of special legislation. The EP&A Act was also recently amended, following a legal challenge, to empower local councils to impose an affordable housing levy.

Additionally a sate based transport tax is levied on residents in certain new release areas of Sydney. New residents will be charged $15,000 per lot for the provision of public transport services.

Independent Pricing and Regulatory Tribunal (IPART)
IPART is an independent body that oversees the setting of prices for water, power and public transport services in NSW. IPART also functions to ensure that competitive neutrality is practised by the various monopoly agencies.

Planning Legislation and Housing Affordability
Objects of the EP&A Act include references to the orderly and economic use and development of land; the protection, provision and coordination of communication and utility services and "the provision and maintenance of affordable housing" (the latter is narrowly defined as housing for the very low, low and moderate income households).

Victoria

The Planning and Environment Act 1987 regulates the provision of infrastructure typically associated with residential development. Clause 56 of the Victorian Planning Provisions sets out requirements for subdivisions including the design and servicing of residential land.

Physical Infrastructure Provision
Most on site infrastructure is provided by the developer with developer contributions generally accounting for provision of headworks for water, sewerage and main drainage as well as for regional open space provision and arterial roads.

Development Contributions and Social Infrastructure Provision
The Planning and Environment Act 1987 allows for development contributions to be collected from the proponent of a new development through the planning scheme amendment process, planning permit process or building permit process. A council collects development contribution levies from new development through an approved DCP which must form part of their local planning scheme.

A recent review of development contributions by the Minister for Planning is widely tipped to result in a new Ministerial direction that will redefine infrastructure to include a broader range of entities. It is likely that the following items will be included in the new definition – drainage, land forming and landscaping of public open space, street furniture, roads, paths, bike paths, traffic management facilities, public transport, the acquisition of land for roads, public transport corridors, drainage works, family services buildings, child care centres and kindergartens. Clearly, Victoria is heading in the same direction as NSW in terms of expanding the potential scope of local development charges. This will impact significantly on housing affordability.

Planning Legislation and Housing Affordability
Clause 56 of the Victorian Planning provisions relates to subdivision and aims to: "*encourage subdivisions that provide a wide range of lot size, are cost effective and meet community standards for health and amenity*."

There are no other considerations for housing affordability in Victorian legislation.

Independent Pricing Agency
The Essential Services Commission regulates the price of utility services supplied by the electricity, gas, water, ports, grain handling, and rail freight authorities. The Commission commenced operations on 1 January 2002.

Queensland

Infrastructure provision in Queensland is delineated by clear responsibilities set out in State based legislation.

The Integrated Planning Act 1997 provides councils with an infrastructure charging regime to recover costs for the three urban infrastructure networks considered essential to meet basic community needs. These are water (including water supply, sewerage and environmental water management), transport infrastructure (including local roads, footpaths, cycle ways and car parks) and community land networks (including land for public recreation and community facilities).

Physical Infrastructure Provision
Typically the developer pays for water and power installation with gas provided by the gas supplier free of charge to the developer.

In Queensland, water is provided mostly on a monopoly basis by a variety of government authorities. Gas and electricity are provided on a competitive basis and telecommunications are provided by monopoly.

Development Contributions and Social Infrastructure Provision
The Integrated Planning Act 1997 provides local government with the ability to impose development charges for infrastructure as part of the development assessment process.

Local Planning Schemes are the instruments used to deliver the infrastructure charging regime. Contributions can take the form of cash or works-in-kind. In larger master planned communities, infrastructure provisions can also be managed through infrastructure agreements. Infrastructure that is typically provided upfront or funded as part of the development includes water and sewerage (both reticulation and headworks), roads, open space and drainage.

Social infrastructure is defined in Queensland legislation as *"public recreation predominantly serving a local area or otherwise prescribed in regulation"*. Legally, development charges cannot require a greater provision, therefore the bulk of social infrastructure is funded by the broader user base.

It is noteworthy that some councils in Queensland impose additional social infrastructure requirements on developments, without any regulatory basis. It is also noteworthy that in Queensland there is a tendency for developers of master planned communities to provide facilities well in excess of what the regulations call for.

Independent Pricing Agency
The Queensland Competition Authority monitors prices set by the government owned monopolies in the water sector and ensures competitive neutrality in the privately provided utilities.

Planning Legislation and Housing Affordability
The provisions of the Integrated Planning Act 1997 and its ancillary guidelines that define the ability of local governments to set infrastructure charges require that:

> *"infrastructure charges are limited to three urban networks because as an up front charge usually levied at the time of development,* ***they threaten housing affordability****."*

Western Australia

New development in Western Australia falls within the jurisdiction of The Town Planning and Development Act 1928. In Western Australia the consent authority for subdivisions is the State government.

Typically in Western Australia, all on site infrastructure is provided by the developer including water, sewerage, drainage and subdivisional roads and underground power.

The power to apply developer contributions is derived from the Town Planning and Development Act and implemented primarily via the subdivision approval process.

Councils cannot levy development contributions in their planning schemes without the approval of the Western Australia Planning Commission and the Minister for Planning and Infrastructure. The extent to which development contributions can be sought is set out in the Western Australian Planning Commission's Planning Bulletin No.18.

Development contributions usually include headworks for water, sewerage and drainage and land for local open space and primary schools.

Physical Infrastructure Provision
Typically the developer pays for water, power and telecommunications installation with gas provided by the gas supplier free of charge to the developer. All service provision including water, electricity, gas and telecommunications is provided on a monopoly basis.

Development Contributions and Social Infrastructure Provision
Social infrastructure is not defined in State legislation in Western Australia. However, the scope of work legally able to be subject to development contributions is set out in the West Australia's Planning Commissions PB 18.

Developers are, however, expected to contribute towards primary schools, regional roads and in some cases public transport reserves. These requirements are normally imposed by the West Australian Planning Commission as conditions of subdivision approval.

Independent Pricing Agency
The West Australian government is presently considering a proposal to establish an independent pricing tribunal.

Planning Legislation and Housing Affordability
Housing affordability objectives are not mentioned in State based planning legislation. Supporting regulatory documents emphasise the importance of 'orderly development'.

South Australia

Generally user pays principles apply to the provision of all on site infrastructure for new housing in South Australia. Utility costs are predominantly met through user charges and/or partly subsidised by the State.

Physical Infrastructure Provision
Gas and telecommunications are provided directly by monopolies. Water and electricity are provided by competitive tender and are handed over to South Australia Water and ETSA. Headwork charges are directly attributable to the development and are soon to be included in a published schedule.

Development Contributions and Social Infrastructure Provision
In South Australia, developer contributions only relate to the provision of land for open space (at 12 percent of site area) or a cash contribution in lieu of open space land.

Some councils require a contribution for stormwater, of up to $600 per dwelling. Whilst this is not regulated, it is generally accepted practice.

There is no clear distinction between the provision of social infrastructure and other infrastructure in the State planning legislation. Social Infrastructure does not require a contribution from developers, however, its provision is typically negotiated as part of the approval process.

Planning Legislation and Housing Affordability
Housing affordability is not considered in any State based planning legislation.

Independent Pricing Agency
South Australia does not have an independent pricing tribunal.

ACT

The development of new housing is somewhat different in the ACT to the rest of Australia. As all land is owned by the Commonwealth Government, the cost of servicing it is usually included as part of the leasehold price.

Physical Infrastructure Provision
Estate sized parcels of greenfield land are auctioned from time to time to private land developers, although the government has recently decided to take a more direct role in land development matters and may now involve the private industry only by choice.

Development Contributions and Social Infrastructure Provision
As costs required to service new estates are covered by the reserve price paid for the land, the amount directed to the provision of social infrastructure is not immediately transparent.

Planning Legislation and Housing Affordability
There is no requirement to specifically consider housing affordability in ACT legislation.

Independent Pricing Agency
The Independent Pricing Regulatory Commission has been established in ACT to regulate and monitor utility prices set by ACTEW/AGL.

Tasmania

Development of new housing in Tasmania is controlled by the Land Use Planning and Approvals Act and the Local Government Act. Whilst there is mostly a user pays principle that exists for servicing new development in Tasmania, the Land Use and Planning Act allows for agreements to be made between councils and developers regarding the provision of infrastructure.

Physical Infrastructure Provision
The cost of providing on-site physical infrastructure associated with development is met totally as part of the development process.

Development Contributions and Social Infrastructure Provision
Developers are required to provide an open space allocation of 5 percent of total land area or a cash-in-lieu contribution. Planning legislation in Tasmania does not require the provision of social infrastructure. As such builders and developers tend to provide community facilities on a voluntary basis or as negotiated as part of the approval process.

Planning Legislation and Housing Affordability
The State based Tasmanian legislation does not provide any specific reference to housing affordability.

Independent Pricing Agency

The Tasmanian Government has established the Government Prices Oversight Commission which oversees the pricing policies of government agencies, government business enterprises, local government bodies, statutory authorities and State owned companies.

APPENDIX 2

Assessment Of Zoned Land Stocks

The following snapshot estimates current land supplies and housing needs for each of the capital cities, based on information derived from government sources, recent research projects and from discussions with private land developers and builders.

Perth

Greater Perth's population is predicted to increase from 1.5 million to 2.4 million by 2031 at about 1.4 percent per annum (based on medium scenario projections that estimate equal increases in natural growth and migration)[32]. The majority of growth is expected to occur within the Perth Metropolitan Region. This growth is predicted to require an additional 405,300 dwellings (a 65 percent increase in the current dwelling stock, or a total dwelling stock of 1,024,500 achieved at a production rate of an additional 13,500 new dwellings per year).

Currently, there is 105,400 ha of land zoned 'urban' (including 20,900 ha of undeveloped zoned land) and a further 8,000 ha of land identified for possible future urban uses[33]. Based on current planning intentions and achieving densities on the urban fringe in the order of 15 dwellings per net hectare, Greater Perth has a theoretical dwelling capacity of approximately 1.1 – 1.7 million dwellings.

Zoned land stocks are therefore sufficient to accommodate the predicted 2031 population although, if relying only on currently zoned but undeveloped land, a shortfall in the order of 60,000 dwellings results. Perth's ability therefore to meet projected demand at 'typical densities' is to a large extent dependent on the redevelopment of underdeveloped land. Alternatively, higher density development (in the order of 20 dwellings per net hectare) could achieve the 2031 demand levels from current stocks of undeveloped zoned urban land.

The adequacy of Perth's residential land supply may therefore be tested if the city's ability to develop at higher densities or to redevelop partially developed land is thwarted by community opposition.

Despite being in a position of relative strength when it comes to long term land stocks, the reality is that housing affordability in the Perth has declined in recent years due mainly to escalating land prices. Following consumer preferences, housing affordability problems are more acute for the detached home market than for medium density stock.

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[32] Western Australia's overseas migration share is about 11 percent of the national intake. Perth attracts about 80 percent of these. Without migration, the Greater Perth population would level out at about 1.6 million in the mid-2020s and then start to decline around 2030. This is due to the long term trend for people to have fewer children - see *Greater Perth – Population and Housing, Discussion Paper No.2*, Western Australia Planning Commission, August 2003.

[33] See *Greater Perth - Residential Land Balance Discussion Paper No.6*, Western Australia Planning Commission, August 2003.

Adelaide

A recent study has identified approximately 50,000 potential allotments in metropolitan Adelaide, or 6-8 years supply at predicted demand levels.[34] Additional potential land stocks sourced from underutilised land could increase this supply to 95,000 lots or 12-16 years supply. Beyond 2016, however, it is predicted that the contribution to development sites from greenfield areas will diminish drastically, unless new land is identified for urban development. About 4,000 sites are expected to be sourced from greenfield areas from 2017-2023 with the remaining 41,000 of required dwelling sites sourced from established areas.

The capacity for Adelaide to 'redevelop' at this rate will test the community's acceptance of urban consolidation.

Current population projections estimate a peak population for Adelaide of around 1,142,000 by 2022. Changes to Australia's migration intake, however, have resulted in a recent net migration gain for Adelaide. If this trend continues the estimated peak population will be larger and additional dwellings will be required.

Based on these likely scenarios, UDIA predicts that 100,766 dwellings will be required in Adelaide by 2016 at a production rate of 7,200 per year. In this eventuality Adelaide's urban growth boundary will show signs of strain and would need to be reviewed both immediately and again within a 5 year timeframe.

Sydney

Sydney is presently growing by approximately 50,000 persons per annum. The city's population is expected to reach 5 million by 2020, representing a net increase of approximately 1 million people over this period.

The State government's 2002 publication 'Managing Sydney's Urban Growth' (MSUG) States:

> *"In December 2001, the NSW Government agreed that Sydney's housing demand would be met from a combination of urban redevelopment and greenfields residential development. This approach is consistent with the current planning policy of achieving a mix of 30 percent of new release on the metropolitan fringe and 70 percent in existing areas."*

MSUG 2002 predicts that 139,395 dwellings will be constructed over the next 5 years at approximately 27,800 dwellings per year. Over the last 5 years construction has averaged around 29,200 dwellings per year, buoyed by stronger than expected population growth and consumer demand.

For the next 5 years 23 percent of dwellings are forecast to come from Sydney's inner ring suburbs, 28 percent from the middle ring (the largest contributor, earmarked to add 39,425 dwellings to Sydney's housing stock), 24 percent from the outer

[34] Assuming an underlying demand of 6,000-8,000 lots per year. See *A Matter of Growth – Population Projections, Land Supply and Policy Directions for Adelaide*, UDIA, July 2003.

established areas and 25 percent from new greenfield release areas. 50 percent of the total predicted housing supply is forecast to come from 10 out of the 44 Local Government Areas (LGAs) in Sydney, including inner, middle and outer ring LGAs, with South Sydney and the City of Sydney contributing the most additional stock.

An analysis of housing production figures and the 2002 supply forecasts shows that:

- over the past decade detached housing as a proportion of total approvals has fallen from 52 percent to 42.5 percent;
- detached housing as a proportion of forecast housing mix is predicted to fall to 31 percent over the next 5 years;
- apartment buildings of 4 or more storeys increased from 9 percent of new housing stock at the beginning of the decade to 32 percent at the end;
- total multi-unit housing is predicted to contribute 67 percent of Sydney's additional housing stock over the next 5 years;
- if 30 percent of new housing development is to occur in greenfields areas (note this target figure is higher than the 5 year projection of 25 percent), there will be a shortfall of some 7,000 lots over 5 years (presuming, of course, that the estimated 33,145 lots identified as coming from greenfield release areas can actually be produced).

According to the MSUG projections, the city is predicted to become more dense by 2007 at twice the rate experienced over the past decade. The MSUG scenario is finely balanced – demand is predicted to be met by supply, but with an increasing reliance on in-fill housing, both in the inner and middle ring suburbs, and also in the outer established parts of the city.

The MSUG projections raise a number of concerns for the housing industry, viz:

- the government predictions of population growth may be wrong – Sydney grew at a much quicker rate than anticipated over the last decade and may do so again. Already, since the MSUG projections were formulated, the commonwealth government has increased the total available migrant intake. Whilst MSUG is based on a high prediction of 100,000 immigrants per year the current commonwealth program allows 110,000 places plus a contingency of 4,000 places and a further 12,000 places under the humanitarian program. These adjustments will affect Sydney's rate of growth;
- an increasing public resentment of urban consolidation may spill over into local council policies and practices, making it more difficult for new urban infill projects to gain approval;
- there is a decreasing supply of urban infill opportunity as large under utilised land parcels are taken up, thereby affecting the ability for multi-unit housing in the established LGAs to contribute to housing stock at the forecast rate;
- the processes of land release are cumbersome and are likely to slow actual lot production.

Most importantly, there is no government fallback position to accommodate Sydney's expected population increases if and when the above factors come into play, nor any known (or politically viable) mechanisms for ramping up housing supply to meet a

chronic short term need. Approximately 5,000 odd lots only are predicted to be produced annually for the next 3 years, despite an underlying demand for detached housing in Sydney of around 10-13,000 lots annually.

Melbourne

Metropolitan Melbourne grew by 1.5 percent or 52,475 people in the year ending 30 June 2002, a rate of growth that is slightly ahead of Sydney's. This rate of growth is significantly above Melbourne's average annual growth rate for the last 5 years (1.1 percent). By 2030, metropolitan Melbourne's population is expected to increase by 680,000 households and by over 1 million people (approximately 10 percent higher than predicted in Melbourne 2030).

Like other cities, some of the population challenges of Melbourne include:

- the greying of its population – almost 30 percent of its total population will be over the age of 60 by 2030;
- a change in household structures – one person and two person households will become more numerous and account for an estimated 90 percent of all additional households between now and 2030;
- a change in the types of houses produced – for reasons of cost, changing lifestyles, and greater diversity in housing stock; and
- adjusting housing supplies to meet variations in overseas immigration levels[35].

Melbourne 2030 aims to make Melbourne a more compact and sustainable city by introducing an Urban Growth Boundary, channeling new growth into nominated 'activity centres' and designated growth areas and, like Sydney, setting an aspirational 70/30 housing split for new housing contributed from the established areas and from development on the urban fringe.

For new urban areas the aspirational target is for 214,000 new households (31 percent) to be located in broadacre development areas by 2030, as opposed to the current trend that would see 256,000 households located in new development areas. For the established areas the aspirational target is for 468,000 households (69 percent) to be accommodated in urban infill areas by 2030 as opposed to 426,000 on current trends.

Currently there are approximately 150,000 lots in zoned land supply, although total potential supply is closer to 180,000 (ie land within the Urban Growth Boundary is identified as potentially urban but not yet zoned). Like Perth, its land stocks are capable of producing higher housing yields at slightly higher densities. By ramping up densities to 12.5 dwellings per hectare (as opposed to the current rate of 10 dwellings per hectare) total land stocks could yield over 210,000 dwellings (roughly equal to the 2030 aspirational levels for greenfield housing)[36].

[35] Victoria typically accommodates 25 percent of the national migrant intake and Melbourne attracts 92 percent of the State's intake. In 2002 Melbourne's share of the total was 34,249 persons.

[36] Melbourne is the most prolific producer of residential allotments in Australia, currently producing around 25,000 lots annually. The aspirational level of 214,000 greenfield houses by 2030 averages at less than 8,000 lots per year, a marked difference to current production levels. The current production rate is predicted to taper over time, however, in keeping with changing lifestyle and housing preferences. The newly formed UDP will

One of the objectives of Melbourne 2030 is to maintain housing affordability and business attractiveness and competitiveness. The strategy is predicated on the premise of a 15 year rolling land supply for the growth areas and the early identification of potential constraints (likely to be in the form of transport and water infrastructure, planning processes and community attitudes) that will allow predictions to be adjusted over time.

A major concern for industry is the effect that the Urban Growth Boundary has already had on land prices[37] and the impact that concentrated areas of activity will have on building practices. This latter concentration is especially threatening to industry efficiency, as the technology and labour relations practices of the multi-unit builders are similar to those of industrial and commercial builders – marked by poor work practices and bitter and costly disputation with unions. The average cost of building detached homes in Victoria in 2002 was $157,000 compared with $111,000 5 years previous – a 41 percent increase. The average cost of building units in 2002 was $183,000 compared with $102,000 five years hence – an 80 percent increase.

The most important challenge that Melbourne faces, therefore, is to achieve a more compact city form at little cost to the home consumer. This has not been achieved in Sydney.

Brisbane

Queensland grew by 2.4 percent in 2002, an increase of more than 86,000 people. Current drivers of this growth include higher net gains from both interstate (36,500 people or 100 people a day during 2002) and overseas migration (26,000 people in 2002). In 2002 Queensland recorded a pro-rata share of Australia's overseas net gain (19 percent of Australia's net gain from overseas migration and 19 percent of Australia's population)[38].

