29 February 2016

Standing Committee on Infrastructure, Transport and Cities
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Attention: Standing Committee on Infrastructure, Transport and Cities

Standing Committee on Infrastructure, Transport and Cities - *Inquiry into the role of transport connectivity on stimulating development and economic activity both in major urban areas and regional Australia*

Thank you for the opportunity to comment on the inquiry into the role of transport connectivity on stimulating development and economic activity both in major urban areas and regional Australia. Please find our submission attached.

In developing this submission we have involved many of our members through a special Sub-Committee chaired by Will Dwyer, Head of Strategy Planning at Goodman Limited.

Both Will and myself as CEO of the Urban Taskforce would be keen to be involved in further discussion on this issue and to present to any hearings that the Standing Committee may be holding to provide a development industry perspective on this issue. Please feel free to contact me on telephone number 9238 3927 to discuss this further.

Yours sincerely

Chris Johnson AM
Chief Executive Officer
Urban Taskforce Australia

Urban Taskforce
AUSTRALIA

The role of transport connectivity on stimulating development and economic activity

Submission to the Standing Committee on Infrastructure, Transport & Cities, prepared by ***Urban Taskforce Australia***, February 2016

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Introduction

The Urban Taskforce is very supportive of urban areas in Australia receiving new infrastructure that stimulates development and economic activity. It is clear that major cities like Sydney are going through a structural change from being substantially sub-urban to being more urban, with higher densities. If this swing to higher density living is matched by new forms of public transport connectivity this will lessen road congestion. We also understand that retro fitting new public transport infrastructure is expensive and that governments need to look at ways to get beneficiaries of improved transport connectivity to contribute towards the costs of the new infrastructure. We are, however, very concerned that a simplistic 'value-capture' approach that adds taxes to the developers of new housing is likely to increase the cost of that housing for home buyers. There are other ways to generate funds that we will outline in our submission.

The Urban Taskforce submission has been structured to specifically address each relevant aspect of the Terms of Reference for the Inquiry (see below).

The definition of 'value capture' that is referred to in the Terms of Reference is a very broad concept. The Urban Taskforce submission addresses a range of 'value capture' mechanisms, however when we refer to a 'value capture tax', we are referring to the concept that new development would provide funding back to government based on a perceived uplift in value. The most commonly-discussed application of this approach is to apply a per-square metre or flat rate charge on new housing development within a specified distance of new transport infrastructure. This approach essentially becomes a tax on housing development.

Terms of Reference

The Committee is to inquire into and report upon the role of transport connectivity in stimulating development and economic activity both in major urban areas, and in regional Australia, in particular:

NOTE: The Urban Taskforce submission will concentrate on major urban areas although our comments are likely to apply to regional Australia as well.

a. ***Identifying the likely impact on property values and property related tax revenues as a result of transport connectivity.***

While new transport connectivity is likely to lift property values it is very difficult to discern the change in property values associated with the infrastructure improvements. There will be a range of 'winners' and' losers' for varying locations and varying uses. It is even more difficult to ascertain the impact upon the viability of development as a result of a value capture tax.

The costs of making development sites available varies widely. The cost of capital is an important component to development feasibility, and this becomes more costly as risk increases. Key variations in costs can include:

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- ***Fragmentation:*** Whether the land or sites to be developed is in fragmented ownership. Lots firstly need to be amalgamated in order for a viable development site to be assembled. The costs and risks of land assembly from a single large lot, such as a former industrial site, are nil, but the risk and cost for land assembly for a series of small residential allotments can be very high.
- ***Contamination:*** Whether the land is significantly contaminated and the extent of remediation that may be required (the costs and risks of dealing with highly contaminated sites are much greater than those that have no history of potentially problematic industrial use).
- ***Risk:*** The degree of planning risk that a development needs to absorb. In areas with anti-growth councils, vocal and well-resourced objectors, or uncertain and inconsistent planning approaches, total costs of consultants are higher (due to the likely additional time taken to secure re-zonings or development approvals).

Many studies and approaches to value capture tax fail to recognise the wide range of variables that impact upon development sites. As a result, conclusions are drawn about the ability for development to absorb taxes or profit share, based on development with only **one type** of cost and risk profile.

The reality is that sites that have been developed in the past 15 years within the Sydney metropolitan area were 'low-hanging fruit', or the 'easier' sites with lower costs and risks. Many of the infill development sites that need to be developed in the next 20 years are high cost developments (requiring lot amalgamation, greater risk, etc). It is fundamental mistake to evaluate the capacity to sustain the cost of a value capture tax based on past developments, without considering how the development sites that must be developed in the future are different from those developed in past years.

