MASTER BUILDERS AUSTRALIA

INFRASTRUCTURE CHARGES

where bad taxes beget more taxes

High level of developer charges at State and local level → Lower housing affordability & lower supply → Higher Commonwealth taxes to fund affordability programs

CONTENTS

Executive Summary

Developer charges have been one of the fastest growing taxes in Australia in recent years, increasing at an average rate of 8.2 per cent per annum. This is more than double the rate of increase in state and local government revenues, and more than triple the rate of increase in municipal rates.

Developer charges …

In the growth areas of Sydney, for example, developer charges can now amount to $66,000 – about 30 per cent of the sale price – for a single vacant block of land zoned for residential development.

…one of the fastest growing taxes…

The rising level of developer charges has flowed through to higher prices for newly built homes, making them less affordable and depressing building activity. The resulting housing undersupply has contributed to broader social problems such as a lower level of home ownership, undersupply of rental housing and higher rental prices.

…affecting affordability

Historically, infrastructure provision for housing development has been funded through a combination of local council rates and state/territory government general taxes, but the built-in political incentives for state and local governments to impose high developer charges has seen them rise to unprecedented levels.

…driven by political arrangements and incentives

In the past year there has been increasing recognition at official level of the damage caused by developer charges, with Commonwealth and state governments, as well as the Reserve Bank, introducing or endorsing measures to ameliorate the developer charges problem.

Issue coming to a head…

The Deputy Prime Minister has described developer charges as "a significant supply-side barrier" to housing, while the Commonwealth government is raising more than $500 million in taxes to fund a scheme – the Housing Affordability Fund – to pay local and state governments to specifically offset the impacts of these rising developer charges.

"Catch 22" type policies…

The fact that the Commonwealth government is raising taxes to offset the damaging effects of taxes imposed at local and state level illustrates the striking illogicality of the current arrangements.

…simply illogical

The Reserve Bank says that the optimum way to improve housing activity on a sustainable basis is to reduce supply-side impediments that raise the costs of construction, and that reducing infrastructure charges will lift housing supply and lower the cost of housing in the medium term.

Wider economic & social ramifications…

Master Builders Australia agrees with this analysis, and contends that the current system is causing economic and social damage and needs to be changed.

A series of policy proposals are presented in this paper that restrict the ability of councils and state governments to impose economically harmful charges; enhance the accountability and transparency of the process; and expand the capacity of these governments to raise revenue through more rational means.

…necessitate policy change

Master Builders Australia urges the Henry Review to acknowledge the harmful outcomes deriving from the current arrangements and make recommendations to improve the situation.

Role for Henry Tax Review

CHAPTER ONE

How did developer charges become a problem?

In recent years there has been a significant trend towards charging developers for the cost of building infrastructure for housing developments.

"In essence, developer contributions have become an uncontrolled form of backdoor taxation on the family home."

New South Wales Department of Planning, April 3, 2008

Prior to this recent phenomenon, the costs of providing infrastructure for new residential housing developments were borne by the general taxpayer in the form of local council rates and state/territory government taxes.

A significant component of new infrastructure provision – from economic infrastructure like roads to social infrastructure such as libraries – is now funded through developer charges.

State governments and local councils which decide to provide infrastructure up-front have found imposing charges on developers to be a convenient method of raising revenue.

A key attraction of this new form of tax is that charging developer fees is less politically painful than raising state taxes or increasing local government rates.

Those directly impacted by the charges – developers – are an extremely small portion of the community, and the new home buyers that ultimately pay the higher price are also relatively few in number and generally unaware that they are paying higher prices as a consequence of upstream tax imposts. Developer charges are, in this sense, a "hidden tax".

At local council level, many of those deterred from buying a new residence under the higher price will live outside the council's boundaries.

Councils facing funding pressures have found it easier to charge property developers – where the ultimate losers, new home buyers, are few in number and often live and vote outside the council boundaries – rather than increase rates on the voters inside their boundaries.

State governments, similarly, have greatly expanded the weighting of developer charging in their revenue base in recent years.

Nub of the problem…

…councils/states imposing developer charges beyond what is economically responsible…

…an inherent flaw in the system

Rational local councils and state governments have a built-in incentive to bias their revenue-raising towards the less politically painful developer, thus shifting the political pain to the federal level where the Commonwealth government is seen to be responsible for housing affordability issues.

This inherent flaw in the system — incentives encourage state and local authorities to impose a level of developer charges beyond what is economically responsible — is the nub of the current problem.

Cost-shifting and revenue source crimping

State (and, to a lesser extent, Commonwealth) governments have contributed to cost pressures on local councils through cost-shifting — transferring many of the infrastructure responsibilities onto local councils without a commensurate compensation mechanism.[1]

Cost shifting and rate-capping…

Some state governments have added to the pressure on councils to introduce or increase developer charges through rate-capping (or rate pegging) or other restrictions on revenue raising through fees and charges.

…increases pressure on councils

The imposed ceiling on rates artificially distorts potentially more economically rational forms of revenue raising, and increases the pressure on councils to seek other funding sources to cover their expenditure requirements.

Types of Infrastructure subject to infrastructure charges

a. *Economic infrastructure* — traditional infrastructure such as water, sewerage, drainage, electricity, gas, telecommunications, public transport and roads.