More than 6 out of 10 Queenslanders now live in the south-eastern corner of the State, however 8 out of every 10 new people to the State choose to live in this region. The local government areas with the largest population increases in 2002 were Brisbane City (20,700 at a rate of 2.3 percent) and Gold Coast City (14,700). Brisbane City now has a population of 917, 216 persons.

More than 7 out of 10 new multi-unit dwellings approved in 2002 were located in Brisbane and Gold Coast Cities. Approvals for high-rise units in Brisbane City increased three-fold, whilst approvals for townhouses halved. Approvals for high-rise units in Gold Coast City increased by two-thirds. Whilst fringe suburbs continue to be the location of most residential activity in the south east Queensland region, for the first time (in the March quarter of 2002) residential approvals in Brisbane City's core matched those in the city's outer ring.

monitor production rates and densities to determine whether the 2030 aspirational levels need to be adjusted or whether greater rates of infill development need to be encouraged.

[37] It has been estimated that the average price of a residential lot at the city's fringe has increased by $40,000 since the Urban Growth Boundary was introduced.

[38] Queensland's natural increase in population is declining, but at a slower rate than for the rest of the country. A natural decrease in the population is not expected within 50 years.

A recent government 'broadhectare study' of land supplies for Brisbane City[39] shows that:

- 15.9 percent of broadhectare land is already developed (based on parcel sizes of 0.25 hectares or less);
- 12.7 percent is allocated to roads, railways and watercourses;
- 69.2 percent is not suitable and/or not available for residential development; and
- only 2.2 percent (or 3,115 hectares) is considered suitable and potentially available for residential development. The majority of this land is held in small parcels between 1.0 and 1.9ha in size (47 percent of all parcels). Land parcels suitable for large scale development are scarce.

The broadhectare stock of 3,115ha:

- equates to a residential yield of approximately 30,000 dwellings (just over 8 year's supply); and
- can accommodate a population increase of 82,000 persons.

Brisbane is expected to grow by 132,000 persons by 2016 (a medium series projection). This population cannot be accommodated solely by the identified broadhectare land supply.

Based on current development trends, land for residential development is likely to be exhausted by 2012. If the projected population growth to 2016 were to be accommodated solely by broadhectare land, an additional 1,700ha would be required.

Diminishing broadhectare land stocks in Brisbane City will necessitate a shift over time in residential development activity from large scale master planned subdivisions to infill development and smaller scale subdivisions. For Brisbane City to accommodate its expected population growth, options such as the identification of additional greenfield sites and the promotion of higher densities in appropriate locations will need to be pursued.

Given the degree of growth that has and continues to occur in the South East Queensland (SEQ) region, it is necessary when looking at Brisbane's possible land constraints to also look at the region more broadly. SEQ (which includes local governments such as Brisbane City, Caboolture, Toowoomba, Gold Coast, Redland, Pine Rivers and Maroochy Shires, Caloundra City and Logan City) generally accounts for 80 percent of the State's population growth and typically produces about 10,000 lots per year. The SEQ2001 Project, commenced in 1990 in response to the high population pressures, determined that development up to 2016 should be focused around four major urban centres – Brisbane, the Sunshine Coast, the Gold Coast and Toowoomba. The strategy also required that areas needed for urban expansion beyond 2016 be protected for that purpose. Approximately 36,205 ha of suitable broadhectare land has been set aside for residential development in the total SEQ region, or the equivalent of 20 years supply. Whilst Brisbane City is a major lot producer in the

[39] See *Queensland Department of Local Government and Planning's Broadhectare Study 5*, 2003.

region, other areas (Pine Rivers Shire, Gold Coast, Redland Shire) would be expected to increase their share of production should Brisbane's supplies diminish. The new SEQ2021 project will further develop strategies to manage the region's predicted population increases and land supply needs.

APPENDIX 3

Assessment Of The Savings From More Equitable And Efficient Taxation And Infrastructure Funding For Residential Development

1. House and Land Package Examples - Current Situation

	Sydney		Melbourne		Brisbane	Perth	
	Greenfield	*Infill (1)*	*Greenfield*	*Infill (2)*	*Greenfield*	*Greenfield*	*Infill (4)*
Raw Land Cost	$110,000	$93,000	$60,000	$75,000	$67,500	$25,000	$75,000
Stamp Duty	*$2,340*	*$3,787*	*$1,240*	*$1,600*	*$1,181*	*$575*	*$1,725*
(a) **Design and Land Development Costs**	$60,000	$130,000	$50,000	$40,000	$40,000	$30,000	$25,000
(b) **Developer Charges**							
Local Physical Infrastructure	$21,825	$7,944	$3,010	$4,200	$14,299	$16,847	$4,360
Social Infrastructure	$29,092	$14,508	$5,840	$1,140	$13,719	$18,663	$13,868
Developer Sale Price to Builder	$223,257	$249,239	$120,090	$121,940	$136,699	$91,085	$119,953
GST	*$11,326*	*$15,624*	*$6,009*	*$4,694*	*$6,920*	*$6,609*	*$4,495*
Stamp Duty	*$6,304*	*$7,213*	*$2,865*	*$2,976*	*$3,543*	*$2,222*	*$3,478*
(c) **Dwelling Construction Cost**	$190,000	$152,000	$178,000	$180,000	$165,000	$125,000	$130,000
GST	*$19,000*	*$15,200*	*$17,800*	*$18,000*	*$16,500*	*$12,500*	*$13,000*
Total Land + Building Cost	$449,887	$439,276	$324,764	$327,610	$328,662	$237,416	$270,926
(d) **Other Cost and Margins**	$75,113	$90,724	$75,236	$72,390	$46,338	$42,584	$54,074
Sale Price	$525,000	$530,000	$400,000	$400,000	$375,000	$280,000	$325,000
Stamp Duty	*$19,115*	*$19,340*	*$19,660*	*$19,660*	*$11,600*	*$11,425*	*$14,080*
Final Price to the Home Buyer	**$544,115**	**$549,340**	**$419,660**	**$419,660**	**$386,600**	**$291,425**	**$339,080**

Notes: *All Examples refer to Spec Homes*
(a) Design and civil costs associated with land development - includes margin, immediate road construction etc
(b) Utilities, Roads, Local Drainage etc
(c) Source, ABS Building Approvals
(d) Other includes planning delays, land tax, rates, finance costs, holding costs, approval fees, selling costs, and margin

(1) Medium to high density infill on brownfield land
(2) Low density Infill
(3) Developer and builder are the same
(4) Multi-unit infill - land sold to builder

2. House and Land Packages minus Cascading Stamp Duty and GST on Developer Charges

	Sydney		Melbourne		Brisbane	Perth	
	Greenfield	*Infill (1)*	*Greenfield*	*Infill (2)*	*Greenfield*	*Greenfield*	*Infill (4)*
Raw Land Cost	$110,000	$93,000	$60,000	$75,000	$67,500	$25,000	$75,000
Stamp Duty	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
(a) **Design and Land Development Costs**	$60,000	$130,000	$50,000	$40,000	$40,000	$30,000	$25,000
(b) **Developer Charges**							
Local Physical Infrastructure	$21,825	$7,944	$3,010	$4,200	$14,299	$16,847	$4,360
Social Infrastructure	$29,092	$14,508	$5,840	$1,140	$13,719	$18,663	$13,868
Developer Sale Price to Builder	$220,917	$245,452	$118,850	$120,340	$135,518	$90,510	$118,228
GST (excluding developer charges)	*$6,000*	*$13,000*	*$5,000*	*$4,000*	*$4,000*	*$3,000*	*$2,500*
Stamp Duty	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
(c) **Dwelling Construction Cost**	$190,000	$152,000	$178,000	$180,000	$165,000	$125,000	$130,000
GST	*$19,000*	*$15,200*	*$17,800*	*$18,000*	*$16,500*	*$12,500*	*$13,000*
Total Land + Building Cost	$435,917	$425,652	$319,650	$322,340	$321,018	$231,010	$263,728
(d) **Other Cost and Margins**	$75,113	$90,724	$75,236	$72,390	$46,338	$42,584	$54,074
Sale Price	$511,030	$516,376	$394,886	$394,730	$367,356	$273,594	$317,802
Stamp Duty	*$18,486*	*$18,727*	*$19,353*	*$19,344*	*$11,332*	*$11,047*	*$13,655*
Final Price to the Home Buyer	**$529,517**	**$535,103**	**$414,239**	**$414,073**	**$378,689**	**$284,641**	**$331,457**

Notes: *All Examples refer to Spec Homes*
(a) Design and civil costs associated with land development - includes margin, immediate road construction etc
(b) Utilities, Roads, Local Drainage etc
(c) Source, ABS Building Approvals
(d) Other includes planning delays, land tax, rates, finance costs, holding costs, approval fees, selling costs, and margin

(1) Medium to high density infill on brownfield land
(2) Low density Infill
(3) Developer and builder are the same
(4) Multi-unit infill - land sold to builder

3. House and Land Packages minus Cascading Stamp Duty, GST on Developer Charges and Social Infrastructure Charges

	Sydney		Melbourne		Brisbane	Perth	
	Greenfield	*Infill (1)*	*Greenfield*	*Infill (2)*	*Greenfield*	*Greenfield*	*Infill*
Raw Land Cost	$110,000	$93,000	$60,000	$75,000	$67,500	$25,000	$75,000
Stamp Duty	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
(a) **Design and Land Development Costs**	$60,000	$130,000	$50,000	$40,000	$40,000	$30,000	$25,000
(b) **Developer Charges**							
Local Physical Infrastructure	$21,825	$7,944	$3,010	$4,200	$14,299	$16,847	$4,360
Social Infrastructure	$0	$0	$0	$0	$0	$0	$0
Developer Sale Price to Builder	$191,825	$230,944	$113,010	$119,200	$121,799	$71,847	$104,360
GST (excluding developer charges)	*$6,000*	*$13,000*	*$5,000*	*$4,000*	*$4,000*	*$3,000*	*$2,500*
Stamp Duty	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
(c) **Dwelling Construction Cost**	$190,000	$152,000	$178,000	$180,000	$165,000	$125,000	$130,000
GST	*$19,000*	*$15,200*	*$17,800*	*$18,000*	*$16,500*	*$12,500*	*$13,000*
Total Land + Building Cost	$406,825	$411,144	$313,810	$321,200	$307,299	$212,347	$249,860
(d) **Other Cost and Margins**	$75,113	$90,724	$75,236	$72,390	$46,338	$42,584	$54,074
Sale Price	$481,938	$501,868	$389,046	$393,590	$353,637	$254,931	$303,934
Stamp Duty	*$17,177*	*$18,074*	*$19,003*	*$19,275*	*$10,852*	*$9,946*	*$12,837*
Final Price to the Home Buyer	**$499,116**	**$519,942**	**$408,048**	**$412,865**	**$364,490**	**$264,877**	**$316,771**

Notes: *All Examples refer to Spec Homes*
(a) Design and civil costs associated with land development - includes margin, immediate road construction etc
(b) Utilities, Roads, Local Drainage etc
(c) Source, ABS Building Approvals
(d) Other includes planning delays, land tax, rates, finance costs, holding costs, approval fees, selling costs, and margin
(1) Medium to high density infill on brownfield land
(2) Low density Infill

FINANCING INFRASTRUCTURE FOR RESIDENTIAL DEVELOPMENT

REPORT BY
ACCESS ECONOMICS PTY LIMITED

FOR

HOUSING INDUSTRY ASSOCIATION LIMITED

OCTOBER 2003

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EXECUTIVE SUMMARY

As part of the Productivity Commission's inquiry to evaluate the affordability and availability of housing for first home buyers, the Commission has identified charging for urban infrastructure as a matter of interest. This report, commissioned by the Housing Industry Association (HIA):

- reviews the economic principles underlying the financing of urban infrastructure; and
- comments on the extent to which they are reflected in current arrangements. The focus is on the guidelines for developer contributions applying in NSW, Victoria and Queensland.

Urban infrastructure includes:

- 'economic' infrastructure services such as water supply, sewerage and drainage, roads, public transport, gas and electricity supply;
- provision of 'social' infrastructure or community services such as libraries, child care centres, community halls and open recreational space.

The diversity of infrastructure makes it difficult to determine the optimal way to charge for it. It is hard to generalise about who benefits, who should pay, and how funds should be raised.

In the past, urban infrastructure has generally been financed out of general tax revenue and borrowings at the state and local government levels. More recently there has been greater reliance on direct contributions and cost-reflective user charges. Increasingly, local councils are levying 'developer contributions' to recover costs associated with the provision of local infrastructure. However, these charges often rate poorly on grounds of efficiency and equity.

ECONOMIC PRINCIPLES

The report draws on the economic principles of efficiency, equity and simplicity in examining charging arrangements. Efficiency is important to ensure that limited resources are used in the most socially productive manner to improve overall economic welfare. Prices have a key role to play in securing the efficient allocation of scarce resources. As a general rule, infrastructure and other services should have prices that reflect the real resource cost of service delivery.

Notions of equity can be consistent with efficiency, to the extent it is equitable as well as efficient that those who benefit from infrastructure bear the burden of its financing. However, there is also a view that it is equitable that individuals have a minimum level of access to some infrastructure services regardless of their ability to pay.

Simplicity is also important. An arrangement may be efficient and equitable but be too complex to administer.

For normal market goods and services, where the benefits are captured and paid for by private consumers, the market generally leads to an efficient outcome. However, urban infrastructure is an area where there may be substantial 'market failure' - left to itself, the market may not result in an efficient outcome. This may be due to the existence of externalities in consumption or public good characteristics. Local governments may choose to provide social infrastructure, such as libraries, community halls or sporting facilities as they

are seen to have positive externalities. In addition, governments may choose to ensure a minimum level of access to 'merit goods' such as basic health and education.

Due to their cost characteristics, certain economic infrastructure services such as water and electricity supply are highly regulated or provided by governments. Where monopoly services are provided, they are subject to independent price regulation.

INFRASTRUCTURE CHARGING IN PRINCIPLE AND PRACTICE

The report proposes a charging regime which focuses on the 'beneficiary pays principle' - that is, the principle that individuals should only finance infrastructure in proportion to the benefits they receive.

A direct charging approach (such as levying of developer contributions) is appropriate where the vast majority of benefits are captured by the user as private benefits, or the benefits are largely confined within a new development (while any broader social benefit is small). This would include many capital works within a subdivision (new development) including reticulation of economic infrastructure services, connection of individual homes, internal roads, drainage and other facilities for use primarily by the residents of the new development.

However, most urban infrastructure facilities provide benefits to existing residents, as well as those in the new development. In these cases, the selected charging mechanism should target all the beneficiaries. Where a subsidy is applied to the activity to account for social benefits, this should be funded by the whole of the relevant community through appropriate general taxation.

For many items of 'social infrastructure' the prime beneficiaries are those who use the service, while non-payers can be excluded from access to the service. Technically, fees can be directly levied on a user pays basis (such as per hour charges for child care and access to a community hall). However, governments often choose to subsidise services such as these as they are seen to be socially beneficial, or improve equity.

A 'user pays' approach can therefore be combined with a public subsidy (of anything between zero and 100 per cent) to account for positive externalities, or limited public good characteristics. This is a well targeted mechanism of charging the beneficiaries, with capital costs recouped over time through user charges. This appropriately leaves the risk that the facility will be patronised with the local council making the decision to provide it, rather than transferring it to the developer or new resident.

Traditionally, social infrastructure services have been available to users at little or no cost. Up-front developer contributions are now being used as a de-facto user charge, calculated on the basis of estimated use by new residents. However, this practice is inefficient and inequitable. Compared to charging actual users it is a blunt and ill-targeted method of charging beneficiaries, as it apportions a charge regardless of actual use. It is also inequitable as the existing residents are unlikely to face a similar charge in proportion to the benefit they also receive from the new capital.

Some services (supplying 'merit goods' or exhibiting substantial public good characteristics) are more appropriately funded by the whole community through general taxation - basic health and education services fall into this category.

There is a range of infrastructure services, particularly economic infrastructure, where the benefits are not limited to new residents, and it is often difficult to apportion costs between

users. Examples include urban freeways and arterial roads, and the upgrading of public transport facilities. However, if direct charging based on estimated usage is to be implemented (instead of general taxation funding or borrowing) it should apply consistently between new and existing residents.

CURRENT PRACTICE OF LEVYING DEVELOPER CHARGES

Arrangements differ across State jurisdictions and between councils in the types of infrastructure to which charges apply and the amount levied.

Queensland restricts the ability of councils to apply levies, limiting these to 'basic and essential infrastructure' such as water and drainage facilities. In this way, councils are more accountable as residents have a say in whether other types of infrastructure are provided, and at what standard.

By contrast, in NSW, councils have broad discretion to levy charges for infrastructure with a nexus to the development. In practice, this has included levying new residents with a share of the costs of libraries, sporting facilities and regional open space. This is regardless of the extent to which new residents desire these facilities or use them, which are open to use by all residents.

More generally there is a large amount of discretion over the types of infrastructure provided, its standard and how to apportion costs between new and existing residents. This discretion leaves open the potential for councils to use developers and new residents as a convenient revenue source to fund their activities.

With the move towards direct charging of developers/new residents, there is inequitable treatment of new and existing residents. Even if new residents are charged a fair share of the capital cost (that is, the estimate reflects actual usage), the remainder of the cost of the facility, which benefits existing residents is usually funded by the council out of general rate revenue or grants from higher levels of government.

In cases where rates of new residents are not selectively reduced, there will be subsequent 'double dipping' by councils, as the new residents are levied at the same rate as existing residents, despite the fact that they have already contributed towards the capital costs of the facility.

PUBLIC SECTOR FINANCING AND DEBT

State and local governments are the main levels of government directly involved in the funding and/or provision of urban infrastructure. State governments ultimately rely on revenue sources including state taxes, Commonwealth specific purpose payments, GST revenue, and borrowings through government bonds. Large public utility networks have traditionally relied on user pay revenue streams, budget finance and borrowings to invest in new capacity and maintain existing networks.

At the local government level, grants from higher levels of Government, and general rate revenue dominate the funds available to finance infrastructure. Direct infrastructure charges and user charges arrangements are a more recent source. Some commentators have viewed the trend towards developer contributions as being motivated by a desire to raise revenue in the context of limited local council budgets.

For the public benefit component of infrastructure, to be funded by the whole community, governments can source funds either by re-prioritising existing expenditure; raising additional revenue from taxpayers/ratepayers (via ongoing recurrent general taxation measures); or borrowing funds and increasing public sector debt.

Of these options, increasing public debt is the most efficient and equitable method of funding long lived assets. Consistent with the 'benefit taxation principle', debt spreads the taxation burden further across time (and across generations), rather than imposing a large up front tax burden on the current generation.

While debt financing has a number of benefits, it can also be justly criticised if there is no strategy to repay the additional debt over the (finite) period during which the benefits of the investment are derived. Past lack of discipline has led to concerns, at a political level, to be seen to be reducing public debt rather than undertaking borrowing which may increase it. More open and transparent disclosure to financial markets and the electorate can assist in distinguishing between productive investment and 'white elephants', and ensuring that councils establish a clear nexus between increased rates or user charges and the cost of the infrastructure.

Private financing, or 'Public-Private Partnerships' (PPPs) may be desirable where the risks associated with infrastructure provision can be better managed by the private sector, or the project run more cost-effectively. For PPPs more generally, contract design and enforcement need to be well implemented. Adopting proper value for money criteria and ensuring genuine risk transfer are key elements in a successful partnership with the private sector.

KEY POINTS

It is important that charges for urban infrastructure reflect the real resource cost of provision, account for market failure, and are applied in an efficient and equitable manner. This involves implementation of charging mechanisms that are well targeted towards beneficiaries and are applied consistently (including between new and existing residents).

Where there is a public benefit from the provision of urban infrastructure services, that element should be funded by the whole community through general taxation, not disproportionately by new residents.

Long-lived publicly funded assets have a large up front cost, but provide a stream of benefits into the future. The use of public debt effectively spreads the costs of infrastructure across time, to better reflect the distribution of benefits across current and future taxpayers.

