

URBANISED

Kick Starting the Productivity Discussion – NSW Productivity Commission

The Urbanised Submission

www.urbanised.net

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1. Introduction

Urbanised Pty Ltd welcomes the opportunity to provide comments on the paper “Kickstarting the Productivity Discussion”. This paper focuses on the third question posed in the discussion paper. We have a keen interest in the state’s economic performance with respect to the real estate sector. As economists with decades of experience in the property industry, we understand the regulatory slog that is the New South Wales planning system. But we are also amazed with the resilience and innovation by participants in the market place to continually create good urban form (in the main).

Even the most passionate advocate for the planning system will concede that in, New South Wales, it is complex and costly. This is probably a function of the fact that it runs US style zoning and UK based planning permission frameworks in parallel. But that said, there probably isn’t a jurisdiction in the world that is completely satisfied with the planning system.

Global comparisons of planning systems are well meaning but problematic in a public policy sense. Each jurisdiction has markedly different attributes and characteristics where activity in the real estate market takes place. Sydney for example, has unique waterways and topography that shape urban outcomes and regulations like no other city in the world. Planning systems can’t easily be globally benchmarked and the professionals in the market must devise ways to work within the unique rules established within any specific jurisdiction.

The best indication of whether a city’s planning system is working is the price of real estate (in most instances). Without a doubt scarcity of land influences price, but in a country like Australia land is scarce because of land use boundaries set by policy makers. Another, major contributor to price is government taxes and charges relating to property (which are more than 25% of the costs of a new house and land package) as well as holding costs and delays (it can take 12 years in NSW for a project to move from conception, approval and onto completion).

Sydney requires more availability of land or greater densities to meet a growing population. Improving productivity (and efficiency) of the planning system is critical in bringing land to market faster to match demand. It will also require measures to address delays and upfront taxes and charges. Productivity is impacted by taxes and charges as they change investment and labour supply preferences by households. The Productivity Commission discussion paper bounds the discussion with a “no one being left behind” axiom. Paradoxically, the present planning system is doing just that by adding to costs that will put housing out of reach for a generation trying to establish households.

There should be changes to the planning regime if the goal is to boost productivity. However, there have been many attempts to reform the NSW Planning System and they have mostly fallen short of expectations. What has worked are small transformational changes such as capping the developer charges and introducing the planning gateway amongst others. Given recent reform history an attempt at overhauling the entire planning system is best avoided.

This submission will provide some insights into some practical measures that can be adopted that will make it easier to innovate and promote productivity in the property economy.

Summary of Recommendations

Recommendation 1. Reduce the number of clearance points in the planning system by giving the Department of Planning, Industry and Environment primary responsibility of concurrence required under subordinate legislation.

Recommendation 2. Align the incidence of property taxation with the creation of property value.

Recommendation 3. Explore opportunities to change the rating base to improved capital value in NSW. Start with apply changes specific transit-oriented districts and then determine whether this can be extended to the broader rating system.

Recommendation 4. Broaden infrastructure charges to align changes in the economic life of an asset with the extension of the economic life required for local infrastructure.

Recommendation 5. Consider whether it is appropriate to introduce a low rate, broad based land tax to replace stamp duty.

Recommendation 6. Encourage the establishment of multi-disciplinary teams within the Department of Planning, Industry and Environment.

Recommendation 7. Improve accountability, transparency and responsibility from conception to completion for staff in the Department.

Recommendation 8. Regulatory risk assessment should be more thorough and include comprehensive economic impact analysis and risk mitigation strategies. Risks that can be mitigated should not be used as a proxy for refusal.

Recommendation 9. The State Government has a role in the planning system and should be particularly careful about devolving functions to councils that may be ill equipped to deal with projects of significant economic importance.

Recommendation 10. The regulatory system should promote innovation because innovation produces major step changes in productivity. The gateway approvals process and State Significant Development process should be reviewed with a view to expand them rather than be replaced with innovation stifling strategic planning hierarchies.

2. Complexity and Cost

Planning has evolved into a particularly complex set of rules and regulations. The system is placed high on a pedestal as a cure-all to the urban ills of congestion, renewal and climate change to name a few. Planning is a valid policy instrument in terms of ensuring land use is consistent with a strategy but expecting anything more out of the system may disappoint. Complexity adds costs, delays and uncertainty to what can be thousands of dollars in a renovation or billions of dollars in a master planned community.