- *Major (shared) economic infrastructure* — infrastructure that services a number of land subdivisions. Examples include trunk water, sewerage and drainage, gas, electricity and telecommunications, urban rail services, major roads and airports.

- *Basic economic infrastructure* — infrastructure within a subdivision, in most cases connecting each lot to major infrastructure (for example, roads, water, sewerage, gas and electricity connections). Basic infrastructure is sometimes referred to as private infrastructure, because the benefits accrue overwhelmingly to the residents of the particular subdivision.

b. *Social (or community) infrastructure* — infrastructure used in provision of community services. It can primarily be for the use of residents within a subdivision (for example, parks), or it can service a whole range of subdivisions (for example, a library or a sports ground).

From Productivity Commission, *Report into First Home Ownership*, 2004

[1] The Commonwealth Parliament's Standing Committee on Economics, Finance and Public Administration inquiry into local government found numerous instances of cost-shifting. See their report *Rates and Taxes: A Fair Share for Responsible Local Government*, October 2003, p. 29.

CHAPTER TWO

The fast rising level of developer charges

In recent years developer charges have risen very significantly in most jurisdictions. They are one of the fastest growing taxes in Australia.

In the growth areas of Sydney, for example, developer charges can amount to $66,000 – or about 30 per cent of the sale price – for a single vacant block of land zoned for residential development.[2]

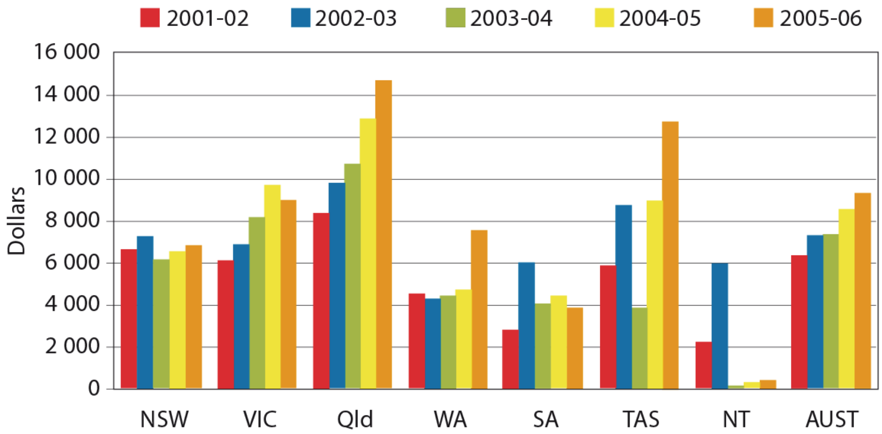
The Productivity Commission in collaboration with the Australian Bureau of Statistics has calculated that over the four years from 2001-02 to 2005-06 developer contributions across Australia grew at an average rate of 8.2 per cent per annum per new dwelling.[3]

The Productivity Commission data showed that developer contributions per dwelling were highest in Queensland in each year, with NSW having the second highest charges in 2001-02 and 2002-03, Victoria having the second highest charges in 2003-04 and 2004-05. South Australia had the lowest overall level of any state over the four year period of the analysis.

"The developer contributions component of local government revenue has grown considerably in recent times in most jurisdictions."

Productivity Commission, April 2008

Figure 1. Rising Level of Developer Charges



Measured in developer contributions revenue per new dwelling commenced.[4]
(Reprinted from Productivity Commission Report, *Assessing Local Government Revenue Raising Capacity*, April 2008, p133)

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[2] NSW Department of Planning, Planning Circular, 23 December, 2008.
[3] Productivity Commission Inquiry, *Assessing Local Government Revenue Raising Capacity*, April 2008, p. 132.
[4] Points to note re data
a. 2005-06 dollars
b. Data are adjusted to 2005-06 dollars using the ABS non-farm GDP deflator.
c. A building is commenced when the first physical building activity has been performed on site in the form of materials fixed in place and/or labour expended. A dwelling is a self-contained suite of rooms intended for long-term residential use.
d. The NT revenue data prior to 2002-03 are considered unreliable and are not reported. NT local government can levy developers only for contributions to car parks, roads and drainage infrastructure, external to a development.
e. Results might be driven somewhat by timing differences, and/or time lags, in the data.
Source: ABS (2007e); ABS unpublished; Productivity Commission calculations.

A comparison of this rate of increase with other taxes over the same period undertaken by Access Economics has found developer charges to be one of the fastest growing taxes in Australia.[5]

Developer charges...

Out of the 30 categories of tax levied by Commonwealth, state, and local government, developer charges ranked as the 6th fastest growing tax.

The rate of increase of developer charges at an annual average of 8.2 per cent per annum is more than double the rate of increase in state and local government revenues (3.3 per cent), and more than triple the rate of increase in municipal rates (2.7 per cent).