In many cases, developer contributions are being used to raise funds from a sub-set of the community, with only a weak link between the infrastructure and the benefits derived by those making a contribution. Even if this apportions the benefits correctly, similar charges are not levied on existing residents.

More efficient and equitable financing of social infrastructure would result from charges being levied on actual beneficiaries (the users) whether they are existing or new residents. This does not preclude the public subsidisation of these activities, but avoids arbitrarily allocating the cost to new residents as a convenient revenue source.

Access Economics

October 2003

1. BACKGROUND

The Productivity Commission (PC) is currently undertaking an inquiry to evaluate the affordability and availability of housing for first home buyers. As part of the PC's issues paper, the Commission has identified infrastructure charging as a matter of interest to the inquiry.

The Housing Industry Association (HIA) has commissioned Access Economics prepare a report reviewing the economic principles underlying the financing of urban infrastructure in the context of current institutional arrangements, including examination of who should pay, and available funding mechanisms.

In relation to urban infrastructure charges, the PC issues paper asks:

- *What infrastructure costs should be recovered through infrastructure charges? Should the costs of providing services such as schools, parks and libraries be recovered via infrastructure charges?*
- *Are current infrastructure charges justified by the efficient cost of providing services? Is there evidence of over-recovery of infrastructure costs?*
- *Is the basis for calculating infrastructure charges transparent? Is it subject to undue discretion of governments?*
- *Are the charges an equitable way of funding infrastructure services?*
- *Do infrastructure charges become fully capitalised into the value of the land?*
- *What alternative methods of funding would be appropriate?*

This report sheds light on the economic principles that should underpin decisions on these and other issues relevant to the provision of urban infrastructure.

1.1 PREVIOUS CONSIDERATION OF THE ISSUES

There has been previous consideration of these principles, including by the PC's predecessors. In 1993 the Industry Commission undertook an inquiry into *Taxation and Financial Policy Impacts on Urban Settlement*.

That report was completed in the context of concern about the extent of 'urban sprawl' and whether fringe development was being subsidised. The IC recommendations focussed on the setting of charges across locations to improve the efficiency of resource allocation and, where possible, remove locational bias. Some questions (for example the appropriate way to pay for social infrastructure) received limited consideration.

There have also been a number of important developments since the 1993 IC report.

1 In 1995, the Commonwealth and all State and Territory governments agreed to implement a National Competition Policy. Since then there have been a number of reforms to public utilities, including a greater role for private sector provision. Similarly, the business activities of governments, including local government are now subject to competitive neutrality provisions.

2 The private financing of major infrastructure such as roads has expanded, through 'private-public partnerships', especially at the State level.

3 Developers have reported increasing reliance on development fees and charges to fund urban infrastructure (such as developer contributions of cash or in kind under s.94 of the *NSW Environmental Planning and Assessment Act 1979*). The widespread use of developer charges has raised the issue again of exactly which types of infrastructure should be subject to direct charging. While directly charging for economic facilities such as reticulation of electricity is relatively well established, the extent to which new residents should bear the cost of broader community services such as public libraries and child care centres is less clear.

1.2 STRUCTURE OF THIS REPORT

The report is organised as follows:

- The remainder of this section describes the types of 'economic' and 'social' infrastructure relevant to urban development;
- Section 2 reviews the various sources of finance available to different levels of government;
- Section 3 examines economic principles and their application to urban infrastructure, including the core economic criteria of efficiency and equity, and the extent of 'market failure';
- Section 4 discusses the nature of costs and who benefits from urban infrastructure;
- Section 5 examines equity considerations of charging regimes;
- Section 6 reviews financing options for the element to be funded by the public sector, including the use of recurrent revenue, public debt and 'public-private partnerships';
- Section 7 describes the nature of developer charges, including their economic incidence and up-front versus ongoing charges;
- Section 8 highlights the impact of National Competition Policy on urban infrastructure provision, including the roles of the private and public sector; and
- Section 9 reviews current infrastructure charging policies and guidelines in NSW, Victoria and Queensland against economic principles, focussing on the developer contributions levied by local councils.

1.3 TYPES OF INFRASTRUCTURE

The term 'urban infrastructure' encompasses a range of 'economic' and 'social' infrastructure accessed by urban residents. Both 'economic' infrastructure and 'social' infrastructure confer benefits to individuals, as well as society more generally.

Economic infrastructure refers to facilities that directly support the production and consumption of housing services. It includes such services as water supply, sewerage and drainage, roads, public transport, gas and electricity supply. 'Social' or 'community' infrastructure provides services, of the kinds in which governments are often involved, to support or improve the amenity of the people who live in the dwellings. It includes facilities and services such as those provided by schools, open recreational space, child-care centres, libraries and other cultural facilities, and hospitals.

Determination of optimal pricing and charging for urban infrastructure is complicated by this diversity. It is difficult to generalise about who benefits, who should pay, and how funds should be raised. As a consequence, there is no single financing regime appropriate for all types of infrastructure

1.3.1 'ECONOMIC' INFRASTRUCTURE

Many types of urban economic infrastructure are long-lived networks, such as water, sewage, telecommunications, rail, gas and electricity. These facilities have:

- A 'lumpy' investment profile. Large fixed capital costs must be financed up front, with the resulting asset providing a stream of economic benefits over time.
- Joint costs of provision, where it is difficult to separate benefits and allocate costs appropriately across users.
- Economies of scale and scope. It is often more cost effective to build in excess capacity up-front in anticipation of future demand growth rather than extend or expand an existing network. For example, it is cheaper to build a single, larger capacity water supply pipeline rather than build a smaller pipeline up-front and add a second pipeline in the future, as capacity increases more than proportionately than cost.
- Costs of service provision that may vary significantly between locations. This may be due to factors such as distance from the main network, or technical costs of servicing a particular location (such as the height for pumping water).

Economic infrastructure often contains natural monopoly elements and is subject to significant regulation. In the absence of normal market competition, a range of charging mechanisms can be devised to allocate costs amongst users, generate an appropriate return on investment or encourage efficient levels of consumption.

1.3.2 'SOCIAL' INFRASTRUCTURE

There is a range of other types of urban infrastructure that can be broadly grouped as 'social' or 'community' infrastructure. As well as health and education services, governments are involved in the funding or provision of services such as libraries, child care centres community halls, open recreational space and youth centres. Once established, social infrastructure tends to be accessed by new and existing residents. Traditionally, such services have been available to users at little or no cost.

While there is the question of the extent to which individual users should be subsidised in their use of 'social' infrastructure, the determination of appropriate charges is usually not complicated by network characteristics.

BOX 1. CATEGORISING URBAN INFRASTRUCTURE

We have followed the classifications used previously by the IC and the OECD in defining 'economic' infrastructure as networked services such as transport services, hydraulic facilities and energy distribution networks. 'Social' infrastructure[1] includes community services such as health, education and recreational facilities.

Similarly, Neutze[2] notes the common distinction between 'physical (or 'economic') infrastructure which provides services to property and 'social' infrastructure which provides services to people. He suggests that it is more accurate to say that physical infrastructure services are provided to occupants of property at the property they occupy, while social infrastructure services are provided at particular locations to which users are expected to travel.

While these classifications provide a convenient method of identifying the types of urban infrastructure, they do not necessarily provide clear guidance regarding appropriate financing and the extent to which there should be a public subsidy.

For example, from an economic point of view it would be incorrect to assume that all 'social' infrastructure should be funded by 'society' through the public sector. Facilities such as child care centres and sporting facilities provide significant private benefits to users - on efficiency and equity grounds such users should make a financial contribution when accessing the service.

Similarly, elements of 'economic' infrastructure such as access to clean water and adequate sewerage provide broad social benefits, such as reducing the risks to public health. In addition, it is often difficult to identify all the direct beneficiaries of economic infrastructure and to apportion costs on a 'user pays' basis.

[1] Industry Commission, 1993, *Taxation and Financial Policy Impacts on Urban Settlement* Volume 1 (page 95).

[2] Neutze, M., 1997, *Funding Urban Services*, Allen and Unwin, Sydney (page 18).

2. GOVERNMENTAL FUNDING ARRANGEMENTS AND URBAN INFRASTRUCTURE

State and local governments are the main levels of government directly involved in the funding and/or provision of urban infrastructure.

The Commonwealth has a few direct responsibilities in this area, for example in relation to telecommunications, tertiary education, aged care and medical services. But for the most part any specific interests in urban infrastructure derives from:

- its general interests in the wellbeing of Australians;
- the efficiency gains stemming from nationally co-ordinated and uniform approaches to regulation and policy; and
- its great command over taxation (vertical fiscal imbalance). The Commonwealth also influences the provision of infrastructure through: the impact of taxation and other fiscal settings on incentives facing economic agents; and through the its regulation of markets in the National Competition Policy, the Corporations Law and the regulation of financial institutions.

The Commonwealth should ensure that its policy settings do not distort decision making relating to urban infrastructure, and that it provides the states and local government with adequate levels and distribution of funds and expenditure guidelines, in those areas where state and local governments are its agents in achieving broader policy objectives.

At the State Government level, schools, hospitals and major road networks dominate infrastructure provision. Local government is usually responsible for infrastructure such as local roads, child care centres, community halls, recreational facilities, libraries, waste management, and provision of open space.

State governments ultimately rely upon a limited range of revenue sources including state taxes, Commonwealth specific purpose payments, GST revenue, and borrowings through government bonds or private finance arrangements to enable them to provide significant public infrastructure. Large public utility networks have traditionally relied on both user pay revenue streams, budget finance and borrowings to invest in new capacity and maintain existing networks.

At the local government level, the potential revenue sources are even more restricted. Local government funding is closely supervised by State governments. Grants from higher levels of Government, and general rate revenue dominate the funds available to finance infrastructure. There is limited access to borrowing. General rates have been set to recoup the initial capital and borrowing costs associated with the provision of infrastructure, as well as its upkeep over time. However, it is unclear to what extent councils are universally setting their general rates to adequately account for the depreciation and eventual replacement of capital associated with their existing infrastructure.

Similar to vertical fiscal imbalance between the Commonwealth and the States, there appears to be an increasing mismatch between States and local governments in their ability to raise revenue and expenditure responsibilities. Some argue that, due to limited sources of

finance and broader responsibilities, local governments are operating under increasing budgetary pressure. As commented recently by Webb:[3]

> *Successive Commonwealth governments have maintained the level of assistance to local government in real per capita terms and so allowed assistance to fall relative to GDP. Even so, Commonwealth general purpose assistance as a proportion of local government revenue has risen while State government assistance has fallen…The contrast between Commonwealth general purpose assistance arrangements for the States and local government is striking. The States have access to a source of general purpose assistance, namely, the goods and services tax (GST). Revenue from the GST is likely to increase in line with growth in the economy. In contrast, local government does not have access to such a 'growth tax'…Local governments seem to be increasingly caught in a 'cost squeeze'. State governments, in particular, are shifting increasing responsibilities onto local governments without providing additional commensurate revenue.*

More recently there has been a greater reliance on direct contributions and user charges by local councils, with one of the most common forms being the array of infrastructure charges imposed upon developers of new residential areas. These 'developer contributions' (for example in NSW, those imposed under section 94 of the *Environmental Planning and Assessment Act 1979*) have been used to directly fund urban infrastructure provision.

The trend towards developer contributions may be motivated by a desire to raise revenue in the context of limited local council budgets. According to McNeill and Dollery[4]:

> *Traditionally Australian urban infrastructure, such as drainage, community facilities and some roads, has been financed out of general tax revenue at the state and local government levels. However, in recent years constraints on borrowing and a reduction in grants from higher levels of government mean that local government in Australia is not only finding it more difficult to fund new urban infrastructure, but also to maintain existing infrastructure.*
>
> *With its own revenue base limited by various factors, not least "rate pegging" (i.e. state government limitations on increases in property taxes), municipal councils have explored other methods of financing urban infrastructure, including user pays. A significant Australian example of a user pays funding mechanism resides in Section 94 of the New South Wales (NSW) Environmental Planning and Assessment Act of 1979.*

It is not surprising that this new revenue source proved attractive to councils. In NSW, as a result of mounting criticism over the inconsistent application between councils and the relatively unbounded nature of the potential charges, there was an inquiry into developer contributions in 1989. A key change to flow from that review is that councils are now

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[3] Webb, R., *Commonwealth General Purpose Financial Assistance to Local Government*, Department of the Parliamentary Library, August 2003 (page 19).

[4] McNeill, J and Dollery, B (Dec 1999) *"Funding Urban Infrastructure Using Developer Charges: The Case of Section 94 Contributions and Road Financing in New South Wales"*, Working Paper Series in Economics, UNE. (p 3)

required to prepare a detailed development plan which identifies and addresses local needs, and outlines the basis for their particular charging regime under section 94, including how the monies are to be allocated, and how they will be derived[5].

What these plans (and similar ones in Victoria and Queensland) do not do, is properly address the questions of what standards of infrastructure are affordable and how the financing burden should be shared. As noted in a recent discussion paper by the NSW Division of the Urban Development Institute of Australia[6], these are key issues and go to the heart of what charges are reasonable and equitable to impose.

In subsequent sections of this report we will analyse some of these key questions regarding who should pay for the infrastructure covered by 'developer contributions', and in what circumstances they should they pay.

The next section reviews economic principles relevant to the financing of urban infrastructure.

[5] ibid. (p 121)

[6] Urban Development Institute of Australia (UDIA) (2002) "A Better Way – Financing Regional Public Infrastructure in Urban Areas" UDIA NSW Discussion Paper, June.

3. ECONOMIC PRINCIPLES AND URBAN INFRASTRUCTURE PROVISION

In assessing different methods of financing urban infrastructure, we are mainly concerned with the question of who bears the cost – i.e. who should pay? Different charging regimes will impact on the efficiency of resource use and the equitable distribution of the financing burden.

Efficiency is important to ensure that limited resources are not wasted; that they are used in the most socially productive manner to improve overall economic welfare. Prices have a key role to play in securing the efficient allocation of scarce resources. As a general rule, infrastructure and other services should have prices that reflect the real resource cost of service delivery. If services are under-priced this will encourage over-consumption, while over-pricing will artificially constrain demand.

Notions of equity can be consistent with efficiency, to the extent it is equitable as well as efficient that those who benefit from infrastructure bear the burden of its financing. However, there is also a view that it is equitable that individuals have a minimum level of access to some infrastructure services regardless of their ability to pay.

A third criterion that needs to be taken into account is that of simplicity. An arrangement may be efficient and equitable but be undermined by a high degree of complexity. In implementing a charging regime, administration and compliance costs also impact on the overall resource cost to society.

3.1 EFFICIENCY

Efficiency has several dimensions. It refers to the extent to which a given set of infrastructure services ('outputs') is being delivered with the minimum possible resources ('inputs'). Importantly, it also refers to the efficient allocation of resources between alternate uses. In a dynamic sense, efficiency includes innovative activity such as the introduction of new technology, processes or modes of delivery that reduce resource costs or better meet consumer needs.

Efficiency supports the 'beneficiary pays' principle. In simple terms, those who receive the benefits of infrastructure should contribute proportionately to the cost of its provision. In terms of pricing, fees and charges should be set to reflect the proportion of private benefits, and the real resource cost of infrastructure provision.

However, while the principle may be relatively clear, identifying beneficiaries and attributing costs in practice is not straightforward, especially in the case of network facilities.

Wastage and inefficiency may occur as a result of inappropriate pricing. For example, charging a flat fee for access to potable water does not provide any price incentive to adjust consumption once the access fee has been paid, as the same charge would apply with high or low levels of use. While there are additional resource costs in supplying an extra litre of water to the consumer, the additional cost is not reflected in the price charged. As such, there will tend to be a higher level of water consumption than would be the case if the consumer were confronted with the real *marginal* resource cost of their decision.

Similarly, failure to adjust charges for the differential cost of servicing a high cost area will tend to encourage residents to locate in that area (or vice-versa). As a result, total costs to society will be higher than necessary.

The efficiency of urban development is sometimes viewed from a narrow governmental budgetary perspective, to mean the lowest cost of infrastructure provision from the government's point of view. However, as the Industry Commission[7] emphasised, consumer preferences also matter. For example, people may choose to live on the fringe of the city to avoid noise pollution, have greater access to open space and cheaper land, despite relatively high costs of providing infrastructure. Conversely, others may prefer to live closer to the CBD to be closer to work and benefit from the more vibrant nightlife. Incidentally, the cost of providing incremental infrastructure may be lower in some such locations.

Ultimately, individuals decide where to locate taking into account affordability and their own housing preferences (proximity to schools, work, inner city or suburbs etc). Through their impact on relative housing prices, differential fees and charges impact on location decisions. In general, as long as individuals are confronted with the real resource costs of their decisions (including costs or benefits accruing to third parties), a more efficient outcome will result if they are allowed to express their own preferences, rather than being constrained by the preferences of governments.

3.2 EQUITY

Equity can be defined in a number of ways and may encompass ends and means. Equity may involve: ensuring equitable access to particular infrastructure services; facilitating equitable outcomes in the consumption of infrastructure services; and the financial contribution expected from different groups in society.

Equity goals may include **horizontal equity** (treating alike those in similar situations) and **vertical equity** (treating preferentially those with lesser ability to pay). In sharing the burden of infrastructure financing, it may be regarded as equitable (as well as efficient) that individuals who benefit from infrastructure provision contribute proportionately towards its cost.

Due to the long-lived nature of urban infrastructure, issues of **inter-generational equity** arise. For example, the current generation may finance the large up-front costs of new infrastructure development that benefits future, as well as current, generations of residents.

Equity issues of relevance to infrastructure charging, including equity between generations, between new and existing residents, and between residential developments, are discussed in Section 5.

3.3 'MARKET FAILURE' AND URBAN INFRASTRUCTURE

In the absence of 'market failure', where the benefits are captured by private consumers, a system of direct charging, or a 'user pays' approach is efficient. As Kirwan commented:[8]

[7] Industry Commission, 1993, *Taxation and Financial Policy Impacts on Urban Settlement* Volume 1 (page 137).

[8] Kirwan, R. (1991), *Financing Urban Infrastructure: Equity and Efficiency Considerations*, The National Housing Strategy Background Paper No.4, AGPS, Canberra (page 37).

A 'user pay' system of recovering costs and financing investment is usually regarded as efficient and equitable because it accords with the benefit principle. Individual consumers are left to determine the scale of the costs they wish to incur in light of the benefit they derive from the available service.

However, urban infrastructure is an area where there may be substantial 'market failure' - left to itself, the market may not result in an efficient outcome. This may be due to the existence of externalities in consumption or public good characteristics. In addition, governments may choose to ensure access to 'merit goods'. Certain infrastructure services are also highly regulated, or provided, by governments, due to 'natural monopoly' characteristics.

3.3.1 EXTERNALITIES

Efficient charging for infrastructure is complicated by the fact that there may be 'externalities' in the consumption of infrastructure services. Externalities refer to 'spillover' benefits (or costs) that accrue to third parties/society in addition to the direct, private benefits captured by the consumer. The direct consumer does not take these externalities into account when deciding what quantity to consume. As individuals only incorporate direct benefits into their decision making, their consumption of some goods will differ from that which is optimal from society's point of view.

There may be externalities from the provision of specific urban infrastructure (such as vehicle emissions from road transport), or the combined impact of new urban development, which may bring with it a suite of externalities (such as loss of biodiversity and crowding).

Education and health are areas where it is generally accepted there are wider social benefits beyond those accruing to the individual (although their magnitude is less certain). For example, social benefits from a more educated population may include a more tolerant, stable society, with individuals better able to make informed decisions. Rather than being fully funded by the individual student or patient, such services are heavily subsidised by the general taxpayer.

