29/05/2020
Office of the Productivity Commissioner
Re: Review of infrastructure contributions

Dear Commissioner Achterstraat,

It is our understanding that the NSW Productivity Commission is seeking input from stakeholders to tease out the issues associated with the existing infrastructure contributions system in NSW.

As a non-government organisation, Prosper Australia has long advocated for fair and efficient approaches to sharing the costs and benefits of urban and regional development.

Broadly, infrastructure contributions are a mechanism by which the costs of new development (such as the delivery of site services, coordination and planning, public transport, green space etc) are shared between the proponents of intensification and the community.

These are often conceptualised as 'impact mitigation fees' or 'user pays charges' and are contested by industry on the dubious basis that they increase the cost of housing provision. Meanwhile, further funding to support development and population growth, particularly for major transport infrastructure, is expected to come from the general tax take.

What is missing and ought to be more coherently embedded in the infrastructure contributions system is the principle of 'beneficiary pays.'

Besides the proponent developer of the current cost recovery approach, there are other beneficiaries of development and associated public infrastructure provision: 'whole of economy' benefits in the first instance, and then benefits that accrue mainly, but not limited to, beneficiary landholders.

The relative weighting of funding contributions between taxpayers, users, and other beneficiaries is an open question with important practical, productive, and ethical dimensions. It is rightly answered by a public policy decision-making process which rests on *a clear assessment of benefits as well as costs* of infrastructure delivery and the development it enables.

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On existing Infrastructure Contributions

NSW already does better than most by levying Special Infrastructure Contributions (SICs) for state-provided infrastructure in defined areas. Even so, the levels are too low.
The first major SIC, beginning in 2011 for the Western Sydney growth areas, was designed to recover only 50% of the cost of state infrastructure attributable to new development, *excluding* capital costs for school, health, police and emergency service facilities.[1]

Full cost recovery will not deter development, because the economic incidence is on the landowner at the time of announcement of the charge -- and if it did so this is not a problem. If a particular development adds less value to the existing land use than the costs it imposes on society, why should the general taxpayer subsidise it? If a rationale exists, it will emerge from strategic land-use planning or some other public policy process with a broader sweep of beneficiaries from whom contributions ought to be extracted.

We note that industry will likely claim infrastructure contributions (ICs) are a burden to homebuyers and housing affordability. This is largely untrue, and such lobbying occurs because it is the industry itself that bears the incidence of contributions in reduced land rents and super profits.[2] Homebuyer advocates do not usually campaign against ICs because they are not the ones who bear the cost.

Higher ICs promote faster, not slower, development. This is because development is a matter of timing as well as type (it is a 'real options' problem). Higher ICs reduce the payoff from waiting to develop land to a higher value use, thus encouraging more development sooner.[3] Strongly binding and certain strategic planning, with a concomitant programmatic infrastructure schedule, will likely do the same (despite claims to the contrary).

There is however a case to improve the design of contributions so they more efficiently spread the risk of financing ICs and reduce the risks imposed on the development industry. This would create more certainty for industry, while increasing the potential for beneficiary funding. Alternative financing mechanisms could convert lump sum contributions into long term, ongoing payments tied to the landholdings itself.

On Beneficiary Funding

In principle, contributions should be made by beneficiaries over the lifetime of the infrastructure, not merely by the immediate stakeholders.

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[1] See Prosper Australia's submission to the NSW Federal Financial Relations Review https://www.prosper.org.au/wp-content/uploads/2020/02/Prosper-Australia-submission-to-NSW-Review-of-Federal-Financial-Relations_-26-Nov-2019.pdf

[2] Murray, C. K. (2018). Developers pay developer charges. *Cities*, *74*, 1-6. https://www.sciencedirect.com/science/article/pii/S0264275117301051

[3] Murray (2018) and Murray (2019), "Time Is Money: How Landbanking Constrains Housing Supply", working paper available at SSRN: https://ssrn.com/abstract=3417494

It is important to consider all beneficiaries over a broad time horizon. The benefits of public infrastructure accrue to land and its (potentially multiple) owners over the lifetime of the infrastructure.

Value capture mechanisms predominantly tax economic rent - this is due to restricted land supply. The difference between the premium for residential land and its previous use is taxable without penalising development or passing on additional costs to homebuyers.[4]

In instances where this premium is exceeded by contribution requirements, increased costs ensure that infrastructure dependent development is efficiently priced, so development proceeds in the order of the most cost effective projects first.

Unless a beneficiary funding approach coincides with early spatial planning and development processes, value creation is anticipated and will dissipate to private landholders. Hence, it is critical that a suite of value capture mechanisms are available and announced alongside activities which create value i.e. boost land values. This is including but not limited to:

- strategic planning frameworks with new transport or land-use changes
- introduction of new statutory zones and/or overlays
- announcement of key transport land corridors

For public transport infrastructure the case for value capture is particularly strong. Prosper's recent report The transit transformation Australia needs covers the rationale, the need, and the means of doing this in detail. Please find attached.