... one of the fastest growing taxes in Australia

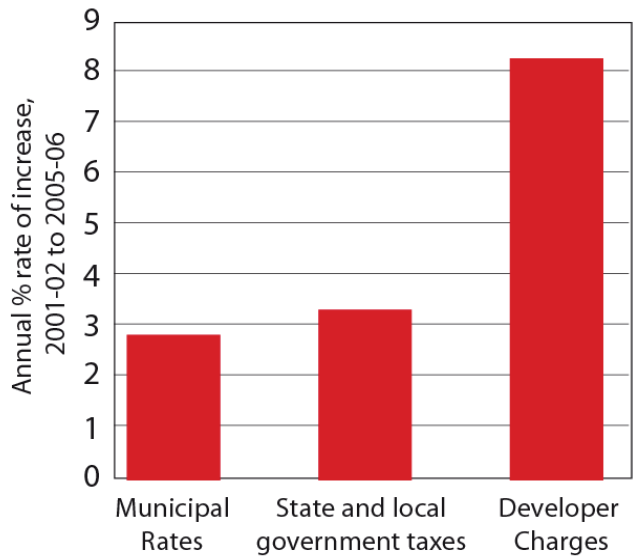
Developer charges grew at a faster rate than income tax, GST, stamp duties, fuel excise and fringe benefits tax.

Last year the New South Wales Government Department of Planning said that "In essence, developer contributions have become an uncontrolled form of backdoor taxation on the family home."[6]

The Australian phenomenon of high developer charges reducing affordability has been noted by the United Kingdom think tank, Policy Exchange, whose analysis of international housing issues found that "we identified developer levies as the main cause of Australia's affordability problems."[7]

...major cause of Australia's affordability problems

Figure 2. Developer charges growth



Source: Access Economics, 2009.

More recent evidence indicates that the increases in developer charges have continued.

[5] Comparison undertaken by Access Economics on behalf of Master Builders Australia. The period of time — 2001-02 to 2005-06 — is directly comparable with the Productivity Commission research on developer charges published last year, cited above.
[6] New South Wales Department of Planning Press Release, April 3, 2008
[7] *Better Homes, Greener Cities*, Professor Alan W. Evans and Dr Oliver Marc Hartwich, Policy Exchange, 2006, p. 33.

The Fraser Coast Regional Council in Queensland, for example, has recently proposed massive increases in infrastructure charges.[8]

The Charlton Esplanade, Torquay, consisting of 30 residential units, has seen a more than doubling of infrastructure charges proposed by the local council.

Table 1. Infrastructure charges at Torquay, Queensland

Infrastructure	Present Charge	Proposed 2008-09 Charge	Percentage increase
Water	$54,675	$121,730	123
Sewer	$62,515	$141,080	126
Roads	$55,480	$120,670	118
Pedestrian/cycleways	$8,570	$18,215	113
Stormwater	$11,160	$12,310	10
Parks	$25,880	$121,815	371
Total	$218,280	$535,820	145

Source: Urban Development Institute of Australia, *Response to Fraser Coast Regional Council Infrastructure Charges Draft Policy*, April 2009

A dual occupancy (2 bedroom) at Pialba, Queensland, confronts a similarly dramatic increase.

Table 2. Infrastructure charges at Pialba

Infrastructure	Present Charges	Proposed 2008-09	Percentage Increase
Water	$2,996	$6,670	123
Sewer	$2,977	$6,718	126
Roads	$2,628	$5,485	109
Pedestrian/cycleways	$406	$828	104
Public transport	-	$51	-
Parks	$774	$5,537	615
Total	$9,781	$25,289	159

Source: Urban Development Institute of Australia, *Response to Fraser Coast Regional Council Infrastructure Charges Draft Policy*, April 2009

[8] Urban Development Institute of Australia, *Response to Fraser Coast Regional Council Infrastructure Charges Draft Policy,* April 2009, p. 33.

CHAPTER THREE

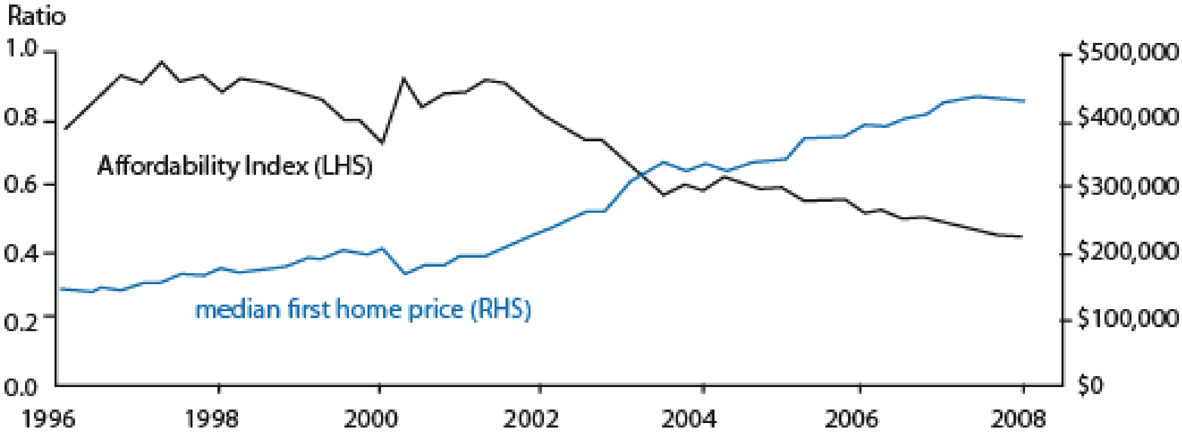
The harmful effects of developer charges

The application of a high level developer charges has led to a number of problems.