Positive externalities (third party benefits) from new urban development may include:

- Benefits to consumers from greater available choice of residential location and characteristics. These will include the demonstration effect of innovations incorporated in new developments; and
- Greater variety of consumption and working opportunities, stemming from the greater division of labour and product differentiation possible with a larger population base.

Negative externalities (third party costs) from new urban development may include:

- increased levels of noise, pollution, car accidents and traffic congestion through higher levels of car traffic;
- Greater levels of environmental degradation, including impacts on biodiversity, greenhouse gases, air and water pollution of greater industrial activity or residential development; and
- Reduced resident amenity including crowding, household noise, reduced access to open space.

However, there are positive or negative externalities associated with most forms of activity. Simply because externalities exist is not a sufficient rationale for government intervention, as

the risk of 'government failure' must also be taken into account. In particular, the externalities may not be able to be accurately measured and targeted without introducing greater distortions to behaviour.

The conventional solution to the market failure of externalities is to apply a Pigouvian tax or subsidy, set at a level such that the individual incorporates the marginal social costs and benefits into their decision making. For example, library services may receive a public subsidy as there are social benefits from the dissemination of knowledge and a more educated population.

However, there are a number of policy instruments available to governments if they seek to address external costs and benefits.[9] In practice, governments often employ separate, targeted policy measures rather than adjust urban infrastructure financing arrangements. For example, activities can be subject to direct regulation, such as emission standards for vehicles or restricting the location of industrial activities away from residential zones and the like.

3.3.2 IMPACT OF URBAN INFRASTRUCTURE ON LAND PRICES

The provision of urban infrastructure may also impact on the price of existing land, involving 'pecuniary externalities'. For example, improved roads to outer areas may increase the value of existing dwellings. Similarly, population growth and expansion of outer suburbs may increase prices in inner locations.

Economic analysis of urban infrastructure needs to take account of two unique features of urban development. (1) It involves a fixed factor of production: land; and (2) spatial relationships are both fixed and an important attribute of the product.

There is a burgeoning theoretical and empirical economic literature on: the economics of agglomeration and the formation of cities; urban development and land prices[10]. This has its roots in standard neoclassical economics and in studies of agglomeration and spatial economics dating back to the work of Alfred Marshall and von Thunen in the 1800s. Key insights are that:

- cities form and grow because they allow more efficient production and consumption. Productivity is higher in cities because of economies of agglomeration. Clustering of firms and households reduces information barriers and transaction costs; allows greater division of labour, specialisation and product differentiation; foments innovation because information spillovers are wider and more rapid;

[9] The question of negative externalities and how they might best be responded to was examined in detail by the Industry Commission in Industry Commission, 1993, *Taxation and Financial Policy Impacts on Urban Settlement Volume 2,* (Appendix F).

[10] Recent texts include: M Fujita, P Krugman and AJ Venables *The Spatial Economy: Cities Regions and International Trade* MIT Press, Cambridge Mass. 2001; M Fujita and J-F Thisse *Economics of Agglomeration* Cambridge University Press 2002; and J-M Huriot and J-F Thisse (eds) *Economics of Cities: Theoretical Perspectives* Cambridge University Press 2000. These predominantly theoretical texts contain references to relevant international empirical literature. For a classic applied Australian study see the Housing Costs Study Steering Committee *Housing Costs Study* report by Travers Morgan and Applied Economic Associates for the Australian Building Research Grants Scheme, Department of Health, Housing and Community Services, Canberra 1992

- the price of the fixed factor (urban land) rises at the heart of cities to reflect the higher productivity of other factors that locate there. The price of residential land then forms a gradient, reflecting transport cost and travel time to the core, and the opportunity cost of land at the periphery. While there are cycles of decay and renewal, the price of residential land at any particular point in the city will tend to rise in real terms as the city expands;
- house prices (and the value of unimproved land) at different locations will adjust to reflect their relative values to consumers. These values incorporate the net effects of local changes in availability and quality of infrastructure, amenity, accessibility, congestion etc.;
- It is often claimed that land values within a city contain a substantial element of economic rent. To the extent that this is true, many argue that land-based taxes are economically efficient. In practice, the base for such taxes is not the physical property, but rather some valuation (eg, based on UCVs) of it. Over time, that valuation should be sensitive to demand and supply forces, and these in turn should be sensitive to returns on alternative investments (including alternative parcels of land). This implies that pure rents are unlikely, and that it is more realistic to assume some sensitivity of demand and supply (even if modest) to prices and taxes. This implies that land-based taxes will involve some economic efficiency losses over time. That does not preclude:
  - increases in land values in any period being included in a comprehensive definition of income tax;
  - land values being included in any definition of wealth for wealth taxation purposes; but
  - it does argue against selectively applied taxes on land as a subset either of income or wealth. Note that, in this context, a large component of one land-based tax – local government rates – can be regarded as a general community tax for local government services, rather than as a tax on rents.

A key point is that new developments should lead to increases in the prices of housing in existing suburbs – both as a result of the general expansion of the city, and as a result of any net improvement in accessibility or amenity stemming from the infrastructure investments associated with the new development.

3.3.3 PUBLIC GOODS

Related to the idea of externalities is the economic concept of a 'public good'. This should not be confused with the more general use of the term in the sense of providing services 'in the public good'.

Pure public goods display two essential characteristics:[11]

- non-rivalrous consumption. That is, consumption by one person does not reduce the benefit or enjoyment derived by all others.
- non-excludability. This is essentially the 'free rider' problem. Regardless of whether individuals pay for the good or service, they cannot be excluded from benefiting from it's provision.

[11] See for example Rosen, H., 2002, *Public Finance,* sixth edition (page 56).

Not only do individuals have no incentive to pay for public goods (and it is impossible to exclude them from benefiting) it would be inefficient to charge a price for them – as their consumption does not diminish the consumption of others, the marginal cost of supplying an extra person is zero.

In practice, there are very few pure public goods (national defence is often cited as an example). However a limited set of urban infrastructure displays public good characteristics, as normal levels of activity involve low levels of rivalrous consumption, and the costs of excluding additional users are high.

For example, street lighting displays some local public good characteristics as it benefits local residents and passers by, without diminishing the enjoyment of either. Roads are sometimes regarded as having public good characteristics, to the extent that, with low levels of congestion (such as a country road) an additional car does not significantly reduce the benefit of existing travellers. There are still practical obstacles to excluding non-payers from accessing roads (however, with the availability of electronic charging and toll roads, the cost of excluding non-payers has been reduced).

Access to potable water, adequate sewage and garbage removal reduces the incidence of disease and contributes to public health. Regardless of whether individuals pay for these services they cannot be excluded from the benefits.

There are a range of other services that may provide social benefits, but are not 'public goods'. For example, library services are usually provided free (or at low nominal cost) as there is a social benefit from widespread access to knowledge, and a more highly educated population. However, while there may be a positive externality from library use, access to the limited number of books can be effectively rationed through a price mechanism just as users are charged for renting videos at a commercial video store. Similarly, child care centres, youth centres and counselling services may benefit society more generally, as well as the individual. However, these are not 'public goods' in the strict sense. Individuals can be excluded from accessing these services unless they pay a fee. A child care place, or use of facilities at a youth centre clearly diminishes the benefit able to be derived by others.

As Kirwan commented:[12]

> *It is therefore fair to conclude that 'public goods' considerations should play at most only a very minor role in the definition of an efficient system of urban infrastructure. Urban infrastructure is clearly of predominant benefit to well-defined groups and individuals – external effects apart; the supply is finite, the quantity or quality of service diminishing rapidly as the demands placed on it increase; and, at least in principle, it is possible to exclude marginal consumers by means of some form of price mechanism.*

3.3.4 MERIT GOODS

Goods such as basic health and education are sometimes described as 'merit goods' – goods that are deemed to be of such intrinsic value or merit that all members of society

[12] Kirwan, R. (1991), *Financing Urban Infrastructure: Equity and Efficiency Considerations*, The National Housing Strategy Background Paper No.4, AGPS, Canberra (page 39).

should have a minimum level of access to them, regardless of their own preferences, or ability to pay. In the extreme, this can take the form of compulsion, such as compulsory primary and secondary school education.

To the extent it is desirable that individuals have a role in determining the type of services they wish to fund, the extent of merit goods in the field of urban infrastructure could be regarded as limited.

However, access to essential services such as potable water and adequate sewerage is usually required to be provided as a minimum standard. In practice, it is likely that individuals would demand these services (and there are broader public health considerations).

Where policies involve the routine provision of broader social infrastructure (such as child care centres) the issue is less clear. Mandatory provision of these services assumes public authorities are in a better position than individuals to determine their own best interests. It overrides individual preferences, and ensures that individuals have access to quantities deemed appropriate by the public authority.

The provision and funding of social infrastructure is examined further in Section 4.4.

3.3.5 NATURAL MONOPOLIES

Traditionally, utilities such as gas, water and electricity have been provided by governments as they were regarded as 'natural monopolies'.

A natural monopoly occurs when cost and demand conditions are such that the market can only support a single supplier. Fixed costs in the industry may be so large that average cost declines over the full range of market output. In these circumstances, one firm can satisfy the whole of market demand at a lower cost than could more than one firm. Any new entrant would therefore fail (or else drive out the incumbent), leaving a single supplier.

For example, gas, water and electricity networks display natural monopoly characteristics, at least in distribution infrastructure, i.e. the part of the network linking customers to supplies. The usual view is that this infrastructure cannot economically be duplicated. The market is spatially limited; for example, an electricity or gas distribution network in Sydney cannot supply customers in Melbourne. A transmission line in Australia is irrelevant to the supply of gas or electricity in another country. National Competition policy reforms have focussed on separating potentially contestable elements in these industries (such as retailing and generation of electricity) from natural monopoly elements.

The existence of a natural monopoly requires that the market be small relative to economies of scale. Changes in the underlying cost structure (such as advances in technology) or changes to the size of the market can mean an industry ceases to be a natural monopoly.

As a result of the natural monopoly elements of utilities, these industries are highly regulated in areas where monopoly pricing could occur. This is discussed further in Section 8.

4. NATURE OF COSTS AND BENEFITS OF URBAN INFRASTRUCTURE

With the expansion or upgrading of urban infrastructure to service new residential developments, the benefits may accrue to new residents, new and existing residents and/or the wider public. Consistent with the 'beneficiary pays' principle, new residents should only bear the burden of funding infrastructure services in proportion to the extent they derive a private benefit.

The determination of appropriate charges therefore rests on the distribution of benefits across individuals; the degree to which such beneficiaries can be clearly identified; and the degree to which there are positive externalities in consumption that may justify a public subsidy element (less than full cost recovery).

This section firstly examines the distribution of costs and benefits of an expansion of economic infrastructure, before discussing the costs and benefits of providing additional social infrastructure.

4.1 ECONOMIC INFRASTRUCTURE AND THE NATURE OF INCREMENTAL SYSTEM COSTS

In expanding an existing network, the relevant costs for recovery are incremental system costs. That is, the additional costs that must be borne to service the new development or group of residents. For network infrastructure such as water, sewage electricity and gas, a distinction can be made between

- Changes to headworks or large mains facilities, which increase the capacity of the whole system, providing services to new and existing residents (such as dams, sewage treatment plants and main drains).
- Local distribution networks, which might service new residents in a large development, or a series of smaller developments.
- Minor works within a particular development, such as reticulation of gas, including the connection of individual households.

Where the cost of providing infrastructure differs across locations, this should be reflected in differential charges. In essence, while not creating a bias between locations, location-specific charges ensure individuals are confronted with the real resource cost of their location decisions. Depending on their own preferences, individuals will be prepared to pay the higher (or lower) cost of accessing infrastructure.

Minor works such as reticulation of hydraulic services provide a location-specific benefit. That is, the additional infrastructure is installed within a new development, and is of little if any benefit (in terms of increasing capacity) to people living elsewhere. Upgrading a distribution network provides benefits to a wider group of residents, but will also involve location-specific costs. In contrast, changes to headworks improve the capacity of the whole system, with costs that do not vary by location or particular development. As such, charges should not vary across locations. As the Industry Commission commented:[13]

[13] Industry Commission, 1993, *Taxation and Financial Policy Impacts on Urban Settlement* Volume 1 (page 157).

'Charging for the provision of headworks could not sensibly be based on anything other than an equal per customer basis.'

4.2 ECONOMIC INFRASTRUCTURE AND THE DISTRIBUTION OF BENEFITS

For economic infrastructure with network characteristics, a hierarchy of beneficiaries can be identified. The benefits may:

- largely accrue to individual new residents;
- be largely confined to residents of a new development, but also provide benefits to existing residents and the wider community; or
- involve significant benefits to new and existing residents.

4.2.1 BENEFITS LARGELY ACCRUING TO INDIVIDUAL NEW RESIDENTS

Some minor works within a development provide a clear private benefit to an individual new resident (or household). Efficient pricing would involve households carrying the full cost of provision, with charges levied directly or through the developer.

Infrastructure services that fall into this category include:

- Capital costs associated with the connection of an individual house; and
- On-going consumption of services such as gas, electricity and water within the home.

4.2.2 BENEFITS LARGELY CONFINED TO A NEW DEVELOPMENT

Some benefits are largely confined to the residents of a new development, as a whole. These include:

- capital costs associated with the reticulation of utilities within a development and connection to an existing distribution network;
- where required to service a new development, expansion of distribution networks of utilities (however distribution works may also service a number of smaller developments); and
- works within the subdivision, including internal roads, drainage, street lighting and open space for use primarily by the residents.

While the residents of the new development are the prime beneficiaries, other local residents may also benefit from upgrading of local distribution networks.

4.2.3 BENEFITS ACCRUING TO NEW AND EXISTING RESIDENTS

Rather than providing benefits only to new residents, some urban infrastructure provides significant benefits to both new and existing residents. For example, additional headworks for hydraulic services such as water and sewage to service a new development improves system-wide capacity, benefiting users across the network.

In addition, there may be a significant public benefit element associated with:

- improving gas and electricity mains; and

- upgrading urban freeways and arterial roads.

In the case of roads it may be difficult to identify users (and the distribution of benefits between parties) in the absence of electronic road user pricing (as increasingly occurs with toll roads). A major highway may be used by new residents to travel to a fringe development. However, additional lanes will also benefit existing residents of closer suburbs by relieving congestion and improving travel time.

Traditionally, services such as these have been funded by general taxpayers and made available to residents at little or no direct charge.

4.3 COST OF SOCIAL INFRASTRUCTURE

Social infrastructure, such as the building of a child care centre or library involves up front capital costs as well as on-going recurrent costs (maintenance and replacement of capital). In addition, provision of social infrastructure services is labour intensive (more so than for capital-intensive economic infrastructure) with wages and salaries of staff a significant on-going cost.

Unlike economic infrastructure, in general the construction and running costs of social infrastructure do not vary significantly across locations. However to the extent the value of the land is a significant part of the overall cost, this can cause costs to vary between locations.

4.4 SOCIAL INFRASTRUCTURE AND THE DISTRIBUTION OF BENEFITS

There is a range of 'social infrastructure' services that may be accessed by new and existing residents across a suburb or wider area. These include child-care centres, libraries, sporting and recreational facilities, community halls and open recreational space.

For these services, the prime beneficiaries can be easily identified and non-payers can be excluded from access to the service[14]. Fees can therefore be directly levied on a user pays basis (such as per hour charges for child care and access to a community hall). The direct charge is recognition that the user derives a private benefit . However, governments often choose to subsidise services such as these as they are seen to be socially beneficial, or else to achieve redistributive goals by providing cheap, widespread access to certain services.

For example, library services display some public good characteristics, to the extent access to books contributes to the dissemination of knowledge. While the borrowing of books is a rivalrous activity, the cost of spreading published knowledge to an additional person is low.

Other facilities may have positive externalities. For example, access to cheap sporting facilities may reduce the cost to society of funding health care, by reducing the risk of diabetes and cardio-vascular disease. Beyond the benefit accruing to the direct users, access to a community hall may add to social cohesion and the sense of community.

[14] With the possible exception of large areas of open space where the cost of exclusion (such as fencing) would be high.

Governments may choose to subsidise these activities to account for the social benefits. Inclusive of the public subsidy element, individuals will patronise services if they value them at a higher rate than the fee charged, according to their own preferences. This is consistent with the assumption that individuals are best able to determine their own needs and wants, purchasing goods or services to maximise their overall welfare.

Beyond goods such as basic health and education it is difficult to sustain a broader 'merit good' argument that social infrastructure such as child care facilities, youth centres and sporting facilities should be provided by local councils regardless of whether residents value such facilities above the cost of provision.

If governments choose to subsidise social infrastructure to account for the perceived social benefits, the public subsidy should be funded by the whole community through general taxation revenue, rather than by specific charges on developers and/or new residents. Similarly, if individuals are to be charged for the private benefit from such services, there should be equity in the treatment of new and existing residents.

Regardless of the degree of subsidisation, developers and/or new residents should not be burdened with financing a disproportionately large share of the costs of such infrastructure simply because they represent a convenient revenue source.

As the IC concluded in 1993:[15]

> *Where social infrastructure is provided to achieve social objectives of subsidised consumption among sections of the population – or where such services generate significant spillover effects – it would seem preferable to finance them through a general revenue source that does not confine costs to residents in new developments, wherever they are located.*

Local councils may subsidise the provision of social infrastructure as a mechanism to redistribute income to poorer sections of the community. However, free or heavily subsidised provision is often an indirect and ill-targeted mechanism to achieve this, as the level of assistance is related to usage rather than wealth or income. In general, transfer payments are a more transparent and targeted method of alleviating poverty, rather than delivering income support through hidden, indirect subsidy arrangements linked to the consumption of particular goods or services.

4.5 KEY PRINCIPLES FOR EFFICIENT CHARGING

This section proposes the types of urban infrastructure services that should be subject to direct cost recovery from an efficiency perspective, consistent with the 'beneficiary pays principle'. This may involve adjusting charges to accurately reflect differences in costs across locations. However, individuals should only finance infrastructure in proportion to the benefits they receive.

[15] Industry Commission, 1993, *Taxation and Financial Policy Impacts on Urban Settlement* Volume 1 (page 209).

4.5.1 DIRECT CHARGING

A direct charging approach is appropriate where the vast majority of benefits are captured by the user as private benefits, or the benefits are largely confined within a new development. This would include:

- personal household consumption of utility services such as water and electricity;
- reticulation of economic infrastructure services, including connection of individual homes;
- works within the subdivision, including internal roads, drainage, street lighting and open space for use primarily by the residents.

4.5.2 'USER PAYS' WITH A SUBSIDY ELEMENT

The extent to which 'user pays' applies will depend on judgements regarding the degree of private benefit accruing to the individual and the extent of positive externalities. For some services a 'user pays' approach can be combined with some element of public subsidy (funded by the general taxpayer) to account for these externalities, or limited public good characteristics. Rather than funding up-front, capital costs should be recouped from users through user charges, which more accurately reflect the distribution of benefits across residents. Examples include social infrastructure such as:

- child care centres,
- libraries;
- community centres;
- sporting facilities.

The position is a little more complicated where investment is 'lumpy' and facilities are under-utilised (particularly in the early years) following completion. In this case, it is economically efficient for the user charges to be set to recover only marginal operating costs. The unrecovered on-going capital costs will then need to be recovered by a public subsidy from general taxation levied on the overall community.[16]

4.5.3 PURE PUBLIC FUNDING

- Some services are more appropriately funded by the whole community through general taxation; where they can be considered 'merit goods' or exhibit substantial public good characteristics. For example,
  - basic health services;
  - basic education services; and
  - large areas of open recreational space.[17]

[16] This of course assumes that the investment was justified on social cost-benefit grounds to begin with. For example, where there is a higher value alternative use of the asset reflected in the market value, the taxpayer's investment could be recouped by selling the facility.

[17] Assuming that excluding non-users is not practicable or cost-effective.