We recommend the following mechanisms to the Review for consideration and inclusion in a reformed infrastructure contributions system:

1. *Capture value through the mainstream tax system*; a broad-based state land tax would facilitate value sharing for 'whole of economy' benefits in the fairest and most efficient manner. Hypothecated infrastructure contributions could be levied from existing local government rates.

2. *Special fees or levies* to capture land value increases delivered by transit system development, or by changes to development rights. Fees or levies should be charged in proportion to benefits received, and returned back into the value generating

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[4] Henry, K., Harmer, J., Piggot, M., Ridout, H., & Smith, G. (2010). Australia's future tax system, final report, part 2, chapter E4-5 (Housing Affordability), from the report to the Treasurer by Australia's Future Tax System Review, Department of Treasury, Canberra.

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infrastructure on which that 'fee for service' rests. There are a number of international examples worth referencing and understanding:

a. *Betterment levies* that target defined subject areas, levied on beneficiaries of a major transit upgrade (and often constructed around increases in property value).

   For example, Auckland council NZ used fixed interest encumbered land titles within a public-private partnership. Auckland council raised 54% ($49m out of $91m NZD) in infrastructure funding for its Milldale development. This was in addition to contributions from the council (37%) and the developer (9%).

   A 35 year fixed rate debt was created against encumbrance over land titles. This debt had no recourse to the council, and so avoided council debt limits. The council was responsible for enforcing and collecting the rates surcharge levy. This allowed institutional finance in infrastructure development, as it created a low risk, fixed interest investment for *The Accident Compensation Corporation*.[5]

b. *Connection fees* under which nearby property owners pay to interface their property directly to a rail or light rail station. As a funding mechanism, the connection fee should exceed the cost of construction, and be referenced to mutually-agreeable value uplift estimates.

c. *Rezoning fees* through which landholders contribute-back a portion of the windfall benefit they receive from intensive up-zoning of their property. Importantly, taxing windfall gains from rezoning would disincentive rent-seeking behaviour by removing the 'honeypot', improving the efficiency and rationality of urban development.

   The A.C.T Lease Variation Charge levies 75% of the value uplift due to site rezonings. This has been in operation since the 1970's and is arguably the nation's most efficient and effective developer contribution mechanism. Below is an estimation of the revenue potential of an ACT style rezoning windfall gains tax on a state by state basis.

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5 https://www.interest.co.nz/opinion/102808/crown-company-borrows-money-infrastructure-crown-entity-rate-537-sake-keeping-debt

Table 1: Estimated revenue from adoption of ACT system of capturing planning windfalls

	Capital city median price	Private new dwelling completions	Price ratio	Dwelling ratio	Total markup	Revenue 2018-19 ($m)
NSW	**$805,000**	**73,420**	**1.3**	**15.0**	**20.0**	**8,218**
VIC	**$635,000**	**64,953**	**1.1**	**13.3**	**14.0**	**5,735**
QLD	**$492,000**	**39,008**	**0.8**	**8.0**	**6.5**	**2,669**
SA	**$428,000**	**11,942**	**0.7**	**2.4**	**1.7**	**711**
WA	**$436,000**	**16,387**	**0.7**	**3.4**	**2.4**	**993**
TAS	**$459,000**	**2,691**	**0.8**	**0.6**	**0.4**	**172**
NT	**$389,000**	**768**	**0.6**	**0.2**	**0.1**	**42**
ACT	**$604,000**	**4,882**	**1.0**	**1.0**	**1.0**	**410**
Total						**18,949**

Sources: ACT Suburban Land Authority 2018-19 annual report (total SLA return), ACT 2018-19 Statement of Finances (LVC revenue), CoreLogic capital city medians (Sep-19), ABS 8752.0 dwelling completions (trend).

3. *Auction or sale of development rights* allows local governments to sell permission to build beyond a prescribed minimum envelope.

   This approach is used by Brazilian municipalities to finance urban services ranging from hard infrastructure to social housing. It is achieved through strong and binding minimum development density ratios within local plans, with options for developers to purchase additional development rights. In São Paulo and other cities, these sales are managed by open market auctions for Certificates of Additional Construction Potential (CEPACS).[6]

In conclusion, Prosper challenges the review to look at infrastructure contributions and funding from a holistic value capture perspective, in addition to complete cost recovery. Any improvements made to certainty for industry should be accompanied by increased revenue.

Kind Regards,
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Policy Director
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[6] See for example, Marcelino, M. A. (2019). Charging building rights as non-negotiable developer obligations: The case of Brazil. In Gielen, D. M., & van der Krabben, E. (Eds.) *Public Infrastructure, Private Finance* (pp. 56-67). Routledge.

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