Reduced housing affordability

When the cost of provision of infrastructure is shifted from the broad community to a narrow subset of the community the natural outcome is a diminution of economic outcomes for that subset. In the case of the residential building industry, developer charges are passed on from developers to new home buyers in the form of higher prices, thereby reducing the affordability of new homes (see Figure 3).

Figure 3. Declining Housing Affordability



(Reprinted from State of Supply Report, National Housing Supply Council)[9]

Access Economics found in their analysis of the issue that "the vast majority of literature on the subject" concludes that the "economic incidence of developer charges is ultimately borne by the final home purchaser."[10] Access Economics agreed with this conclusion.

"Housing is now less affordable than at any time in our recent history... the underlying reason is we are not building enough new homes."

Minister for Housing, Tanya Plibersek, June 2008

Reduced housing activity and housing under-supply

The reduced affordability of new homes leads to a dampening of building activity and a lower level of housing supply. The lower level of house

[9] Note: The affordability index is based on the ratio of average weekly ordinary time earnings to the income required to service the mortgage required to buy a median-priced dwelling with a 10 per cent deposit and a maximum debt service ratio of 30 per cent (assuming a 25-year loan at standard variable bank housing interest rates). Source: Housing Industry Association – Commonwealth Bank, unpublished data on median first home prices, HIA-CB, 2008; Reserve Bank of Australia, *Indicator Lending Rates*, 'Standard variable bank housing loans', Statistical table F5, RBA, Canberra, 2008; RBA, *Labour Costs*, 'full-time adult average weekly ordinary time earnings', Statistical table G6, RBA, Canberra, 2008.

[10] Access Economics, *Financing Infrastructure for Residential Development*, October 2003, p. 35.

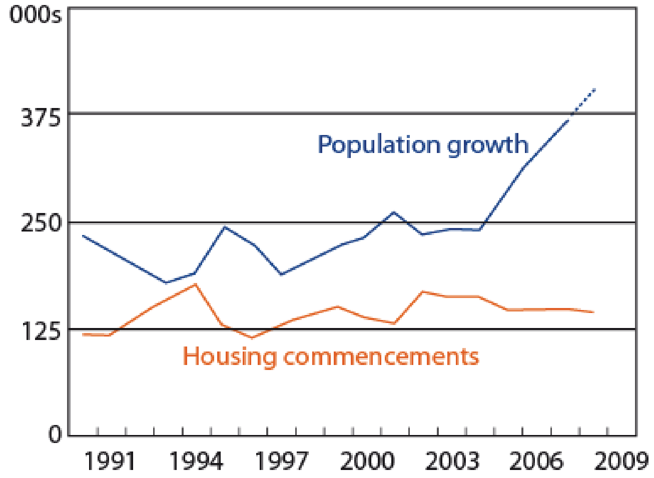
building adds to pressure on the prices of existing stock as demand outpaces supply, thus further diminishing housing affordability.

In March 2009 the Government released the National Housing Supply Council report, *State of Supply*, which estimated an undersupply of housing of 85,000 in 2008 growing to 203,000 by 2013 and 431,000 by 2028 under current policy settings.

The Report cites developer contributions as a factor constraining the rate of development of new housing, and concludes that "measures to increase land supply and reduce the cost of urban infrastructure to homebuyers would likely stimulate an increase in production and a reduction in the price of new housing."

The Council states that the "infrastructure provision and charging regime is ripe for review."

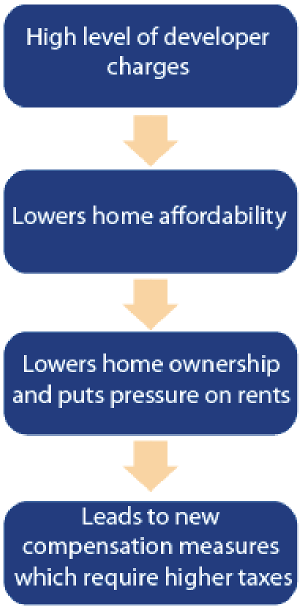
Figure 4. Housing Demand and Supply



Source: Reserve Bank of Australia, *Financial Stability Review*, March 2009

Increased pressure on housing rents

Diminished housing supply adds to the pressure on rental housing availability and rent levels. High rent levels impact disproportionately on lower income members of the community. Vacancy rates have shown a downwards trend since 2002, have generally been lower than 3 per cent, and are currently at a very low level of around 1.5 per cent. This has led to the Commonwealth government introducing expensive new measures, such as the National Rental Affordability Scheme, to compensate for the scarcity of affordable rental properties.



Lower level of home ownership

The government has an explicit goal of increasing home ownership for both economic and social purposes. A high level of home ownership contributes to social responsibility and cohesion, as citizens become stakeholders with considerable assets to aspire to and protect.

By diminishing housing supply and reducing the level of home ownership, unduly high developer charges undermine this overarching goal.

CHAPTER FOUR

The origins of the developer charges problem

The significant increase in the level of developer charges over the past decade has highlighted many of the economic problems associated with the trend.

Developer charges…

Negative externalities

The imposition of high developer charges at local and state government level has negative impacts beyond their domain of responsibility.