4.5.4 APPORTIONMENT BETWEEN BENEFICIARIES

For investment in network infrastructure, the benefits are not necessarily limited to new residents, and it is often difficult to apportion costs between users. If direct charges are used, they should be applied proportionately between new and existing residents. Examples include:

- distribution networks of utilities;[18]
- urban freeways and arterial roads;[19] and
- headworks, major rail upgrades and other incremental costs that provide a system-wide benefit to all users.
  - For these capital costs, where costs do not vary across locations, financing should be shared equally across all users.

The above is a classification according to the efficiency criterion. Ideally, efficient pricing principles would also be applied consistently (such as between new and existing residents).

Equity considerations, including consistency between residents and ensuring access for the less well off are discussed further in section 5.

To the extent there is an element of urban infrastructure that is to be financed by the general taxpayer through the public sector, there are a number of sources of finance that may be used, with various implications for efficiency and equity. Financing options for the public benefit element of urban infrastructure is examined in Section **Error! Reference source not found.**.

[18] In practice utility charges may reflect a range of objectives beyond efficient allocation of capital costs, such as encouraging more efficient consumption and peak-load pricing.

[19] In the case of roads, electronic road pricing can be used to efficiently recoup costs in proportion to use, however there are implementation costs and the use of road pricing is not widespread in Australia.

5. EQUITY CONSIDERATIONS

Direct charges, including developer charges, can be regarded as equitable to the extent that those who benefit from infrastructure provision are responsible for its funding. Where private beneficiaries can be clearly identified, the alternative of funding new infrastructure through general revenue sources would involve cross-subsidies (over-charging of existing users to subsidise consumption of new users) which could be regarded as inequitable.

However, while the introduction of charges that better reflect costs, and differential costs across locations will tend to promote more efficient outcomes, it also has important implications for the equitable financing of urban infrastructure.

5.1 EQUITY BETWEEN GENERATIONS

There is a range of government policies that impact on equity between new and existing residents and across generations, including taxation policies, levels of income support and regulations.

In the past, investment in much urban infrastructure was financed by the whole community through general taxation revenue or borrowings. Reforms to the financing of urban infrastructure (such as direct charging of new residents on a 'beneficiary pays' basis) are a relatively recent phenomenon.

Previous generations of residents were not required to make direct contributions to the capital cost of the existing network. To a large extent, this windfall gain would have accrued to the owner as the property was sold, to the extent the value of infrastructure services is capitalised into the price paid for the property. One way or another – either through an explicit charge for new infrastructure or a higher price to purchase an existing property – the current generation is likely to have made a financial contribution to the capital cost of urban infrastructure.

Similarly, with the move towards 'user pays' in new developments, the ready availability of infrastructure in older areas will result in a price premium being capitalised into the value of existing dwellings.

Another aspect of inter-generational equity – the extent to which the financing burden of long-lived infrastructure is borne by the current generation through recurrent taxation or spread across future generations through the use of public debt is examined in section 6.1.

5.2 EQUITY BETWEEN NEW AND EXISTING RESIDENTS

Within the same generation, charging may not be applied equitably between new and existing residents. For example, a developer may be required to pay the capital cost of upgrading water, sewage and social infrastructure at a particular location, the up-front costs of which may be passed on to the new resident. However, inequitable treatment may result if new residents finance the full capital cost of facilities that benefit the wider community (such as water headworks, a suburban rail station, or a library accessed by all residents).

Thus it is inequitable for new residents to finance social infrastructure that the whole community can access at little or no charge. For example, developer contributions are sometimes collected to enable the local library to increase its collection of books. This is justified on the basis that the additional cost is required to adequately service the larger

population. However, existing residents (more specifically members of the library regardless of where they live) benefit from this wider range of books. Traditionally, users have not been levied a charge per book or other joining fee. It is inefficient and inequitable to charge new residents for such services regardless of the extent to which they use the facilities. Conversely, existing residents would not be charged even if they were heavy library users.

As described previously, if social infrastructure services are to be subsidised, it is equitable that this subsidy, to account for the public benefit of such activity, should be funded by the whole community – not a small subset of residents.

Even if the cost of upgrading infrastructure is apportioned correctly to new residents, existing residents may not face a similar charge to cover the remaining portion. New residents are 'singled out', if existing residents are effectively quarantining from pricing reforms.

'Double dipping' may also occur if new residents explicitly pay an up-front capital contribution and then face the same access charge and recurrent costs as existing residents (which incorporate a charge for existing capital).

In 1991, Kirwan suggested that 'double dipping' should be avoided by adjusting ongoing charges be to take account of capital contributions by new residents:[20]

> *User charges should explicitly identify whether or not the property on which they are levied has been subject to a capital levy (and to what extent) in relation to the capital cost of infrastructure service provided. Where a capital contribution has been paid, recurrent charges should be equivalently reduced.*

In order to promote efficient outcomes, charges levied on new residents may reflect cost differentials across locations. Existing residents may fund depreciation of the existing network (to fund replacement cost) via an access fee. However, unlike contributions from new residents, this contribution may not differ by location, nor cover the full cost of major maintenance or replacement of existing infrastructure.

If a consistent approach to infrastructure upgrades across locations is to be taken, existing residents should face additional fees and charges when current infrastructure needs to be replaced. Such an approach, with appropriate phasing in of new charges, was supported by the IC in its 1993 report:[21]

> *The Commission considers that since residents at the fringe would desirably face the costs of infrastructure provision to them, it would be equitable for established residents to at least face charges that matched the cost of replacing infrastructure required to service them and that charges for existing households should be examined as part of any reform of pricing structures. This reinforces the need for differential rates of charging for services across different locations, and does not deny the possible need for gradual rather than sudden changes.*

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[20] Kirwan, R. (1991), *Financing Urban Infrastructure: Equity and Efficiency Considerations*, The National Housing Strategy Background Paper No.4, AGPS, Canberra (page 82).

[21] Industry Commission, 1993, *Taxation and Financial Policy Impacts on Urban Settlement Volume 1,* (page 238).

5.3 EQUITY BETWEEN DEVELOPMENTS

It is equitable that new developments be levied different charges to the extent these reflect differential costs of service provision, related to location or other factors. However, in setting charges across jurisdictions, it is desirable to minimise the potential for the arbitrary application of charges to distort location decisions and lead to inequitable outcomes.

However, it is not surprising that there is little uniformity in the application of infrastructure charges between developments, reflecting inconsistent policies and methods of apportioning costs around the country. Urban infrastructure charges are levied by a myriad of State, local government and private providers. For example, road transport charges may be levied by State and local government authorities; electricity charges vary across regions depending on the private provider; developer contributions vary between councils, depending on local policy and variations in the interpretation of State guidelines and legislation.

One approach to reduce inconsistencies would be to use legislative authority at the State level to implement greater uniformity across councils. Greater harmony between infrastructure charging and economic principles has the potential to improve efficiency and equity.

However, separate levels of government strongly protect their prerogative to independently determine polices, and are ultimately accountable to their constituencies. Citizens may make representations to a local council, appeal decisions, and ultimately move to reside in a more favourable location. Rather than impose a uniform approach, 'inter-jurisdictional competition' can be a major driver of welfare improvements. However its effectiveness depends on the level of transparency and accountability in decision-making.

Policy-makers sometimes strike a balance between the prerogative of public authorities to determine policy and the perpetuation of policies that may be regarded as inefficient and inequitable.

For example, the Review of Development Contributions in Victoria noted the case on economic efficiency grounds for limiting the ability of local councils to levy upfront infrastructure charges to 'basic and essential' infrastructure (as opposed to many types of 'community infrastructure'). However, in recommending the removal of the previous $450 cap per dwelling on community infrastructure contributions, the review commented:[22]

> *The arguments for rolling back the infrastructure charging powers in the Planning and Environment Act to 'basic and essential' infrastructure as per the IPA remain compelling from an economic point of view. However, these arguments must be balanced against the role and responsibilities of local government as a separate sphere of government. From the latter perspective, more emphasis would be placed on transparency and accountability in the formulation of Infrastructure Charges Schemes (for example, requiring due rigour on the part of Councils regarding policy choices to forego more 'efficient' recurrent user charging mechanisms in favour of up-front contributions).*

[22] Development Contributions Review Steering Committee, *Review Of Development Contributions In Victoria Report & Recommendations,* October 2000 (page 26).

The report further recommended that:[23]

> *Councils should fully explain their rationale for adopting Infrastructure Charges instead of other user charging or traditional funding mechanisms. This explanation should include an impact analysis on local rates.*

The ability of developers and individuals to hold governments accountable for their decisions is enhanced by measures that increase the amount of information available, and the comparability of that information across jurisdictions. Some initiatives already exist to improve the available level of information.

For example, in NSW, councils levying charges under s 94 of the *Environmental Planning and Assessment Act 1979* are required to prepare a draft contributions plan for public comment, outlining planned investments (such as the purchase of open space) and level of contributions to be charged. Developer contributions are discussed further in Section 9.

5.3.1 LOCATIONAL SUBSIDIES AT THE NATIONAL LEVEL

The high degree of 'vertical fiscal imbalance' (the mismatch of revenue raising capacity and expenditure responsibilities) between the Commonwealth, States and local government in Australia is well recognised. To distribute funds to the States, Commonwealth grants are currently allocated according to complex formula through the Commonwealth Grants Commission (CGC). Such payments reflect the principle of 'horizontal fiscal equalisation' (HFE). In 1999, the CGC defined HFE as follows:[24]

> *State Governments should receive funding from the Commonwealth such that if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.*

In practice, compared to allocation on a per capita basis, this involves reallocating funds away from the larger states such as NSW and Victoria to the smaller states such as Tasmania and the Northern Territory.

Commonwealth financial assistance grants to the states for local government purposes are distributed on a per capita basis. However, similar principles of horizontal equalisation apply to the distribution of general grants between local councils within each State. Under the *Local Government (Financial Assistance) Act 1995* State Grants Commissions are required to allocate general purpose grants consistent with the principle of fiscal equalisation. Section 3 of the Act defines fiscal equalisation as an allocation that:[25]

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[23] Ibid.

[24] Commonwealth Grants Commission, Report on General Revenue Grant Relativities,1999 Review, quoted in Garnaut, R., Fitzgerald, V., *Review of Commonwealth–State Funding Background Paper*, Governments of New South Wales, Victoria and Western Australia, 2001 (page 12).

[25] Quoted from Webb, R., *Commonwealth General Purpose Financial Assistance to Local Government*, Department of the Parliamentary Library, August 2003 (page 17).

- ensures that each local governing body in a State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State; and
- takes account of differences in the expenditure required to be incurred by local governing bodies in the performance of their functions and in their capacity to raise revenue.

The question of whether the system of HFE across and within states impacts on the location of individuals is a complex and controversial one, and our intention is not to delve into detail here.

However, to the extent HFE distorts location decisions between states or within states or cities, it sits rather uncomfortably with a focus on efficient and equitable charging for infrastructure at the local level.

5.4 KEY PRINCIPLES FOR EQUITABLE CHARGING

Section 4.5 reviewed charging principles from an efficiency perspective.

As well as being efficient, the 'beneficiary pays' principle is equitable between infrastructure users as they bear the cost of their infrastructure use.

However, to the extent beneficiaries have not been subject to differential charges that reflect the cost of infrastructure in the past (with costs recovered through general taxation measures such as council rates), there is a problem of intergenerational equity when a new generation is subject to a more direct, efficient charging regime.

The fact that inefficient charging has occurred in the past is not a justification to continue such practices. However, in applying a more 'rational' set of charges attempts should be made to ensure equity between new and existing residents, and between developments. In particular:

- If new residents are to be separately charged the cost of upgrading infrastructure, it should reflect the proportion in which they derive the benefit, and not involve a cross-subsidy to existing residents. A similar direct charge should apply to existing residents;
- 'double-dipping' should be avoided. For example, the rates paid by new residents should be reduced to reflect the fact that they have already made an explicit payment for incremental capital costs and should not bear the capital cost component of existing infrastructure;
- If new residents are to be explicitly charged for the capital or on-going costs of social infrastructure (on an up front or ongoing user-pays basis), similar charges should be levied on existing residents;
- If consumption of certain services is to be subsidised (to ensure equitable access for low income groups or account for externalities), the public subsidy should be funded by the whole community, not a narrow subset of new residents; and
- To the extent possible, there should be consistent treatment of new developments within a jurisdiction and across jurisdictions, to remove bias in location decisions.

6. FINANCING OPTIONS FOR THE PUBLIC BENEFIT ELEMENT OF URBAN INFRASTRUCTURE

As discussed previously, urban infrastructure can involve a significant 'public benefit' component (due to positive externalities or public good characteristics), beyond the private benefit enjoyed exclusively by an individual, or residents within a new development.

When these wider public benefits are present, then the community as a whole should contribute to the costs associated with provision. In sourcing funds to cover the costs associated with the provision of this infrastructure, governments can either:

- Re-prioritise the existing expenditure base and releasing funds for such investment;
- Raise additional revenue from taxpayers/ratepayers (via ongoing recurrent general taxation measures); or
- Borrow funds and increase public sector debt.

These funding choices are applicable not only for large scale State Government provided infrastructure, but also for smaller scale infrastructure that might be provided solely by local governments, or a combination of State and Local Government funding.

Local Government infrastructure such as child-care centres, community halls, recreational venues/facilities, libraries and open space all have the potential to provide benefits to the wider public. To the extent that full cost recovery or user pay arrangements are not possible or desirable, then funding of this infrastructure needs to be considered within the context of who benefits and who should pay.

The **first option** of re-prioritising the existing expenditure base to fund such investment is difficult not only at the local government level, but also at the state government level.

While there will always be arguments about the extent to which existing funds are being properly and efficiently utilised, any potential gains are not likely to be of sufficient magnitude to fund large scale investment projects. At the local government level there is also the problem of a limited set of expenditure responsibilities, and particularly difficult choices would be required by the authorities if spending priorities were to be shifted from recurrent expenditure for the financing of longer-term infrastructure investment projects.

The **second option** of raising additional revenue from taxpayers/ratepayers via recurrent general taxation measures is potentially a more feasible option. It has the attraction of explicitly recognising that additional or new infrastructure provision is an extension of the range or quantum of services being provided.

At both the State and Local Government level, the question then becomes one of how to raise this additional revenue, given the relatively limited set of revenue raising options available. At the local government level, to the extent that new residents add to revenue raising capacity, then more funds will automatically be available.

However, for both State and Local Governments, even if new revenue raising measures were introduced, they would impose a larger financing burden on existing residents to cover up front capital costs. There are difficulties in attempting to use recurrent revenue measures to deal with an expenditure that (for the most part) is not recurrent in its nature.

The **third option** available to governments is to borrow funds to finance urban infrastructure investment (and temporarily increasing public sector debt).

Increasing public debt to finance urban infrastructure, spreads the taxation burden further across time (and potentially across generations), rather than imposing an annual taxation obligation matched closely to the profile of the expenditure or cost incurred as a result of infrastructure investment.

This form of financing has a number of benefits, but it can also be justly criticised if there is no strategy to repay the additional debt over the (finite) period during which the benefits of the investment are to be derived.

6.1 URBAN INFRASTRUCTURE AND PUBLIC DEBT

One of the more practical benefits of borrowing to finance aspects of urban infrastructure is the ability to smooth the impact of the taxation burden over time. Typically, the nature of infrastructure requires that a large up-front contribution is made during a construction phase, followed by much smaller ongoing expenditure for maintenance and upkeep. If no financing or borrowing instruments were used, a regime which imposed taxation, as necessary to meet this underlying cost profile, would have a large impact on existing taxpayers.

A well designed public finance regime would seek to impose a more or less stable and predictable taxation burden, consistent with the more or less stable income profile of most taxpayers. Significant deviations from such a regime would potentially impose intolerable burdens on taxpayers, and radically impact on their consumption and saving decisions, as well as requiring a reassessment of the liquidity attached to their existing stock of wealth. These practical impacts are by no means trivial, but there is also a more fundamental economic principle that would lead one to avoid designing such a potentially damaging taxation regime.

6.1.1 BENEFIT TAXATION

That principle focuses on imposing taxation burdens consistent with the benefit flows that may be enjoyed by the recipients of the infrastructure investment. This principle has a common textbook definition as 'benefit taxation'[26], and it essentially seeks to allocate burdens across time and necessarily between generations for long-lived assets, where the associated benefits are also enjoyed over time.

In relation to urban infrastructure, to take an example such as a community hall or a local recreational facility, it is clear that the benefits of such public urban infrastructure investment will be enjoyed over a long period of time, and indeed probably across generations. In its pure form, the benefit taxation principle would suggest that borrowing should be conducted by the relevant State or local government authority to fund the upfront investment, and that in subsequent years, tax or ratepayers would face annual ongoing taxation liabilities consistent with the benefits or the amount of consumption of that asset that they enjoyed.

In a well designed user pays model, the broad principles underlying the theory of benefit taxation can be closely mirrored. Any user charges can be set to recoup the initial cost of the

[26] Musgrave, R and Musgrave, P. (Third Edition) "Public Finance in Theory and Practice". (p 710)

investment and the interest charges associated with the borrowing, as well as allowing for an element of the charge to vary with the intensity of consumption or benefit received. In practice however, uncertainty may surround the level of demand that may be faced (assuming a relatively predictable asset life), leading to a potential scenario where the costs of the infrastructure are not fully met through the user charge regime.

That possibility does not militate against the arguments for establishing a user pay regime, it merely reinforces how crucial it is to ensure that there is broad accountability and responsiveness by authorities to the question of whether certain urban infrastructure is indeed necessary or desired by the rate-paying population.

Perhaps because this fundamental question has not properly been tested, we usually find that user pay or cost recovery arrangements are not all that common amongst the suite of urban infrastructure that local government (and to a lesser degree State government) authorities undertake.

Instead, the more typical form of financing follows the benefit taxation principle in a less pure form, whereby the authority borrows to finance the infrastructure, and then sets annual taxation liabilities or in the case of local governments, rate structures, to recoup the initial cost of the investment and the interest charges associated with the borrowing.

Given a fixed asset life, this regime imposes a predictable and stable annual obligation on the tax- or rate payers over time, but does not capture the actual benefits that may be received at any point in time.

Regardless of the accuracy of the model chosen, the benefit taxation principle, and its delivery through a borrowing arrangement (including subsequent repayments over time) on the part of relevant authority, is a sound basis upon which authorities can consider funding urban infrastructure with a public benefit element.

6.1.2 DEBT AVERSION

However, the fact that the borrowing on the part of the public sector will increase public debt in the short term, is a factor that has raised concerns in some quarters. It is commonsense that prudent financial management at the State and local government level requires that any public debt burden be both serviceable over time, and incurred in relation to infrastructure projects of clear community need, rather than over-servicing or developing so called ‘white elephants’.

That said, there is concern, certainly at a political level, to be seen to be reducing public debt rather than undertaking borrowing which may increase it. References are often made to the fickle nature of ‘financial markets’ and their alleged intolerance for additions to public sector debt. It is postulated that this then manifests itself in poorer credit ratings for the public sector borrower, and increasing the overall cost of borrowing.

While there may be some positive payoffs for authorities (at least in political terms) to be seen to be managing public sector accounts in the same way as one might manage a household budget, the subtle differences in the management task are not lost on the financial market participants when assessing the credit worthiness of public sector authorities.

That is not to say however that the financial markets are always able to see beyond headline budget estimates and aggregate public debt figures. Notwithstanding this, public sector

authorities do have the capacity to help minimise the extent of any possible myopia on the part of financial market participants.

They can assist in reducing the transaction costs of obtaining a quality information set upon which credit assessments can be made by ensuring that their accounts are as transparent as possible, and that any infrastructure investment and associated borrowing plans are fully explained, both in terms of their impact over time on tax or rate payers, and clearly articulating the rationale and need for the infrastructure in the first place.