There have been many attempts to explain the effects of complexity on the public policy process but there still haven't been any to match "Implementation" a case study on a US public works program written 45 years ago by Pressman and Wildavsky. Amongst many other things they provided a very interesting probability analysis. They identified that if there were 70 clearance (decision) points and there was a 99% chance of support at each of those points then the project had less than a 50% chance of success. This is a perfect illustration of the difficulties that beset the planning system. 70 clearance points would be exhausted by the planning system within three months. The key to getting better outcomes is to reduce the number of clearance points (and increase the probability of support). Ironically, most of the planning reforms that are being implemented at the moment are increasing the number of clearance points (through planning hierarchies) rather than reducing them.

Concurrence is a major problem in this respect. There have been changes floated in the past that there should be deemed concurrence after 3 to 6 months. This is rarely a palatable solution because each concurrence agency is subordinate to a different set of regulatory parameters and sometimes cultural values. The Department of Planning, Industry and Environment should have primacy in any concurrences and be accountable for all regulatory approvals relating to a project. This could be achieved by establishing multidisciplinary teams within the Department to deal with infrastructure, planning, environment etc. It is acknowledged that the bureaucracy has recently been restructured to mega portfolios to achieve this.

If the restructure is implemented correctly it should substantially reduce the number of clearance points and improve the probability of project success and reduce delays. But such a restructure should be subject to continual evaluation to ensure the desired policy outcomes are achieved and efficient processes are mapped.

It should also be noted that in Implementation it says that to deal with delay frustrations solutions are often sought outside of the process (setting up taskforces, local planning panels or even Commissions). It goes on to say these rarely work and normally frustrate the process more. It is acknowledged that there will be advantages of bringing the Greater Sydney Commission within the Department of Planning, Industry and Environment.

Recommendation 1. Reduce the number of clearance points in the planning system by giving the Department of Planning, Industry and Environment primary responsibility of concurrence required under subordinate legislation.

3. Creating Efficient and Equitable Taxes and Charges

Creating cities is expensive. Connections to services, building roads and other infrastructure and providing community infrastructure come at a price. A growing population places increasing load on all infrastructure – especially when community demands for new infrastructure are continually bid up. The issue is that the cost association with infrastructure development and augmentation is a key factor in making housing less affordable as governments at all levels attempt to recover more and more costs from a narrow tax base.

It is critical that it is acknowledged that new development generates positive externalities. For instance, Sydney Water and energy utilities make amortised revenue streams from new households (almost in perpetuity). Councils receive rating income from new households over the same time frame. Sydney Water etc (in most cases) does provide infrastructure at little or no charge in acknowledgement of this. Councils, however, charge local infrastructure taxes and then benefit from the ongoing revenue streams. Admittedly, Councils are subject to rate capping which limits the ability to amortise the costs over time and they are strictly monitored with respect to borrowings. Models for funding infrastructure need to be revisited and analysed to determine whether there is a better way to fund infrastructure.

Taxes impact on productivity in a pernicious way. Taxes change prices and can distort investment decisions which lead to sub-optimal uses of capital across the economy.

Value Capture

New South Wales has invited overseas experts on to advise on the planning system. Their advice was to introduce value capture to help fund infrastructure development. What many didn't realise is that New South Wales had an unimproved value rating system. This small detail demonstrates the difficulty of infrastructure funding in New South Wales. Real value increments (and decrements) cannot be appropriately captured (or released) under an unimproved capital value rating system. Measures such as Special Infrastructure Charges or the new Transport Infrastructure are introduced as a means to capture value to contribute to government investment.

Value Capture (or tax increment financing TIF) is a tax mechanism that aligns the value creation with the incidence of taxation. It is commonly used to solve urban blight issues where TIF districts are created. The district is master planned, bonds are issued for the improvement and then they are secured against future rates that grow because improved capital values grow. It is a particularly equitable way to fund renewal because taxes are not paid upfront by the property purchaser but are instead spread over the ownership time horizon.

Because New South Wales has an unimproved land value system the easily measurable increase in value is at the initial point of sale meaning all the charges are embedded in the new home price and make purchasing a home less affordable (even with low inflation and interest rates the time value of money is significant when it is 25% of the cost).

This also applies to all taxes and charges on property. These are all paid upfront. The incidence of taxation is not amortised over the economic life of the asset. It is recognised that financiers are actually taking on that responsibility by providing mortgage finance which also embeds upfront infrastructure costs.

It is difficult to fix this problem. Existing homes already have the charges embedded in the initial purchase price. To change the whole system would give rise to inequities. However, it may be possible that special rating zones could be established for transit-oriented developments or specific districts that are based on TIF principles and have an improved capital value rating system to assist taxation and affordability. Transitional measures over a longer-term horizon (reflecting the economic life of a home around 50 years) to move to an improved capital value rating system.