…causing wider economic problems…

For example, local councils seeking the least painful revenue source will rationally raise revenue where many of those disadvantaged are outside its boundaries, and the problems raised — such as reduced housing affordability — are spread across the broader community.

Requirements that councils demonstrate a "nexus" between the proposed infrastructure development and the developer charges do not address broader issues of negative externalities, meaning that developer charges can satisfy narrow concerns but ignore broader problems.

Narrow concerns…

… ignore broader problems…

Similarly, infrastructure charges imposed by state governments can have negative consequences at the national level, where housing affordability is regarded as the responsibility of the Commonwealth government through broader economic policies.

Worsening affordability…

The rapid expansion of Commonwealth government initiatives to deal with housing affordability demonstrates the extent to which it is seen as the level of government responsible for the "housing affordability" issue.

… prompting a Commonwealth response

For example, the establishment of each of the following — the $512 million Housing Affordability Fund, the $623 million National Rental Affordability Scheme, the $1.2 billion First Home Saver Accounts scheme, and the National Housing Supply Council — illustrates the Commonwealth government's view of its responsibility for housing affordability.

Each of these programs requires taxes to be raised from the community to address problems caused in part by taxes charged by lower levels of government.

Free-rider problem

The residents of existing suburbs, who have had their infrastructure provided for them by past generations, now contribute nothing to the new infrastructure from which they benefit, meaning that they are receiving, in the common economic parlance, a "free ride."

The result, according to Access Economics, is that "the ready availability of infrastructure in older areas will result in a price premium being capitalised into the value of existing dwellings." [11]

The advent of developer charges provides the residents of established suburbs with a windfall gain, with the cost falling disproportionately on lower income earners of fringe suburbs, an outcome that exacerbates inequality in the broad community.

Double charging

The advent of developer charges has resulted in the residents of newly built homes paying for infrastructure benefiting not only themselves but other people as well. Some new home buyers are paying for both the capital costs of new infrastructure provision with community side benefits as well as the same access charges and recurrent costs as existing residents.

Gold-plating

Councils have an incentive to provide higher infrastructure standards than warranted, the so-called "gold-plating" problem.

As the Productivity Commission found, "one potential problem with funding [basic] infrastructure through developer contributions, is that councils and utilities could have both the incentive and the scope to insist on standards that are excessively high, either in relation to what home buyers want, or to the efficient costs of providing infrastructure over the whole life of the assets."

Lack of transparency and accountability

A significant problem with developer charges is the lack of transparency and accountability associated with their charging.

"Some councils are using developer contributions to fund items such as dog euthanasia freezers, computer upgrades and information rest bays and lookouts."

New South Wales Department of Planning, April 2008

Charges can vary considerably from state to state, from council to council, and even within local council areas.

Charges can appear to be established in a quite arbitrary fashion with little scrutiny at official level and practically no scrutiny at public level.

An illustration of the arbitrary and concealed nature of developer charges is provided by the investigation into corruption allegations affecting Wollongong City Council. The Independent Commission against Corruption inquiry into the matter found developer charges being improperly discounted and deferred by council employees, and it made recommendations for tightening procedures for developer contributions. [12]

The lack of consistency has recently been conceded by the NSW Department of Planning, which stated last year that "at present, local developer contribution levies vary widely between councils for no clear reason. For instance, in south-western Sydney levies vary

[11] *Financing Infrastructure for Residential Development*, Access Economics, 2003 (p21)
[12] *Report on an Investigation into Corruption Allegations Affecting Wollongong City Council*, Independent Commission against Corruption, October 2008, Part Three p. 31, 33, 55, 129, 131

between $11-$53,000 per lot, while on the Central Coast levies range between $7,500-$64,000 per lot."[13]

The Department went on: "Furthermore, there is no clear definition under current State law in regards to the sort of things contributions can fund. As a result, some councils are using contributions to fund items such as dog euthanasia freezers, computer upgrades and information rest bays and lookouts."

The absence of publicly available statistics has hampered the public examination of developer charges and curtailed the effective examination of their effects.

Government agencies such Treasury and the Productivity Commission, industry bodies, academics, the media, businesses and the public have found rigorous examination of developer charges to be hampered by the paucity of available statistics.

Tax efficiency

Tax tables published and used by the Commonwealth Treasury in the Henry Review to illustrate the efficiency of particular taxes show developer charges as a relatively inefficient tax.[14]

It is noteworthy that the tables published by Treasury also show developer charges as a considerably more inefficient tax than both municipal rates and payroll tax.

[13] New South Wales Department of Planning Press Release, April 3, 2008

[14] Australia's Future Tax System Consultation Paper, December 2008, p. 192, Chart 9.3 Inefficiency Ranking of Selected Taxes. Original analysis from Property Council of Australia.

INSIDER ATTACK ON DEVELOPER CHARGES

Former New South Wales Treasurer Michael Costa recently criticised the impact of infrastructure charges on affordability and intergenerational equity.