- In relation to the need for the infrastructure, rigorous cost-benefit analysis is a valuable tool that can assist, but it must contain a thorough assessment of the opportunity costs associated with alternative investment or infrastructure options. Accountability and options for general ratepayer participation in major decisions may also be a fertile avenue for improving decision-making in infrastructure provision.
- Explanations to rate payers and financial markets of financing arrangements can be crucial in ensuring that the public authorities justify a clear *nexus* between the changes in council rates or new user charges and the new infrastructure provision.
- The benefit of having such disclosures is that the public sector authority is subject to additional discipline and financial sector scrutiny in relation to the appropriate financing of its borrowing program, or user charging regime. It also helps to provide greater evidence to rate payers or targets of the user charges, that the costs are not simply a general revenue grab, disguised as cost recovery for necessary infrastructure.

While spreading the burden of infrastructure provision over time has a sound economic basis, a relatively more recent development in Australia has also seen public sector authorities seek to spread the risks associated with the funding and maintenance of infrastructure provision beyond the public sector to private sector participants, who may be better placed to manage some of those risks. Arrangements accommodating this transfer are often referred to as Public-Private Partnerships or PPPs.

6.2 PRIVATE FINANCING ('PRIVATE-PUBLIC PARTNERSHIPS')

Public-Private Partnerships or PPPs are a relatively recent phenomenon in Australia, at least to the extent that such arrangements attempt to explicitly transfer risk from the public sector to the private sector. However, the broader involvement of the private sector in public infrastructure projects has a much longer history.

Traditionally, the dominance of public sector involvement in the provision of infrastructure was justified on the basis of the following characteristics:

- Infrastructure assets are generally long lived, capital intensive and form part of a wider network;
- Infrastructure projects usually involve long pay-back periods; and
- Infrastructure assets usually have 'essential services' attributes, where disruption to service provision can impose significant and widespread costs to users, who cannot readily turn to other providers.

As a result of these factors, Government intervention and regulation in relation to urban infrastructure was and remains commonplace, and perhaps because of this, the investment

returns that may be due to a private sector provider can be highly contingent upon the actions of Government.

Over time though, the sophistication of the relationship between the public and private sector in infrastructure has increased, and improved contract design and pricing has enabled this vulnerability of the private sector to public sector actions to be better managed through explicit price effects or other implicit guarantees.

6.2.1 Trends in Public Sector Infrastructure Provision

We have witnessed a shift from the full public provision of urban infrastructure through public works authorities, to a wide variety of public-private joint ventures and partnerships. Initially, governments in Australia engaged with the private sector in an attempt to avoid increasing public sector debt. In particular, during the 1980s State governments chose this route in an attempt to circumvent the loan council restrictions that effectively contained their ability to directly borrow on their own account. However during the 1990s, Loan Council restrictions were eliminated as part of broader competition reforms agreed to by the Council of Australian Governments.

While there may not be explicit regulatory restrictions on State governments in terms of their direct borrowing ability, it does seem that there remain significant 'political' impediments to direct public sector borrowing. Whatever the motivations, the range and complexity of public and private combinations in the provision of urban infrastructure have certainly increased over time - particularly over the past decade or so.

In the current environment, the public and private sectors can be integrally involved in all aspects of the infrastructure provision. The main areas where this interplay can occur include: planning; design; construction; operation (maintenance); financing mechanisms related to timing differentials between construction costs and ultimate revenue flows; ownership rights; ultimate funding mechanisms such as user pays on toll roads and/or some budget financing or 'take or pay' guarantees; and finally regulatory measures to safeguard broader public interest elements or other safety arrangements.

It would be clear from this list that while these key areas of potential interplay between the private and public sectors are of particular relevance to larger scale public infrastructure in areas such as major roads and water, gas, and electricity provision, the same elements of infrastructure provision are to be found in smaller scale urban infrastructure projects. Local Government infrastructure such as child-care centres, community halls, recreational venues/facilities, libraries and other community assets can easily be partitioned into elements similar to those applying to major infrastructure.

6.2.2 Private Participation in Smaller Scale Infrastructure

There may be issues about the extent to which private participation may be forthcoming in the sphere of operational or demand risk, especially if there is only to be limited recourse to user pay arrangements for some of this infrastructure, but again, contract design and various public sector guarantees (if certain demand thresholds are not met) can accommodate uncertainties in this area.

We already have some good examples of private partnerships at the local government level. In late 2001, ABN AMRO announced a $33 million capital issue to finance one of Queensland's first private sector and local government participation projects for a regional

waste management facility in Cairns. In supporting documentation released at the time[27], it was noted that by using the income stream from the facility in processing a variety of waste products, the private financiers were able to package a capital markets bond issue with appeal for 'green' investment funds in particular.

Increasing financial product innovation has provided scope to structure more complex risk transfer contracts for public-private partnerships and initiatives, but so too has the increasing appetite for corporate bond issuance in Australia's financial sector. In recent years, and especially since 1996, the volume of corporate debt outstanding has risen while the volume of Commonwealth debt outstanding has fallen.[28]

In Victoria in particular we have also seen greater private sector engagement across the full range of risks associated with smaller scale public infrastructure, increasingly in the sphere of social infrastructure such as hospitals. A recent example was the success of the private sector consortium 'Progress Health'[29], in tendering for the design and construction, maintenance and financing of the Casey Hospital. The consortium partners bid for the project by establishing 'Progress Health' in order to undertake the private sector responsibilities over the building phase and then the first 25 years of operations.

These examples demonstrate a clear appetite for smaller-scale infrastructure investments by the private sector. However, there are ongoing debates about the extent to which further investment might be encouraged. These debates have taken a number of forms, ranging from arguments about the need for the public sector to directly issue financing instruments such as **infrastructure bonds**, through to proposals whereby the public sector engages (to varying degrees) in the facilitation of secondary markets for the pooling of a variety of smaller-scale infrastructure projects.

The issuing of infrastructure bonds by the public sector does not in practice relieve the issuing authority of any future obligations beyond that attaching to other borrowing arrangements. The backing of the public sector authority is what matters to the investor in terms of risk, rather than the purpose for which the bond is being issued.

Therefore, the issuing of **infrastructure bonds** only make sense as an instrument to leverage enhanced private sector participation and risk sharing, when the bond issuance is backed by the balance sheet of the relevant corporate bond issuer. In this regard, one would expect that the market, left to its own devices, should be the sole determinant of the size and pervasiveness of this particular financing instrument.

To argue for a greater role for the public sector in the facilitation of infrastructure bonds, would require an argument to be made that there is some structural barrier or market failure that needs addressing. An argument that has been made in the past is that the private sector is irrationally risk averse with smaller-scale infrastructure, and that the lack of risk diversification is a fundamental problem. Supporting this view is the suggestion that the irrationality flows from a lack or perceived lack of reliable information (ie. the council may

[27] ABN AMRO (10 September 2001) "Capital Markets Issue to Support Green Infrastructure"

[28] Commonwealth Treasury (2002) "Review of the Commonwealth Government Securities Market"

[29] Victorian Health Department "Casey Hospital – Bringing Health Services Closer To You" www.health.vic.gov.au

have unreleased potential demand or planning information, or indeed contingent regulatory powers) that leaves the potential private investor subject to unacceptable uncertainty.

While uncertainty will clearly be a crucial factor for a private investor in deciding whether to invest in a bond, the depth and sophistication of financial markets, particularly in relation to infrastructure financing, should be able to accommodate (and properly price) this uncertainty element into the return required on the infrastructure bond. Moreover, with the increasing transparency required of councils, especially through their developer charging/planning documents, there is much greater scope for the public sector to play a role in minimising any impediments that may flow from actual or perceived access to key information.

It has also been suggested that there may be disincentives to private sector investment in financing infrastructure as a result of the income tax treatment of infrastructure investment income.

6.2.3 INCOME TAX TREATMENT OF INFRASTRUCTURE INVESTMENTS

Contrary to basic principles for income tax design, Australia's income tax system does not allow full and immediate claiming of losses incurred in generating assessable income unless and until there is other taxable income against which such losses can be set. Loss refunds generally are not permitted and deferred losses are fixed in nominal terms. Accordingly, in the early years of an infrastructure project, typically with very large up-front capital and financing costs, income tax losses are incurred that cannot be set against other taxable income, and therefore loss crystallisation is deferred, possibly for many years and at declining present value levels.

In practice, arrangements have been introduced for a limited number of investments to deal with this specific disincentive problem in an indirect way, by allowing lenders to derive tax-preferred income from infrastructure investments.

For example, the previous infrastructure borrowings taxation concession allowed interest paid on infrastructure bonds to be tax exempt in the hand of the lender. However, the concession was abolished 1997, following evidence that it was being aggressively used by tax minimisation schemes targeted at high wealth individuals.[30]

More recently, the (even more selective and limited) Infrastructure Borrowing Tax Offset Scheme was introduced, involving a 30 per cent rebate of tax (set at the company tax rate) on the interest income of an eligible lender. This benefit is intended to flow through to the borrower as a reduced cost of funding. Eligible projects must be approved by Minister for Transport and Regional Services according to a number of criteria, while the scheme has an overall revenue cap of $75 million per year. However, as expressed by the Commonwealth's Rail Projects Taskforce:[31]

[30] See Treasurer's Press Release No. 97/03 - *infrastructure Borrowings Taxation Concession*, 14 February 1997.

[31] Commonwealth of Australia, 2002, Rail Projects Taskforce, *Revitalising Rail: The Private Sector Solution* accessed at **www.dotrs.gov.au/transreg/str_barrier3.htm**

There are concerns that there is not 100% pass through of assistance to the project and that its complex nature effectively prevents smaller projects (less than $50m) from benefiting from this scheme.

A direct solution to this tax design defect would be to allow full and immediate claiming of income losses, including via refunds. Similarly, a voucher scheme could be introduced, set at the level of the approved maximum cost to taxation revenue, with funds paid direct to the eligible infrastructure borrower. These alternatives have a number of advantages, including in terms of simplicity, transparency and eliminating the need for involvement of third parties such as financial intermediaries.[32]

At present, this relatively inefficient attempt to address the income tax design defect is confined to land transport related infrastructure facilities.

6.2.4 Risks Associated with Private Partnerships

However, it has become clearer in recent times, both here and abroad (especially in the United Kingdom), that the question of value for money to the tax or ratepayer must always be at the forefront when assessing the optimum engagement of the private sector in the provision of public infrastructure. There is obviously no net benefit to the taxpayer if by engaging the private sector in infrastructure provision, you are merely replacing the cost of direct borrowing by the public sector authority with a guaranteed stream of income to a private sector operator in the form of regular rent or lease payments.[33]

Indeed the likelihood that the public sector authority can borrow at a discount relative to a private provider, may see such an arrangement (if up-front capital costs are a high proportion of overall costs) become an expensive and ongoing burden to the tax or ratepayer.

Generally speaking, private involvement in large and small scale urban infrastructure is best suited to projects where:

- Private involvement offers potential gains in efficiency and/or from better allocation of risks and incentives;
- Clear and explicit contracts can be specified for all key aspects of performance and the outcomes readily and inexpensively monitored;
- Private sector operators have a track-record in delivering comparable services; and
- Competition among potential private providers can maximise the share of benefits able to be captured by the taxpayer.

When crucial elements of the project cannot be properly specified in a contract, or indeed the costs of monitoring and enforcing the contract are significant, such projects are less likely to be successful as a public-private partnership. However, even when contract specification of

[32] A voucher system was suggested, for example, in 2001 in a submission on behalf of the Australian Constructors' Association by Tasman Economics to the Inquiry into Infrastructure and the Development of Australia's Regional Areas.

[33] Quiggin, J (2002) "Private Financing of Public Infrastructure" (p 6).

certain risks is possible, the public sector authority must also determine whether they are prepared to allow that risk to reside with the private provider.

This is particularly relevant if it is possible that any adverse outcomes felt by large elements of the tax or rate-paying populus result in such significant political pressure that these risks are reassumed by the public sector, destroying any gains that may have been notionally available under the original contracts.

6.3 KEY PRINCIPLES FOR FINANCING THE PUBLIC BENEFIT ELEMENT OF URBAN INFRASTRUCTURE

- While re-prioritising expenditure or imposing recurrent taxation measures can be options for financing public infrastructure, they are rarely the most effective and equitable financing mechanisms.
- Economic theory and intergenerational equity considerations lend more support to the financing of public infrastructure through a temporary increase in public debt.
  - There is a sound economic case for applying the benefit taxation principle to infrastructure financing where it is not feasible or desirable to exclude potential recipients from the benefits of the infrastructure.
  - In such circumstances, borrowing should be conducted by the relevant State or local government authority to fund the upfront investment, and in subsequent years, tax or ratepayers would face annual ongoing taxation liabilities consistent with the benefits or the amount of consumption of that asset that they enjoyed.
  - While debt aversion is manifestly a 'political' phenomenon, to the extent that financial market participants can face significant transaction costs in obtaining ready access to clear and comprehensive information about the borrowing programs of State and local authorities, more open and transparent disclosure to the markets by these authorities can assist.
- Borrowing on the public account is not the only option available to authorities when considering how to the finance and operate public infrastructure projects. Over the past decade or so, private financing and public-private partnerships have emerged as a viable option to help facilitate public infrastructure provision.
  - The public and private sectors can be integrally involved in all aspects of infrastructure provision, ranging from the planning, design and construction phase, through to the operation, maintenance and financing mechanisms relevant to a project.
  - Increasing financial market innovation in products and contract design, as well as greater acceptance by public authorities has seen enhanced private engagement in both economic and social infrastructure, including at the local government level.

However, there are potential downsides to public-private partnerships, particularly if contract design and enforcement are not well implemented, either for technical reasons, or because of 'political' concerns with the private partners' response to a key risk element in the project (eg. Sharp increases in toll road charges). Adopting proper value for money criteria, and ensuring genuine risk transfer, are key elements in a successful partnership with the private sector.

7. FUNDING VIA DEVELOPER CONTRIBUTIONS

In section 2 of the report, we described the current funding arrangements for the provision of urban infrastructure. In that discussion it was noted that urban infrastructure such as minor roads, community facilities and drainage works was traditionally financed out of general taxation revenue at the State and local government level. Over time though, with councils facing budget constraints, there has been rapid growth of 'developer contributions' as a source of revenue for councils.

7.1 ECONOMIC INCIDENCE OF DEVELOPER CONTRIBUTIONS

While legislation enables councils to charge developers for the provision of specific urban infrastructure, significant debate has surrounded the increased use of these 'developer contributions'. Much commentary has focussed on the negative impact that the charges would have for home affordability. Implicit in these arguments is a presumption that the economic incidence of developer charges is ultimately borne by the final home purchaser.

The vast majority of literature on the subject supports this proposition, and indeed it is further argued that this general assumption holds more strongly over the longer-term, but in the short-term, market dynamics heavily influence the incidence of such levies or charges.

The legal incidence of a tax or levy will diverge from its economic incidence to varying degrees, in response to supply and demand characteristics across the production chain, and the absence of arbitrary price constraints. In relation to property taxes and levies, while the developer faces the legal incidence/requirement to pay a charge such as a developer contribution, the developer is usually able to incorporate this charge in the final price of their land and home package. In this sense, the economic incidence of the developer contribution charge is 'passed forward' to the new home owner.

The theory underlying such an outcome rests upon the differential between the elasticity (or price responsiveness) of demand in the market for raw land purchased by the developer, and the market for home and land packages into which the developer is selling their product. In this regard, Neutze[34] refers to tax incidence theory which implies that a 'developer contribution' charge will be passed backward if the **supply** of raw land is less elastic, and forward if the **demand** for serviced land is less elastic. Neutze makes the relevant point that demand for serviced land may be less elastic (or price responsive) on account of the fact that servicing costs are only part of the cost of land, with land itself only one element of the cost of a total dwelling, and indeed the demand for completed dwellings itself being quite inelastic.

In the long-run this outcome allows the 'developer charge' to be passed forward. However, on occasion, supply and demand characteristics in each market will alter the extent to which the economic incidence is able to be fully passed forward. If the prevailing market for home and land packages is not strong, and a developer's cost of finance is such that withholding lots from sale for a period of time is not feasible, then the developer may choose to absorb some of the council charge in its profit margin. That said, this outcome can only ever be a limited short-term phenomenon, or else the sustained lower returns on capital for the developers would imply a shakeout in the market further down the supply chain.

[34] Neutze, M., 1997, *Funding Urban Services*, Allen and Unwin, Sydney (page 118)

Returning to the theory for a moment, we can also consider the unlikely but theoretically possible situation where developers might seek to pass the cost and economic incidence of a 'developer contribution' charge backwards to the owners of the raw land.

For this outcome to hold, the developer either needs to be a monopsonist (ie. the sole potential purchaser of the raw land), or alternatively have a unique information set (relative to other developers) regarding the development potential of a plot of raw unimproved land. In addition, the alternate uses and returns to which that land might be put (eg. agriculture or forestry purposes) must be so relatively unattractive as to make the owners of the raw land willing to accept a price for the land which has been depressed to the extent of the contribution charge that the developer was required to pay to the council.

Given the unlikely set of factors that would enable a developer to pass the contribution charge backwards, and noting that developers would only be prepared to absorb an element of this charge in their profit margin in limited circumstances in the short-term, it seems reasonable to assume that the economic incidence of developer contributions is passed forward to consumers in most circumstances.

The application of infrastructure charges to new developments will also flow through to the price of existing dwellings. In deciding whether to purchase a new or existing home, home buyers take into account relative prices. To the extent infrastructure charges increase the price of new houses, this will enhance the relative attractiveness of existing homes.[35] Prices will adjust until the discrepancy caused by the infrastructure charge is dissipated.

7.2 UP-FRONT VERSUS ONGOING CHARGES

There has been an increasing focus on the part of home buyers and some developers about the impact of 'developer contribution' charges on the affordability of housing for new home buyers.

Some of this concern stems from the fact that developer contributions are being charged up-front, rather than being spread over time. This treatment differs from the levying of general council rates which pay for the 'ad hoc' capital upkeep and maintenance of pre-existing urban infrastructure.

Earlier in this report we argued that for long lived capital assets, it makes sense to smooth the impact of up-front capital costs by borrowing funds and repaying the up-front capital and interest costs over time. This better reflects the extent to which the benefits from such investment are enjoyed over time. We support this principle in relation to infrastructure that bestows a broader public benefit, which may be enjoyed by both new and existing residents.

In the preceding section we discussed the economic incidence of developer contributions, and indicated that over time, the full effect of the contribution is ultimately borne by the home buyer in the new residential development. Thus while the legal incidence of the contribution rests with the developer, the cost of the contribution is passed forward to the home buyer in final sale price of the land and home package.

[35] This may be partially offset if new homes are subject to lower on-going rates, to prevent 'double dipping' of capital contributions from new residents. That is, as well as the higher up-front cost of a new home, purchasers will capitalise the lower on-going liability into the value of the home.

In a practical sense, to the extent that urban infrastructure funded by developer contributions provides a direct private benefit to the owner of the new home in a development, then there may only be a limited argument against up-front charges. Many purchasers will finance a larger mortgage than would otherwise be the case as a result of the contribution levy, and effectively spread the additional impost over time through higher mortgage repayments.

To the extent that the new higher price of a home (as a result of the embedded developer contribution) forces owners to finance the additional impost at commercial home loan rates, a disincentive effect will no doubt be present. This will impact on affordability at the margin for new home owners and impact negatively on the consumption decision to purchase the home.

In addition, the transactions costs for lending institutions associated with accurately determining the credit worthiness of a borrower, will result in some borrowers being denied access to the additional finance necessary to cover the cost of the embedded developer contribution charge. In such circumstances, the 'marginal' borrower will be denied access to credit on account of relatively inflexible generic rules about lending limits and repayment schedules as a proportion of a borrower's income stream.