Local Government Charges

Local government 7.11 charges also suffer unique problems. By far and away most development applications relate to renovations and extensions. However, the bulk of taxation collected comes from new homes. A home owner does a renovation to extend the economic life of their house. However, there is no commensurate contribution to infrastructure which also will require renovation as its economic life will have to be extended. 7.11 charges should be reviewed and broadened based on sound economic (and not planning) principles in the absence of changing the rating method.

Stamp Duty

Stamp duty is a transaction tax. The property industry claims it has a “lock in” effect. That claim is reasonable but can be debated by critics. If capital growth is significant, stamp duty is simply a cost of doing business and in absolute terms is less significant. There has been far less noise about stamp duty in recent years where capital growth has been strong. Expect to hear more “noise” in the future.

Land Tax

Land tax is not a popular tax at the moment. The reason is that the rates are too high because the base is too narrow – applying to only investment properties or high value properties/land holdings. Replacing the numerous property taxes with a broad base low rate land tax may have merit. However, this will require some rather important equity considerations as ongoing taxation relating to a property may force people with no or low incomes to dispose of their assets.

Recommendation 2. Align the incidence of taxation with the creation of value.

Recommendation 3. Explore opportunities to change the rating base to improved capital value in NSW. Start with specific transit-oriented districts and then determine whether this can be extended to the broader rating system.

Recommendation 4. Broaden infrastructure charges to align changes in the economic life of an asset with the extension of the economic life required for local infrastructure.

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4. Introducing a Culture of Co-operation Rather than Conflict

Going back to “Implementation”, the probability dilemma assumed that there was a 99% chance of approval at each decision point. This is a wildly optimistic assumption in planning matters in New South Wales. The thing that distinguishes the New South Wales Planning system from the Victorian Planning system is the “culture” of approval. This is not meant to disrespect the hard-working officials with good intentions in New South Wales. In Victoria, case managers deal with the proposals and are responsible and accountable for project stewardship. They are also responsible for new precinct master planning with input from the proponent. In New South Wales, helpful officials in the Department or council reviewing a project only to be rejected by referral agencies that have little intensity of interest or accountability in delivering a satisfactory outcome or even a project.

Culture is an all-pervasive term. In this instance, it is about accountability, transparency and responsibility across the entire decision-making process. Those involved in the process need to be acutely aware of the consequences of their action and the economic impact it has on the State. In New South Wales, the Land and Environment Court has effectively become the de facto approval authority.

The Department of Planning has tried case managers in the past. It doesn't work as well in NSW as Victoria simply because the case managers don't have the authority to act as they do in Victoria. Undertaking a skills assessment with a view to introducing new training courses and introducing multidisciplinary/multiportfolio teams may be a way to change the culture of the system.

Recommendation 6. Encourage the establishment of multi-disciplinary teams within the Department of Planning, Industry and Environment.

Recommendation 7. Improve accountability, transparency and responsibility from conception to completion for staff in the Department.

5. Dealing with Risk

It would appear that the system does not cope with risk very well. It doesn't appropriately apportion risk or mitigate it. Take the discussion on Possible Maximum Flood (PMF) levels in Penrith as a case in point. A flood of biblical proportions has been assumed to take place in the Hawkesbury Nepean catchment. Consequently, 25,000 homes would be under water if this occurred. Instead of increasing the height of the dam wall at Warragamba Dam which would give those residents days to evacuate rather than hours, a Permanent Maximum Flood Line was established, and development was prohibited within this contour.

It would appear that the spill over effects from property development take primacy over the development itself in NSW. This is just one of numerous examples. Risk mitigation strategies should be developed using cost benefit analysis. In other words, what is the opportunity cost of a project not going ahead and what are the costs of protecting lives in the case of the PMF.

Governments respond to risks in very different ways to other participants in the market. The typical response by governments to handle risk is by making rules – in some instances those rules can defy common sense and promote gaming within the market they are attempting to protect. While it is important that a rational regulatory regime exists for the real estate market, new rules and laws should be carefully considered and subjected to risk assessment analysis.

It is acknowledged that Regulatory Impact Assessments typically take place prior to the introduction of new legislation. There is potential for them to work, but in reality they appear to be written to justify legislation with very little risk analysis. RIA's tend to focus on the spill overs rather than trying to estimate the actual economic impact of proposed legislation on market activity. Maybe a thorough review of this process is required and risk analysis be undertaken as part of the assessment.