> *Traditional services such as water, sewerage, schools and community infrastructure attract developer levies and fees which are then passed on to home buyers.*
>
> *This reflects an inter-generational cost shift, which goes against our underlying support for home ownership. It also acts against affordability. It isn't just the added levies and charges (which, in some parts of western Sydney, have pushed up the cost of a housing block by more than $50,000) but also council fees.*
>
> *The section 94 contributions required by local government have, in some cases, increased by 300 per cent to almost $70,000 a block in some areas.*
>
> *The present system of infrastructure funding is inequitable and contributes to the housing affordability issue.*
>
> *Up-front charges for a broad array of long-lived infrastructure is akin to making new car buyers pay the registration of their new vehicle for its entire life at the time of its purchase.*
>
> *The practice is clearly inequitable and unreasonable – even more so when some of these infrastructure charges are almost unrelated to the particular development.*
>
> *An alternative method of infrastructure funding needs to be considered, in order to address the inequity and increases in new house prices generated by the current arrangements.*

Michael Costa "Home Ownership", Sunday Telegraph, March 29 2009, p. 42.

CHAPTER FIVE

The tide turning against developer charges

The Commonwealth government says developer charges are a problem

The Commonwealth Government has explicitly acknowledged the negative impact of developer charges on housing affordability, with the Deputy Prime Minister describing them last year as "a significant supply-side barrier."[15]

The Government has introduced a $512 million programme, the Housing Affordability Fund, specifically designed to offset the damage caused by infrastructure charges.

"The infrastructure provision and charging regime is ripe for review."

National Housing Supply Council, March 2009

Introducing the Housing Affordability Fund, the Government stated that one of the desired outcomes of the Fund would be "reducing the burden of infrastructure charges on developers, in order to generate savings for purchasers of new, moderately priced homes."[16]

The Fund, according to the Government, aims to address the "significant supply-side barrier" of infrastructure costs – "infrastructure costs such as water, sewerage, roads, open space and community facilities, which are incurred variously by local and state governments, often passed on to developers and in turn to buyers of new homes."[17]

Last year Housing Minister Tanya Plibersek stated that "housing is now less affordable than at any time in our recent history," and that "the underlying reason is we are not building enough new homes."[18]

"To help address this problem, the Australian Government is investing $512 million in a Housing Affordability Fund to lower the cost of building new homes by tackling the critical supply side issues of the length of time taken to bring new houses to sale and the impact of infrastructure charges."[19]

The government has been quite explicit that "One of the objectives of the Housing Affordability Fund is to reduce the cost of new homes by reducing infrastructure charges and planning blockages for new developments, which increase the cost to the home buyer."[20]

It is clearly an absurd situation for the Commonwealth government to be raising taxes to fund a program specifically designed to offset the damaging impacts of taxes raised at local and state level.

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[15] Joint media release, Acting Prime Minister the Hon Julia Gillard and Minister for Housing the Hon Tanya Plibersek, 11 June 2008.
[16] Housing Affordability Fund Discussion Paper, June 2008, p. 8.
[17] Housing Affordability Fund Discussion Paper, June 2008, p. 8.
[18] Minister's Foreword, Housing Affordability Fund Discussion Paper, June 2008.
[19] Minister's Foreword, Housing Affordability Fund Discussion Paper, June 2008.
[20] Housing Affordability Fund Discussion Paper, June 2008, p. 18.

Such an outcome can only be justified as a short-term measure; it cannot be accepted as a long-term outcome.

In fact, the direct cost to the Commonwealth is greater than just the Housing Affordability Fund.

"We have listened to industry and local government and it is clear in some areas levies have been too high and have been slowing the construction of new homes."

NSW Premier Nathan Rees, 17 December 2008

As stated previously, the Commonwealth government has numerous other expensive programs designed to deal with the problem of housing affordability, such as the $623 million National Rental Affordability Scheme and the $1.2 billion First Home Saver Accounts scheme.

The end result is a futile round-robin, in which taxes raised at one level of government cause affordability problems that requires taxes at another level of government to address.

Addressing the problem of developer charges would not only improve the affordability issue directly but allow the Commonwealth to wind back or abolish its range of expensive schemes without detracting from housing affordability or housing supply.

State governments admit developer charges are a problem

In December 2008 the NSW State Government explicitly recognised the harmful effect of developer charges on housing activity and affordability.

The NSW Premier, Nathan Rees, stated that "We have listened to industry and local government and it is clear in some areas levies have been too high and have been slowing the construction of new homes."[21]

The NSW Government announced that it would reduce water levies, state government levies and local government levies, cap infrastructure contributions to local councils, and change the timing of payment from up-front to payable on sale.

In its recent long-term blueprint for development, *Melbourne 2030*, the Victorian government also identified the deleterious effects of infrastructure charges as a rationale for reforming the system.

As the Report points out: "Councils presently require local infrastructure charges to offset the costs for local roads, parks and community facilities. The lack of consistency, transparency and flexibility in local charges currently creates uncertainty for the development industry."[22]

The Reserve Bank says developer charges are a problem

The Reserve Bank endorsed both the NSW Government measures to reduce developer charges and the Commonwealth government's Housing Affordability Fund as short-term initiatives which would help to address the pernicious effects of infrastructure charges.[23]

[21] Media release, NSW Government Department of Planning, 17 December 2008.
[22] Melbourne 2030: A Planning Update – Melbourne@5 million, December 2008, p. 16
[23] *Conditions and Prospects in the Housing Sector*, Speech by Anthony Richards, Head of Economic Analysis Department, Reserve Bank of Australia, 26 March 2009

In March 2009 the Bank stated: “Policies such as these will help to support home-building activity at a time when activity in the broader economy will be subdued. They also offer the prospect of lowering the cost of housing in the medium term.”