While appreciating these potential disincentive effects for the marginal new home owner, the alternative of councils' directly charging owners of homes in new developments via an ongoing charge may be an unattractive proposition for councils and the other remaining ratepayers.

If councils were required to convert the current up-front developer contributions into a stream of liabilities over time, which would be directly levied on the new home owners, a number of additional complexities would come into play. In the first instance, the council would need to finance the upfront cost of the urban infrastructure itself, and either borrow, or forego investment returns elsewhere on its capital, to facilitate this alternative arrangement.

This financing cost could be incorporated into the ongoing charges imposed on the new home owners, so that council and other ratepayers were no worse off. However, as the number of new developments that a council approved increased, so too might the administrative complexity and cost attached to councils offering such arrangements.

There is another potential difficulty for ratepayers in adopting a model of ongoing direct infrastructure charges on new home owners. This additional factor relates to the issue of risk transfer of the costs associated with infrastructure development from the property developer to the general ratepayer.

This risk relates to the probability that the amount of infrastructure funded by the developer contribution charges is greater than necessary, if a new development did not proceed as successfully as anticipated. Currently, if a new development does not subsequently utilise infrastructure to the degree implied in the developer contributions, then the developer wears that risk.

If council assumes the role of levying these new ratepayers directly, then the entire rate-paying populus will be assuming the risk associated with potential excess infrastructure provision. On balance, it would seem that upfront charges on developers are likely to be the most desirable charging regime from the perspective of the entire rate paying populus. However, there remain considerable question marks regarding the scope of infrastructure that these contributions should fund.

8. NATIONAL COMPETITION POLICY (NCP) AND URBAN INFRASTRUCTURE

Traditionally, the public sector was heavily involved in the provision of urban infrastructure. In particular, utilities such as water, gas and electricity were government-owned as vertically integrated monopolies. Local council services such as rubbish collection and child care services were often publicly provided as well as being funded through the public sector (sometimes in competition with the private sector). More recently, the role of State and local governments in providing urban infrastructure services has decreased, with more attention paid to competition, cost-reflective pricing and competitive neutrality between the private sector and government business activities.

A major impetus for these reforms has been National Competition Policy (NCP) and related reforms. In 1995, through the Council of Australian Governments (COAG), the Commonwealth and all State and Territory governments agreed to implement a National Competition Policy (NCP). Although local government was not a direct party to the agreement, each State and Territory is responsible for applying NCP principles to local government.

The approach to implementation of NCP differs across jurisdictions. However, in general, a number of reforms have impacted on the provision of urban infrastructure:

- Competitive neutrality between government business enterprises and commercial entities. For example a council-owned and operated child care centre will usually be in competition with a private sector providers. CN does not mandate contracting out or provision by the private sector. Rather it attempts to ensure that the government entity does not receive artificial advantages. Complying with CN principles may involve removing previous sources of advantage such as exemptions from land tax, subsidised electricity and rent.
- Explicit funding Community Service Obligations (CSOs). Traditionally, substantial cross-subsidies were used to achieve equity objectives (such as over-charging of business consumers to subsidise households).
- Structural reform of public utilities such as gas, electricity and water. Structural reform has included separating the natural monopoly elements from potentially competitive elements; regulatory activities from commercial functions. For example electricity generation and retailing (potentially competitive activities) have been separated from transmission (natural monopoly element).
- Third party access to significant infrastructure facilities. That is, access regimes exist for third party access to natural monopoly elements such as electricity grids, where it would not be economically viable to duplicate facilities as the whole of market demand can be supplied by a single firm at lower cost than any combination of two or more firms.
- Prices oversight of government business enterprises that have a monopoly (such as water corporations). As such, independent pricing authorities (such as IPART in NSW) set prices for monopoly services.

As a result of these reforms, these is now substantial private sector involvement in areas such as electricity and gas provision. Private providers must respond to the commercial imperatives of their operations, within the regulatory environment.

More cost-reflective consumption-based pricing of utility services has also been introduced. For example, consistent with the *Strategic Framework for the Efficient and Sustainable Reform of the Australian Water Industry* agreed at the February 1994 meeting of COAG, Tasmanian councils are required to address reforms in relation to urban water pricing including:[36]

- implementation of two-part tariffs for water pricing, where it is cost-effective to do so; and
- for all schemes, adoption of water pricing regimes which achieve full-cost recovery, including the requirement to meet long-term asset maintenance and renewal costs.

Independent pricing bodies (such as the Independent Pricing and Regulatory Tribunal (IPART) in NSW) have also been established to regulate monopoly services. This includes charges imposed by Sydney Water and other monopoly providers for the upgrading of water supply and sewerage facilities. It is beyond scope of this report to examine in detail whether the charges set by these pricing bodies for utilities such as water, gas and electricity are reasonable. There are a number of considerations that pricing bodies take into consideration when setting maximum prices, including efficiency in resource use, appropriate rates of return and environmental impacts. Box 2 contains an overview of IPART's responsibilities and the factors it takes into consideration in making determinations.

NCP has involved reform of charging arrangements employed by local councils. Where they provide monopoly services, local councils may also be subject to price regulation (for example IPART sets prices for water, wastewater and stormwater services charged by Gosford Council).

Competitive neutrality provisions require that prices charged by local government businesses are set to recover the full costs of a business activity, including tax equivalences and a commercial rate of return. This is consistent with the emphasis on cost-reflective pricing and the intention to remove competitive advantages flowing from government ownership.

Similarly, NCP has brought greater transparency to the pursuit of social objectives, such as equitable access to services. This has involved the identification of non-commercial activities (Community Service Obligations), measuring the cost of their provision and determine an appropriate means of funding them. For example, CSOs can be directly funded by local councils from general tax revenue rather than being funded by over-charging certain users.

[36] Government of Tasmania, January 2003, *Urban Water And Wastewater Pricing Guidelines Consistent With The COAG Water Reforms For Local Government In Tasmania* (page 3).

BOX 2. ROLE OF IPART (NSW)

IPART is an independent body that oversees regulation in the water, gas, electricity and public transport industries in NSW. IPART has six core functions, established by legislation and codes. These functions are to:

- set maximum prices for monopoly services provided by government agencies in NSW (including water and public transport)
- regulate revenues or prices of electricity networks under the National Electricity Code and electricity legislation
- regulate natural gas pricing and third party access to gas networks
- administer licensing or authorisation of water, electricity and gas businesses, and monitor compliance with licence conditions
- register agreements for access to public infrastructure assets and arbitrate disputes about these agreements
- investigate complaints about competitive neutrality referred by the government.

Section 15 of the *Independent Pricing and Regulatory Tribunal Act* requires the Tribunal to have regard to twelve factors in making its determinations and recommendations. The factors can be grouped as follows:

- Consumer protection
  - prices, pricing policies and standards of service
  - general price inflation
  - social impact of decisions
- Economic efficiency
  - greater efficiency in the supply of services
  - effect of exercise of functions by some other body
- Financial stability
  - rate of return on public sector assets
  - impact of borrowing, capital and dividend requirements
- Environmental and other standards
  - protection of environment by appropriate pricing policies
  - considerations of demand management
  - standards of quality, reliability and safety

Source: Accessed from the IPART website at http://www.ipart.nsw.gov.au/

The next section focuses on infrastructure charges levied by local councils, normally in the form of developer contributions. The approach differs across States. As the PC identified, a major issue is the extent to which developers should contribute to social infrastructure such as schools, parks and libraries.

9. REVIEW OF CURRENT INFRASTRUCTURE CHARGING GUIDELINES AGAINST ECONOMIC PRINCIPLES

Policies and guidelines have been developed by State jurisdictions to guide local councils and providers of urban infrastructure services in the setting of fees and charges levied on developers and/or new residents.

This section focuses on the stated policies and guidelines of State governments in NSW, Victoria and Queensland. It is not intended as a detailed examination of individual pricing regimes, but rather a preliminary examination of how stated polices and guidelines compare with the economic principles outlined above.

The focus will be on the funding of urban infrastructure for new developments where State or local governments sometimes levy 'developer contributions' to cover capital costs in areas including:

- roads (local and arterial);
- open space (local and regional);
- public transport; and
- other 'social infrastructure' or community services such as child care centres, libraries, community centres, sporting facilities and the like.

Note that we are not seeking to assess the practical application of state guidelines – rather whether the principles articulated in the states' rule books are consistent with sound administrative outcomes.

- Section 9.1 briefly outlines the legislative authority and relevant guidelines governing developer contributions in each State, including the setting of charges and the types of infrastructure levied.
- Section 9.2 considers charging for specific types of infrastructure, consistent with the economic principles we have outlined earlier. These are compared to charging in practice across the three Stets, drawing on some specific examples from local councils.
- Section 9.3 reviews the approach across the three States and offers some conclusions regarding the use of developer contributions.

9.1 LEGISLATIVE AUTHORITY AND GUIDELINES GOVERNING DEVELOPER CONTRIBUTIONS

9.1.1 NEW SOUTH WALES

The *NSW Environmental Planning and Assessment Act 1979* ('the Act') aims to protect, provide and co-ordinate both physical and social infrastructure while providing and maintaining affordable housing.

Section 94 of the Act enables local councils to levy developers for contributions towards public amenities and services required as a consequence of development. This usually involves covering capital costs of upgrading urban infrastructure.[37]

9.1.1.1 REQUIREMENTS OF DCP

There are a number of conditions that need to be met before a local council can levy a developer contribution. As a result of the 1989 Simpson's Inquiry, from 1993 councils are only able to charge developers under s94 if they have completed a contributions plan[38]. The DCP must demonstrate a nexus between the proposed development and the provision of public facilities, including:

- causal nexus – demonstration that the development actually creates a need for, or increases demand for a facility;
- spatial nexus – the development is likely to serve the needs of those who created the demand for it; and
- temporal nexus – the facility is to be provided in a timely manner to benefit those who contributed towards its cost.

The council must use the funds for the purpose for which they were earmarked within a reasonable time and return any unused funds. The council must also take into account any urban infrastructure (including land) the developer has provided free of charge (work in kind) or any funds previously paid to the council.

The contribution plan must be 'reasonable', including the standard of the facility and the level of contribution sought. The s94 manual provides an expansion listing of the type of factors to be taken into account in determining whether a contribution plan is 'reasonable', including whether there is spare capacity in existing facilities, and the location of the facility. However, as stated in the manual, councils ultimately determine whether the contribution plan is reasonable:

> *The s 94 system places the responsibility on council to determine what may be reasonable and to use s 94 in a reasonable manner.*

9.1.1.2 SETTING CHARGES AND TYPE OF INFRASTRUCTURE COVERED

Setting developer contributions involves a complex process of projecting future population, deriving future demand for facilities and outlining the cost of providing such facilities in a works schedule. As part of the DCP process, an attempt is made to apportion the cost of the new facility between new and existing residents. The cost may be expressed in a number of ways, including per lot, per person, or per dwelling.

As stated in the s 94 manual:

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[37] See Department of Urban Affairs and Planning, 1997, *Section 94 Contributions Manual*, 2nd Edition.

[38] http://www.iplan.nsw.gov.au/pdf/taskforce/section942000.pdf

Apportionment is a process which seeks to define the demands of all those who may benefit from the provision of a public facility to ensure that the contributing population only pays for its share of the total demand.

For example, assuming a library is required for every 30,000 people, a development with 20,000 people would bear two thirds of the cost. Once again, the type of infrastructure provided, its standard, and the method of apportioning costs is at the discretion of the council. One council may decide that a library is required with an additional 30,000 people, while another may set the level at 50,000.

While new residents bear the full cost of their share of usage as an up front charge paid by the developer, in the absence of explicit charging of existing residents, the remaining portion is covered by the council from general revenue sources over time, such as grants from higher levels of governments or rate revenue.

Discounts can be applied to the contribution, whereby councils choose to reduce the contribution rate for a specific 'planning, social, economic or environmental purpose'. Developer contributions cannot be used to compensate for any negative impacts of development.

Section 94 can cover any public facilities that the council wishes to provide to the community.[39] For example, the Councils can levy s 94 contributions to cover roads, open space, public transport, child care centres, libraries, community centres and sporting facilities.

A review of s94 is currently underway.[40]

9.1.1.2.1 Public Transport Contributions

In relation to public transport infrastructure provision, and the charging of developer contributions, recent developments appear to highlight an emerging tension. In November 2002, the NSW Government announced a transport levy of $15,000 per lot in four new development areas: Elderslie; Spring Farm; Balmoral Road; and Second Ponds creek.[41]

The monies are to go into a dedicated land release contribution fund, which will only be able to be used for the provision of transport infrastructure to the contributing regions. The Government stated that the principle underlying this policy was to ensure "that those who reap profit from the rezoning and release of new land pay their fair share of the cost of making the new suburbs viable and sustainable".

However, to the extent developer charges are passed forward to the final home buyer, this raises a number of efficiency and equity issues.

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[39] Although contributions cannot be used for recurrent funding, planning studies or ongoing administrative costs.

[40] www.iplan.nsw.gov.au "SECTION 94 Contributions and Development Levies Taskforce" Closing Comments due 23 January 2004.

[41] Media Release, Deputy Premier NSW, Dr Andrew Refshauge (19 November 2002) "Transport Levy to Fund Essential Infrastructure for New Homes".

There is an issue of appropriate targeting of a levy such as this in relation to public transport infrastructure. It is clearly quite possible that those paying for the infrastructure may not end up benefiting from it. That is, not only may the new residents not use the infrastructure, but existing residents can potentially benefit from any new rail, bus and road links. These existing residents thus enjoy the public infrastructure provision already provided to them by all State taxpayers, but also potentially any benefits that may flow from improved public transport infrastructure, within close proximity (which will have been funded by residents in the new developments).

In principle, given that the State Government retains the main charging authority in this area through ticket prices levied on consumers of public transport, it would be more efficient and equitable to seek to recoup the costs of infrastructure provision through user pays ticketing arrangements. Ticket prices could be set to recoup the capital and ongoing costs of infrastructure provision to the new areas through differential ticket prices (based on ticket price zoning related to origin/destination) with some element of subsidy from the Government.

This system would better target the beneficiaries of such public transport infrastructure, and ensure that new and existing residents contribute to the cost of provision in proportion to their actual use.

A complicating factor is that investments in public transport are determined on the basis of their overall social benefit/cost ratio (which takes into account the impact on traffic congestion and traffic accidents), rather than their private commercial return to the transport authority. Once the investment is in place, the charges to actual users of the service need only cover the marginal net recurrent cost of providing the service implying a significant shortfall of revenues over long-run average cost. The capital costs will then need to be recouped in a neutral manner from all prospective beneficiaries of the investment, only a proportion of whom will reside in the new developments in question.

The implicit tensions between the financing of new public transport and the ultimate beneficiaries, as well as the fact that enhanced user charging regimes are currently only available to the State Government through differential ticket prices, suggests that this area is ideally suited to a fundamental review. In this regard, the NSW Government did indicate that their transport infrastructure levy would be an interim measure, while a taskforce reviews the policy with a view to establishing funding options for future release areas.

9.1.2 VICTORIA

The VIC Planning and Environment Act 1987[42] aims

- to provide for the fair, orderly, economic and sustainable use, and development of land,
- to secure a pleasant, efficient and safe working, living and recreational environment for all Victorians and visitors to Victoria, and
- to protect public utilities and other assets and enable the orderly provision and co-ordination of public utilities and other facilities for the benefit of the community.

[42] See Appendix 1 for legislation

Section 173 of the Act enables local councils to levy contributions from developers. Funds from developers can be collected via Development Contribution Plans (DCPs), conditions on planning permits, or voluntary agreements between councils and developers.

A Review of the development contributions system in Victoria was completed in May 2003[43]. The Victorian system is similar to that in NSW, but with a narrower range of social infrastructure that can be charged for.

9.1.2.1 REQUIREMENTS OF DCP

Similar to s 94 contributions in NSW, there are a number of conditions that need to be met before a local council can levy a developer contribution.

DCPs must be approved by the Minister. Infrastructure to be provided under a DCP:

- must serve a neighbourhood or larger area
- must be used by a broad section of the community, and
- will in most cases serve a wider catchment than an individual development.

There are a number of other principles by which DCPs are implemented include:

- Infrastructure projects can be included in a DCP if they will be used by the future community of an area, including existing and new development.
- There must be a nexus between new development and the need for new infrastructure - it must be demonstrated that the new development to be levied is likely to use the infrastructure to be provided.
- DCPs must have a reasonable time horizon (not exceeding 20 to 25 years).
- Infrastructure costs must be apportioned on the basis of projected 'share of usage' across new and existing residents. However, only new development can actually be charged the levy.
- The levies collected must be used to provide the infrastructure specified in the DCP.

9.1.2.2 SETTING CHARGES AND TYPE OF INFRASTRUCTURE COVERED

Recurrent costs of the infrastructure and administration costs of developing a DCP may not be levied.

In general, for each infrastructure project the infrastructure levy for each demand unit (i.e. dwelling or shop) within the main catchment area (MCA) is calculated by taking the cost of the infrastructure project and subtracting the percentage of external/future usage of the infrastructure, and then dividing by the total number of demand units (including those exempt from paying the levy) in the MCA. By doing this for all infrastructure projects a charge levy, by area, can be developed.

However the Victorian Government Policy in 2003 proposes to develop off-the-shelf (OTS) DCPs to reduce the complexities faced by each council of producing their own detailed DCPs

[43] Victorian Government Department of Sustainability and Environment, May 2003 *A New Development Contributions System for Victoria,*

required to collect levies from developers. For each residential development area (namely greenfields suburbs, consolidation of outward urban growth, urban infill, and rural areas), levies for roads, drainage, open space and community facilities will be developed on a per dwelling basis.[44]

The development of OTS DCPs is obviously an attempt to minimise administration costs of smaller councils in completing a full DCP.

Following a recent declaration by the Planning Minister, the following works, services or facilities may be funded from a development infrastructure levy:

- acquisition of land for roads, public transport corridors, drainage, public open space, and community facilities including (but not limited to) those listed under the last dot point in this list
- construction of roads, including the construction of bicycle and foot paths, and traffic management and control devices
- construction of public transport infrastructure, including fixed rail infrastructure, railway stations, bus stops and tram stops
- basic improvements to public open space, including earthworks, landscaping, fencing, seating and playground equipment
- drainage works, and
- buildings and works for or associated with the construction of maternal and child health centres, child care centres, kindergartens, or any centre which provides these facilities in combination.

9.1.3 QUEENSLAND

The Queensland *Integrated Planning Act 1997* (IPA) was designed to alter the way planning and development related assessment would be carried out in Queensland, by creating a single integrated development assessment system (IDAS) and an integrated framework for planning. Key initiatives in the legislation sought to reduce the cost of providing basic infrastructure and services to new communities by ensuring State and local government capital works spending was coordinated with land use planning decisions in local government planning schemes. Importantly, it also aimed to provide clear principles for funding basic and essential infrastructure in new communities through infrastructure charges.

As a result of IPA legislation, local governments are able to impose infrastructure charges on developers to assist with the provision of essential economic infrastructure. All councils are required to prepare Priority Infrastructure plans (PIPs), that outline the anticipated economic and social infrastructure needs for that community. However, the IPA only enables councils to impose infrastructure charges on developers for infrastructure where there is a 'private' benefit, rather than for 'social' infrastructure such as child-care centres, libraries etc, where broader public benefits are present.

In order to levy infrastructure charges on developers for this private benefit infrastructure, councils must prepare an Infrastructure Charges Plan or schedule (ICP) which outlines the

[44] Department of Sustainability and Environment (May 2003) New Development Contributions System (page 4-5)

charging regime and rationale. The ICP can only be applied to the following infrastructure items:

- urban water cycle management infrastructure (charging guidelines provide for some funding contribution for the consumption of existing headworks);
- transport infrastructure; and
- infrastructure for local community purposes (meaning land and basic works for local public recreation purposes, or another purpose prescribed under a regulation).