Recommendation 8. Regulatory risk assessment should be more comprehensive and include comprehensive economic impact analysis and risk mitigation strategies.

6. Working in a Federation

Australia is a federal system of government. Institutional structures are more like the US than the UK and different structures require substantially different policy responses. Australia has Commonwealth, State and local government within its federal structure (although local government is not constitutionally recognised). All three have an involvement in the planning system in some form or another. For example, the Commonwealth is involved in the Environment Protection and Biodiversity Act (1998). The State Government has the Threatened Species Act. Local Councils have environmental zonings within their Local Environmental Plans. Three levels of compliance for one discrete aspect of the development process is a great example of the complexity confronting someone wishing to invest to build homes. There have been some innovative regulatory responses from the Commonwealth such as regulatory switch off where broad agreement has been reached in strategic corridors.

A great deal of literature has been written about making policy in federal systems (mostly from the US). It is generally considered that local government is the level best equipped to deal with planning matters as they are more reflective of a better spatial distribution of electoral preferences. In terms of funding, they are likely to more effectively spend money because of the “flypaper effect” (grants and monies stick to where they land).

Based on the literature, it may be considered that local government is in the best position to assume the bulk of responsibilities in the planning system. It would appear this inclination is the preference of contemporary policy makers.

Devolving more power to local councils is a risky experiment in planning. There are a couple of reasons for this.

Firstly, Councils that are in a transition phase simply don't have the skills or resources to deal with large and complex projects. For instance, Camden Council will grow from a population base of 50,000 (in 2010) to one the size of Canberra. There are significant costs and skills associated with this transition that simply cannot be procured by a Council with a 50,000 rate base. Admittedly, Camden did it rather well but not without incident. Wollondilly, with the new MacArthur South Growth Area is going through this process with more difficulty.

Secondly, local politics is not particularly representative of the interests of the electorates they represent (despite the US academic literature). Local politics is most easily captured by specific interest groups. Most people do not have the time or inclination to get involved in local politics. For the bulk of people, they only get interested in development and planning when it is happening in close proximity to them (supported by Crosby Textor market research in 2011). There are numerous examples of where specific interest groups capture local agendas to the detriment of the broader public good. Development and planning can be used as a rather effective electoral advantage by anti-development political groups because a whole street can be turned against one applicant by opposing a single development.

The State Government should be particularly cautious in devolving its broader planning powers to local councils. The reason being that, in all likelihood, they will get different planning outcomes with some councils accepting growth and others not. This will have significant impacts on geographic equity, productivity and broader economic activity within

the State. The collective action of individual councils making such decisions will provide sub-optimal economic (and productivity) outcomes.

Recommendation 9. The State Government has a role in the planning system and should be particularly careful about devolving functions to councils that may be ill equipped to deal with projects of significant economic importance.

6. Improving Regulatory Design

The planning system should promote innovation which in turn will improve productivity. It needs to promote positive spill overs and reduce negative spill overs (such as environmental degradation). It needs to align the incidence of taxation with the creation of value.

By far and away most development applications are for small and relatively uncomplicated developments. Complying development has worked and has largely (and correctly) taken these projects out of the complex regulatory framework. That should continue.

Innovation does not necessarily come from strategies. It comes from people doing things differently and taking financial risks. Strategies and artificial intelligence algorithms typically cannot cope with this because they are based on what is known and not what is unknown. The State Government has a gateway approval process and a State Significant Development process. Both of these regulatory instruments promote innovation by allowing proponents (risk takers) to submit proposals that do not fit into existing planning parameters. This approach should be encouraged and expanded to promote innovation and step changes in productivity. The fear is that these systems will be diminished and replaced by strategies and algorithms that will create a drag on the economy.

Strategies should be general and develop future visions. The most effective planning strategy for Sydney was the Cumberland Plan from the 1950's and it could be contended that the city is still being shaped by that plan. Admittedly, there has been work done by the Greater Sydney Commission but the effectiveness of their plans will be judged in time. Under those general strategies proponents should be encouraged to put forward innovative ideas to achieve the desired outcomes through the Gateway Process or State Significant Development.

At the moment, the cost of finance is low – there is capital waiting to be employed in the property sector. That capital could be used to create urban outcomes similar to those the city experienced in 1890's to the beginning of the 20th century. Without having a regulatory means to deal with this will lead to a major economic opportunity being lost.

Recommendation 10. The regulatory system should promote innovation because innovation produces major step changes in productivity. The gateway approvals process and State Significant Development process should be reviewed with a view to expand them rather than replace them with innovation stifling strategic planning hierarchies.