“Indeed, perhaps the best chance of boosting housing construction on a sustainable basis may be to seek to reduce impediments on the supply-side that are either boosting the cost of building new housing on the fringes of our cities or are constraining the ability to build more housing closer to the centres of our major cities.”

CHAPTER SIX

Solutions

Local governments need revenue for infrastructure, as do state and Commonwealth governments. But the current system is clearly inefficient.

At present, the Commonwealth government is raising taxes to combat the problems caused by the taxes raised at local and state level.

Taxpayers are paying higher federal taxes in order to compensate new home buyers for the impact of rapidly rising local and state government developer charges.

The three tiers of government are working at cross-purposes. It is entirely appropriate that the Henry Review – with its holistic examination of the tax system at each level of government – provide direction on solutions to the problem.

It is clearly sub-optimal, at best, that the Commonwealth government is compelled to raise taxes to address the problems caused by tax measures imposed by other levels of government.

Rather than a system in which infrastructure taxes are imposed and Commonwealth government taxes are increased to deal with the damage, it would be better not to have imposed the damaging taxes in the first place.

Reducing the damaging level of developer charges will not only lead to a more rational and efficient tax system, but also create the opportunity for Commonwealth cost savings through the reduction or abolition of existing affordability schemes.

Listed below is a range of measures that might be considered as contributing to an improvement in the situation.

The emphases of the solutions are on preventing the problem rather than repairing the damage afterwards.

It needs to be noted that developer charging regimes differ widely between state governments and between local councils, and that solutions offered may vary in their relevance to each jurisdiction.

1. Disallow developer charges that undermine housing affordability objectives

At present developer charges can be imposed by local councils without reference to the spill-over negative effects – affordability, building activity, housing supply, rent levels, congestion – that have an impact beyond council boundaries.

All councils seeking to impose developer charges should be required to receive state government authorisation, based on an assessment that the proposed charges do not undermine the broader economic objective of housing affordability.

Current arrangements differ widely among states: some requiring no state government approval, others requiring Ministerial approvals on developments over a certain level, and yet others requiring Ministerial approval on all developer contributions.

It would be beneficial to have a nationally consistent approach, agreed to by the Council of Australian Governments, that stipulates the affordability criteria and makes clear that developer charges will not be authorised without an assessment of their impacts on housing affordability and housing supply.

The Commonwealth government, with its direct interest in maintaining affordability, should monitor and enforce compliance with the state government level administration of COAG-agreed affordability criteria.

2. State and Territory government infrastructure charges should be subject to affordability assessment

The principle of denying infrastructure charges that undermine broader economic objectives should also be extended to state and territory governments.

Developer charges imposed by state government departments and utility providers should in the first instance be subject to assessment by State Treasuries to ensure that housing affordability and supply is not being undermined.

The states should be required to share all data on infrastructure charges with the Commonwealth, which in turn should monitor and enforce COAG-agreed criteria for maintaining housing affordability.

State or territory governments imposing developer charges found to be excessive should be penalised by the Commonwealth government through a reduction in transfer payments as an incentive to be economically responsible.

3. Establish an official Infrastructure Charges InfoHub

It would be beneficial to establish an official Infrastructure Charges InfoHub, consisting of easily accessible tables on the internet that lists levels of developer charges and allows comparisons among jurisdictions and over time.

Particularly useful information would be:

a. Charts comparing all local councils' developer charges at the aggregate level.

b. Charts comparing all local councils' developer charges per housing unit.

c. Charts comparing developer charges for particular developments.

d. Charts comparing state and territory governments' developer charges at the aggregate level.

e. Charts comparing state and territory governments' developer charges per housing unit.

f. Charts comparing state and territory governments' developer charges by utility type.

g. Charts comparing each of the above over time.

These transparency measures would be a powerful tool in enhancing accountability and helping to expose anomalous charging.

Interactive charts on the InfoHub could easily rank all Councils and all state and territory governments according to the level of developer charges.

The information would be of use to policy makers at all levels of government in developing and assessing policy effectiveness; to the building and construction industry in assessing the fairness of particular charges; and to academia and the media in assessing matters of public interest.

The costs of establishing such an information base would be minimal — a collation of data that already exists at different levels of government, but the benefits to accountability, competition, transparency and trust would be enormous.

The National Housing Supply Council, recently established and funded by the Commonwealth government to "aggregate and assess data on housing supply and demand," is a possible host for such internet transparency measures.

The Council of Australian Governments has agreed to the establishment of a Working Group of state, territory, and Commonwealth officials to ensure that data pertaining to housing affordability is supplied to the Council.

There is a strong case for local government officials to be added to this Working Group so as to enhance the information flow on infrastructure charges.

The Australian Bureau of Statistics should be tasked with measuring developer charges on an annual basis as a discrete revenue source for both local and state government, again allowing temporal and geographical comparisons.

4. Mandatory public disclosure of developer charges

Some states currently allow councils to strike agreements with developers with no requirement for public disclosure of the level of taxes charged.

In the interests of transparency and accountability, and to reduce the risk of anomalous charging, the level of developer charges should always be publicly disclosed. The developer charges imposed by state governments should also be publicly disclosed.