It is important to note that changes may be forthcoming before the end of the year, particularly in relation to the universal requirement to prepare ICPs under council PIPs, as a result of the reforms proposed in the *Integrated Planning and Other Legislation Amendment Bill 2003.*

Broadly speaking, if these reforms become law, the ICP requirements will be altered to enable a 'standard' (State Government endorsed) set of charges to be applied on developers by a council. This off-the-shelf set of charges will enable smaller councils, or councils with limited developments, to avoid the cost and effort associated with the preparation of a fully tailored ICP.

9.1.3.1 REQUIREMENTS OF ICP

The requirements of an ICP are detailed in the draft IPA guidelines for infrastructure charging (nb. These guidelines will be formalised following passage of the current amendment Bill) and some of the key principles that must be followed include:

- Fees for infrastructure which provides a direct, private benefit to users should be explicitly treated as a user charge;
- Infrastructure charges should be limited to facilities and services where consumer choice is constrained for reasons of health and safety or where there are compelling savings in long term provision costs;
- Why alternative, more efficient, charging mechanisms cannot be used, should be demonstrated;
- Infrastructure charges should form part of a service "contract", including a clear plan for the provision of the infrastructure;
- Service provision plans should be based on "reasonable" performance requirements for infrastructure and engineering solutions which minimise the life cycle costs of meeting these requirements; and
- Infrastructure costs should be equitably apportioned based on estimated shares of infrastructure usage.

In addressing these key principles, the ICP needs to provide information that justifies the need for the infrastructure works/services included in the plan. Further, there needs to be clarity about the extent to which this infrastructure will be funded purely from developer charges as against other sources.

In detailing the expected source of funds, it is also necessary to provide some assessment of the required timing of the provision of the infrastructure, and importantly the boundaries of the area for which the infrastructure is being provided. Information is also required in relation to the description of each type of lot, work or use to which developer charges might apply, as

well as the rate at which charges apply in each area and their method of calculation, and any provisions for the collection of infrastructure charges where a development permit is not required.

9.1.3.2 SETTING CHARGES AND TYPE OF INFRASTRUCTURE COVERED

The draft IPA guidelines for infrastructure charging provide some clear worked examples of how the setting of charges under the ICP should be formulated, for the three key areas where charging is permissible. The guidelines indicate the broad steps that a council needs to follow in designing their charging regime, and it includes the following:

- Identification of the existing infrastructure, its current spare capacity, and the beneficiaries or current service catchment of the infrastructure;
- Estimating the depreciated value of the existing infrastructure;
- Identify the new infrastructure need based upon anticipated demand levels;
- Estimate net present value of the new infrastructure need based on the anticipated demand levels; and
- Calculate and apportion charges.

Given that the Queensland regime only permits developer charging for the more identifiable infrastructure that delivers a 'private benefit', the apportionment element of the charging schedule is more straightforward than for other States where 'social' infrastructure apportionment can be complex.

However, some of these more problematic apportionment issues do arise in relation to 'transport' infrastructure, because of the open character of these networks. The draft guidelines indicate that worked examples in this area, to accommodate the necessary apportionment for users outside the development area for local roads and footpaths/cycleways etc will available in the finalised guidelines (due to be released after the passage of the current amendment Bill).

9.2 CHARGING FOR SPECIFIC INFRASTRUCTURE

Before examining details of charging for specific infrastructure in each jurisdiction, the following table summarises whether, under the relevant legislation and/or guidelines, local councils have the discretion to charge for each type of infrastructure, across jurisdictions.

CHARGING FOR SPECIFIC INFRASTRUCTURE ACROSS STATES

	NSW	Victoria**	Queensland
Roads	✓	✓	✓
Open space	✓	✓	✓
Public transport*	✓	✓	✗
Child care centres	✓	**Capped**	✗
Libraries	✓	**Capped**	✗
Community centres	✓	**Capped**	✗
Maternal health	✓	**Capped**	✗

* Does not include rolling stock.
** The Victorian Government intends to remove these caps on 'community infrastructure'.

9.2.1 ROAD CHARGING IN PRINCIPLE

Drawing upon the efficiency and equity principles outlined earlier in the report, we can consider the issue of appropriate road charging principles. Ideally, we can separate the consideration of road funding into three components. The first component would relate to roads within a new development, the second would relate to arterial roads essentially providing the connection between the main road network and the development, and the third component would relate to the major council roads network.

Amongst these three components, it should be obvious that for the component of the road system within a development, the vast majority of benefits are directly captured as private benefits by the residents of a new development. In this sense, there is a case to directly charge the recipients of these benefits, as is currently achieved (indirectly) via developer contribution charges.

In relation to the second component of the road system, the arterial roads, the over-riding principle of charging the beneficiaries of that network should still apply. However, there are clearly difficulties in practice associated with accurately apportioning capital costs related to the provision of the arterial road network. The practical issues are quite pronounced when one attempts to apportion *expected use*, amongst users from a new development, and existing residents who may also on occasion use these arterial roads to either travel to the new development, or as a new alternative route to another destination.

Many councils have attempted to apportion expected use between the new and existing residents, with varying degrees of calculation complexity involved. However, even if the actual use did align with the predictions, councils have still chosen to charge for such use in an inequitable way. For instance, the apportionment formula might see say 20 per cent of

use of an arterial road allocated to new residents and the remaining 80 per cent to existing residents.

- However, the council would then incorporate that 20 per cent of capital costs of the arterial road into a developer contribution, with the remaining portion to be met by council. If that remaining amount is funded from general ratepayer revenue, then while existing residents will be making a contribution, the new residents will be paying twice, through the developer contribution and then ongoing rates. Ideally, councils should endeavour to directly levy the existing residents in proportion to their consumption.

In relation to the third component of road infrastructure, the main council road network, technology is not sufficiently advanced or cost-effective to enable appropriate road user charging according to use by a new resident or existing resident. While apportionment might be feasible at the arterial road level, it becomes quite problematic when major road networks are being considered. Given that the recipients of these road networks are not easily identifiable, it is desirable for councils to spread the cost of the provision of this infrastructure evenly across the rate paying population.

9.2.2 ROAD CHARGING IN PRACTICE

In NSW, section 94 applies to both capital costs and road maintenance (for the duration of development construction) due to excessive wear and tear caused by the construction of the new development, however charging cannot be applied for the expected recurrent costs of future maintenance.[45]

As an example of the NSW regime, **North Sydney Council's** DCP[46] states that developers can be charged (in whole or in part) for: road constructions and improvements; traffic calming devices and amenity based traffic improvements; pedestrian safety devices; residential parking; street scaping; and bus and bicycle network improvements.

Contribution rates were calculated by projecting growth over 8 years of commercial traffic, residential traffic, and through traffic. Where future traffic increases were projected to be greater than 15 per cent, the costs of related traffic calming devices and amenity based traffic improvements are fully funded by developer's contributions. Costs of road works that are directly related to the development, such as resident parking schemes, are also fully funded by developer's contributions.

In circumstances where council funds components of the related road infrastructure, the lack of differential rating can lead to double taxation of new residents. The DCP also notes that some improvements will take longer than the 8 years allotted – in which case there is also temporal equity issues (given that new residents bearing the costs may move away before receiving all the benefits).

In addition to road improvements, **Richmond River Council**[47] in NSW also requires contributions from developers for the future maintenance of roads that the development will

[45] (1997) Section 94 Contributions Manual, 2nd Edition (Page 2)

[46] North Sydney Council (February 2003) North Sydney Section 94 Contributions Plan

[47] Richmond River Shire Council (April 2000) Richmond River Section 94 Contributions Plan

use for heavy vehicle movements. The council also requires the developers to upgrade any roads that are not up to standard for heavy vehicle movements.

In Victoria, the scope of road infrastructure that can face developer levies is generally at the discretion of the Council through the DCP, (provided they follow the appropriate formulae and calculation methodologies), or through voluntary agreement, or potentially through off-the-shelf DCPs in future reforms are adopted.

The **City of Casey Council's**[48] DCP enables charging of developers for part of the costs of the improvement of roads and traffic management works, and the full cost of the provision of a bicycle network in the Narre Warren South region. To the extent that council will assume the remaining funding costs, and if no differential rates will apply, the issue of double taxation of new residents will arise.

In general in Queensland, the IPA only enables councils to impose infrastructure charges on developers for infrastructure where there is a 'private' benefit, rather than for 'social' infrastructure such as child-care centres, libraries etc, where broader public benefits are present. Consequently ICPs can be applied to roads and other transport infrastructure.

Noosa Council's[49] DCP enables charging of developers for the provision of and/or improvement of roads, bridges, roundabouts and intersections, and the widening of pavements. The total cost of these projects (minus state government funds) is allocated across residential, commercial and other (i.e. visitors) road use depending on road usage and then divided by the number of new dwellings in the development.

The method of determining proportions of road use involved projecting growth in relation to where traffic was travelling along the network; who was travelling along the network; and why they were travelling along the network. While considerable effort was devoted to obtaining proportions, because the council will pay for the remaining costs out of general revenue, assuming not differential rates will be applied, new residents may again face double taxation.

9.2.3 OPEN SPACE CHARGING IN PRINCIPLE

When considering the appropriate charging principles for open space, it is useful to attempt to divide the definition of 'open space' into two categories. The first category can relate to a plot of open space (ie. not a recreational facility but nothing more than the capital investment associated with the land and footpaths) within a new development. The second category can be applied to much larger plots of open space, which are not necessarily within a new development, but are still reasonably proximate, and might include more substantial footpaths or walking trails or other landscaping.

In relation to both categories, it may not be cost-effective or practicable for a council to exclude individuals from access (and thus implement a pricing regime for the right of access).

[48] City of Casey Council (1997) Development Contributions Plan for Narre Warren South

[49] Noosa Council (March 2002) Coastal Major Road Network Infrastructure Charges Plan

Due to the potential cost and practical constraints imposed by these sorts of issues, councils need to rely upon 'reasonable' assumptions about the likely beneficiaries of this infrastructure. In this regard it would seem reasonable to assume that for the first category of open space, namely small-scale open land within a development, the most likely beneficiaries are going to be the residents of the new development. To that extent, it is reasonable to either levy a developers contribution for the provision of that open space, or alternatively require developers to quarantine certain land as 'open space'. This way, new residents will fund the open space through higher land and home prices, one way or another.

However, in relation to large open space in close proximity to a development, it is not quite so obvious that a reasonable assumption can be drawn about the ultimate beneficiaries of that open space. This is particularly so if the large open space has attractive features and landscaping or walking trails, which could reasonably be expected to encourage use from both residents of the new development and existing residents within a council area.

Given the high probability that the open space will be enjoyed by new and existing residents, and noting that it is usually impractical to exclude access and impose direct user charging, it is inappropriate to fund the provision of this infrastructure through developer contributions in a new development. The funding for such infrastructure should be funded by the entire rate paying population, and there should be transparency and accountability mechanisms in place to ensure that council directives for open space, accurately accord with the desires of that rate paying population.

9.2.4 OPEN SPACE CHARGING IN PRACTICE

An example of open space charging in NSW can be found in **North Sydney Council's** DCP which enables developer contribution charging for both the embellishment of *existing* open space and the acquisition of additional open space. The council calculates the amount of open space per *current* resident and worker and multiplies this amount by the estimated cost per square meter of embellishing this open space.

In such a case, while the new residents effectively contribute 100 per cent towards the improvements of existing open space, existing residents and workers make no contribution, but are likely to receive most of the benefits. The contribution rates for additional open space are calculated by dividing the total costs of open space acquisition by the number of residents and workers. Although the costs are notionally allocated between new and existing residents and workers, existing residents make no explicit contribution to the costs of acquiring additional land.

For some projects, **Richmond River Council** in NSW allocates notional usage and costs of open space between developers and the "council", and while this treatment is more equitable, it still results in double taxation for new residents if differential rates are not applied.

In Victoria, Section 18 of the Subdivision Act 1988 states that if the requirement for public open space is not specified in the planning scheme then a Council may require the developer to:

- set aside no more than 5 per cent of all of the land in the subdivision for public open space, in a location satisfactory to the Council; or
- pay the equivalent market value, or a combination of both.

When setting the amount of land required for public open space, the council must take into account the intensity of land usage, population density, and existing places for recreation and their adequacy[50].

The **City of Casey** Council enabled the charging of developers for the full costs of four ovals, tennis and netball courts, and an enhancement to the existing retarding basin. While existing residents will no doubt also benefit from these open spaces, especially the improvement to the existing water feature, these residents do not contribute towards the costs of these facilities.

9.2.5 SOCIAL INFRASTRUCTURE CHARGING IN PRINCIPLE

In relation to social infrastructure such as child care centres, libraries, community centres and sporting/recreational facilities, there is a broad scope of charging principles being applied across the country. The regimes in place for the provision of such infrastructure are mostly starkly contrasted in NSW and QLD. In NSW, section 94 guidelines enable a wide range of social infrastructure to be funded through developer contributions, whereas in QLD, funding for this infrastructure is not able to be levied via developer contributions.

- This means that in Queensland, the entire rate paying population subsidises the provision of the social infrastructure, or alternatively 'user pay' charging regimes must meet the capital and ongoing costs associated with the provision of such infrastructure.

Drawing upon the efficiency and equity principles outlined earlier in the report, it is likely that in most circumstances the social infrastructure we have referred to, will deliver direct private benefits, as well as broader public benefits through affordable access to education, health and community recreation facilities. As indicated earlier, for most social infrastructure a 'user pays' approach can be combined with some element of public subsidy (funded by the general rate payer) to account for these broader public benefit elements of such infrastructure.

Given that there will inevitably be a wide spectrum of public and direct private benefits accruing to any of this social infrastructure, and noting that the preferences and demographics of each rate paying population will also vary, there needs to be some mechanism of quantifying any subsidy element when providing this infrastructure.

The most effective mechanism of delivering such an option is to require the capital costs associated with this infrastructure provision to be incorporated into ongoing charges over the life of the relevant asset in the form of direct user charges. The total direct user charge for this infrastructure can then incorporate the capital and ongoing costs of providing the infrastructure, and each council can then decide to make explicit payments to the third party operator (or an explicit reduction in the user charge if council operated) to incorporate a subsidy element into the user charge, to enable more efficient marginal cost pricing.

The extent of the subsidy can be set by the council, clearly taking account of the preferences of the rate paying population and their assessment of the public benefit attached to the infrastructure provision. This approach is a more efficient and equitable mechanism of financing such infrastructure, rather than embedding a hidden subsidy in developer contributions, on a sub-set of the rate paying population.

[50] See appendix 1 for legislation.

9.2.6 SOCIAL INFRASTRUCTURE IN PRACTICE

In NSW, **North Sydney Council's** DCP enables the charging of developer contributions to improve existing community centres and provide new community centres, as well as specific improvements to the library and Olympic pool, and the provision of funds for a major multi-use indoor sports centre, and childcare facility. While the council notionally allocates costs between new and existing residents and workers, the "council" contributes the share of existing residents, thereby potentially leading to double taxation of new residents if differential rates are not applied.

For some projects, **Richmond River Council** in NSW allocates the costs of various social infrastructure projects, such as community halls, public toilets, swimming pools, sports stadiums, and netball and tennis courts, between new and existing residents. The existing residents share is contributed by "council" rather than through explicit charges.

In Victoria, Section 47L of the Planning and Environment Act 1987 places a cap on the community (social) infrastructure levy:

> *In the case of the construction of a dwelling, $450 for each dwelling to be constructed; and in any other case, 0·25 cents in the dollar of the cost of the building work for the development.*[51]

In this regard, community infrastructure is defined as all other "buildings or facilities used for community or social purposes" which are not classified as development infrastructure. For example community health centres, leisure, sporting and recreational facilities on public open spaces, cultural and educational facilities (eg libraries), and other facilities (eg public toilets).[52]

However, the Victorian Government recently issued a policy document outlining proposed changes including an intention to remove this cap. It was suggested that this cap was arbitrary, and that the amount of such levies should be matters of policy for councils based on sound strategic planning relevant to a particular area.

The **City of Casey's** DCP enables developer contribution charges for the full costs of a pavilion/club house, equipment for playgrounds, and a multipurpose community centre to house a childcare centre, a preschool, a health centre, and a meeting hall. Again, while existing residents will probably also benefit from this social infrastructure, they do not make explicit contributions to their provision.

In general in Queensland, the IPA only enables councils to impose infrastructure charges on developers for infrastructure where there is a 'private' benefit, rather than for 'social' infrastructure such as child-care centres, libraries etc, where broader public benefits are present. Consequently council's can not impose developer charges for most projects of the type typically considered to be social infrastructure.

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[51] http://www.dms.dpc.vic.gov.au/l2d/P/ACT01099/7_1.html

[52] http://www.doi.vic.gov.au/DOI/Internet/devcont.nsf/allDocs/5CB5181D2E7E3812CA256C130000A5A8?OpenDocument&Expand=2.1.4.4.2&#Guidelines_about_including_existing_infrastructure

9.3 DEVELOPER CHARGES ACROSS STATES IN REVIEW

9.3.1 COMPARISON ACROSS STATES

Arrangements for the levying of developer charges differ across jurisdictions, with varying degrees of discretion given to local councils in deciding the types of infrastructure to which charges apply, and the amount levied. This reflects the tension between:

A directing councils to use an appropriate (such as efficient and equitable) charging regime in order to maximise social wellbeing of the State as a whole; and

B the more parochial role of local councils as a separate sphere of government, accountable to their local population.

Queensland confines the ability of councils to apply levies, limiting them to 'basic and essential infrastructure' such as water and drainage facilities. In this way, councils are more accountable as residents have a say in whether other types of infrastructure are provided, and at what standard. It also involves a greater role for better targeted user charges, or subsidisation by the whole rate-paying population where there is a social benefit.

By contrast, in **NSW**, councils have broad discretion to levy charges for infrastructure with a nexus to the development. In practice, this has included levying new residents with a share of the costs of libraries, sporting facilities and regional open space. This is regardless of the extent to which new residents desire these facilities or use them. Moreover, the facilities are open to use by all residents.

There is a large amount of discretion over the types of infrastructure provided, its standard and how to apportion costs between new and existing residents. This discretion leaves open the potential for councils to use developers and new residents as a convenient revenue source to fund their activities.

Councils are not required to assess whether a developer contribution is a more efficient or equitable method of recovering costs rather than alternative financing mechanisms, such as user charges, or subsidisation by the broader community (such as through general rates, or grants from higher levels of government).

Victoria is notable for the recent government proposal to remove the $450 cap on 'community infrastructure'. While the Ministerial declaration to councils explicitly includes community facilities with a more basic health or education purpose (buildings and works for maternal and child health centres, kindergartens) councils are not limited to these facilities in their ability to charge. As such, developer contributions can be used to fund 'community infrastructure' rather than the use of more efficient and equitable mechanisms.

9.3.2 END PIECE

In many cases, the practice of levying up-front developer contributions as de-facto user charges, calculated on the basis of estimated use by new residents, is inefficient and inequitable. Compared to charging actual users it is a blunt and ill-targeted method of charging beneficiaries, as it apportions a charge regardless of actual use. As we have discussed previously, where there is a social benefit to be subsidised, this cost is most appropriately borne by the whole community through general taxation (such as general rates).

As well as rating poorly in terms of efficiency, the move towards direct charging of developers/new residents by councils involves inequitable treatment of new and existing residents. Even if new residents are charged a fair share of the capital cost (that is, the estimate reflects actual usage), the remainder of the cost of the facility, which benefits existing residents is usually funded by the council out of general rate revenue or grants from higher levels of government. That is, existing residents are unlikely to face a similar charge in proportion to the benefit they receive from the new capital.

In cases where rates of new residents are not selectively reduced, there will be subsequent 'double dipping' by councils, as the new residents are levied at the same rate as existing residents, despite the fact that they have already contributed towards the capital costs of the facility.