This requirement would allow developers to make comparisons with comparable developments, enable councils to examine the charging regimes of other jurisdictions, and allow the general public to assess the reasonableness of charging levels.

5. Greater Commonwealth funding of local government

The Commonwealth government should investigate reforming intergovernmental fiscal arrangements to provide local government with greater funding certainty and reduce the pressure on local councils needing to pursue developer charges.

Although a shift towards greater Commonwealth funding would exacerbate the current level of vertical fiscal imbalance, this needs to be considered against the greater efficiencies that can be derived from centrally imposed taxes.

It should be noted that an increase in Commonwealth funding that did not result in a diminution of developer charges would simply lead to a higher level of tax overall. This would be an adverse outcome for the building industry and homebuyers.

Any increase in Commonwealth funding for local government should be accompanied by an enforceable undertaking by local government authorities that developer charges be accordingly reduced.

6. Increased use of general revenues to fund infrastructure provision to better reflect user-pays principles

Consistent with the recent acknowledgements that infrastructure provision provides benefits across the community rather than exclusively to the narrow spectrum of new home buyers, an increased use of general revenue by local and state governments to fund infrastructure provision should be considered.

The greater use of general rates revenue or broader state revenues would reflect the broader community benefits of infrastructure provision, and ameliorate the free-rider effect that many are currently enjoying.

7. Increased consideration of debt-financed infrastructure

Where appropriate, local councils or state governments should finance infrastructure provision through debt financing, which can allow the costs of infrastructure to be shared with future beneficiaries.

The global financial crisis has increased the challenges associated with accessing credit for both private and public sector, but the current practice of placing the entire cost of infrastructure which may last decades onto new home buyers is inefficient and leads to housing undersupply.

8. Abolish rate caps and review rate exemptions

Some state governments, most notably New South Wales, impose rate caps that restrict the ability of local councils to raise revenue across the community to pay for infrastructure. This places more pressure on councils to raise revenue through developer charges.

Removing rate caps would allow the costs of infrastructure to be shared more evenly across the community, instead of being concentrated on new home buyers. The Commonwealth Government, as a victim of the effect of rate caps, has an interest in pressing State governments to remove rate caps.

State governments also need to examine the extent to which restrictions on local councils' revenue bases, such as rate exemptions, can add to the pressure for increased reliance on sub-optimal revenue measures.

9. Reconsideration of the upfront provision of all infrastructure

Historically the provision of infrastructure was spaced over time with the provision of vital infrastructure up-front and the supply of less immediate needs coming later as the capacity of the council or government to pay improved.

In recent years many councils have insisted on the full panoply of infrastructure to be provided upfront, which adds to the pressure for higher developer charges. A consideration of a more patient provision of infrastructure is an option for local councils and state governments.

10. End harmful cost-shifting between levels of government

The practice in past years of Commonwealth and state governments shifting responsibilities (and costs) on to local governments without due process or compensation has added to the pressure on councils to increase developer charges.

An end to this form of cost-shifting would relieve some of the pressure on councils.

In 2006 Australian governments at all three levels agreed to implement important principles to address this issue – the *Inter-governmental Agreement Establishing Principles to Guide Inter-Governmental Relations on Local Government Matters*. Adherence to these principles would mitigate the prospects of unreasonable cost-shifting and reduce one source of pressure on local councils to impose excessive developer charges.

11. Place developer charges on the Council of Australian Government reform agenda

The Council of Australian Governments should deal with developer charges as a specific agenda item. This issue is directly linked to all three levels of government, making COAG the most appropriate forum for solutions to the problems that have arisen.

COAG is also the appropriate body to consider effective means to counter the cost-shifting between levels of government that adds to pressure for increasing developer charges.

12. Change in timing of developer charges

At present, the payment of infrastructure levies in some jurisdictions is required prior to the generation of any land/property sales, which can cause significant cash flow difficulties for developers.

Official bodies responsible for setting developer charges should consider addressing this by aligning the payment of developer charges with sales of the properties.

13. Australian Local Government Association representation on the Ministerial Council

The Australian Local Government Association (ALGA) should be represented on the Ministerial Council (Group of Commonwealth, state and territory treasurers).

The representation of ALGA on the Ministerial Council would allow local government revenue raising concerns to be raised directly with the other levels of government. This may help to address concerns about appropriate levels of Financial Assistance Grants, fiscal equalisation, and cost-shifting by Commonwealth and state governments to local governments.

Appendix

It should be noted that the Henry Review consultation paper released in December 2008 contains a misleading statement about developer charges. On page 213 paragraph 2 the Paper states that “there is mixed evidence about the significance of infrastructure charges,” and cites as evidence for the lack of significance of developer charges a Productivity Commission Report from 2008 showing “local infrastructure charges at the aggregate level increasing at around one per cent per annum in real terms in NSW between 2000-06.”

The Productivity Commission Report cited actually states: “The developer contributions component of local government revenue has grown considerably in recent times in most jurisdictions. The national annual real average growth rate was 8.2 percent per new dwelling commenced over the four years to 2005-06.” It is misleading to cite the state of NSW – the slowest growing state for developer contributions – as evidence for infrastructure charges being insignificant, when the much higher national figure was available from the same Productivity Commission report.