An increase in land value from rezoning (due to the provision of transport infrastructure) may represent a 'windfall' to one landowner (Landowner 1), if that landowner has little to no costs and did not have to secure high-cost capital to purchase the site. However, a similar increase in value to another landowner (Landowner 2) may do nothing more than give that landowner a sufficient return to have justified the costs incurred in acquiring and managing a high-risk, complex development site through the time-consuming, expensive and uncertain rezoning process. A value capture tax may have no impact on the likelihood that Landowner 1's land will be developed. However, the same tax – once its introduction is anticipated – will sterilise sites of the kind owned by Landowner 2.

The adverse impacts of value capture taxes can be mitigated (in some high-demand areas) through increasing the density of planned development. However this can lead to inappropriate distribution of density and loss of amenity, as the sites that require the additional density to be viable in the face of a value capture tax would not necessarily be the best sites for the extra density from a community perspective.

A 2010 public inquiry into Sydney's long-term public transport master plan investigated value capture as a funding option and rejected this form of funding, stating that *'It is not a simple exercise to identify and accurately quantify the benefits attributable to new infrastructure, both geographically and over time, and define a 'benefit area.'*[1]'. In particular, it is very difficult and problematic if the benefits accrue quite widely, which is very often the case with large-scale transport infrastructure such as West Connex or new railway lines.

b. *Examining options for the application of value-capture mechanisms to sustainably fund transport infrastructure;*

Value capture or betterment taxes are extremely difficult to administer and sustain in a fair and equitable manner for any extended period of time. This is due to the generic nature of the tax, which does not take into account the fluctuating nature of the property market and the wide range of highly-volatile variables which impact upon the level of 'value' which can be sustainably 'captured' from the development of site. The impacts of value capture can also encourage unsustainable urban form and place an unfair financial burden upon particular sectors of society.

When property prices can no longer absorb or sustain the additional cost of the value capture tax, housing supply in these areas declines as developers and investors move to locations where development is still profitable.

Value capture taxes also deter key elements of sustainability which the investment in transport infrastructure is trying to encourage. For example, the state and federal governments may wish for people to live in areas well connected to the public transport network, to decrease congestion and traffic, improve air quality, and a range of other beneficial reasons. However, the use of value capture taxes risks providing an incentive for developers to provide homes in areas that are not affected by the tax, and hence not so well serviced by the improvements to the public transport network.

Value Capture taxes also do not provide inter-generational equity. Established owners are excluded from contributing towards the cost of the new infrastructure (which they also benefit from), with the burden of the cost largely imposed those trying to enter the market (such as first home buyers) who are unfairly hit with a large lump payment. Value capture taxes are also a 'regressive' form of tax, and this is noted in the Independent Public Inquiry into the Long Term Public Transport Plan for Sydney, which stated that *'These types of levies have equity effects that are generally regressive, because developers generally pass these changes onto consumers*[2].' Property developers require an acceptable rate of return on their investment; and are obliged to secure the highest return to shareholders where possible. As with all other business transactions, all additional costs such as additional taxes, will be

[1] Independent Public Inquiry, Long-Term Public Transport Plan for Sydney (2010) *Independent Public Inquiry into a Long-Term Public Transport Plan for Sydney: Final Report – Themes and Recommendations, 26 May 2010,* submitted to and published by *The Sydney Morning Herald.*
[2] Independent Public Inquiry, Long-Term Public Transport Plan for Sydney (2010) *Independent Public Inquiry into a Long-Term Public Transport Plan for Sydney: Final Report – Themes and Recommendations, 26 May 2010,* submitted to and published by *The Sydney Morning Herald.*

passed onto consumers where there is sufficient demand for that product that the consumer will pay the higher price. Spreading infrastructure costs over the life an assets, for example, through a 'Sydney Metropolitan Transport levy' imposed as a yearly rate upon all property owners in the Sydney area, is a far more equitable mechanism and does not inflict financial burden upon a particular industry or group of buyers. This model is adopted in most countries with more profitable value capture revenue raising models (for example, both France and the United Kingdom have successfully implemented this model to raise revenue for transport infrastructure).

Value capture tax increases the underlying cost of development, which in turn has a flow-on effect on housing affordability. During the 'boom' period, the cost of housing will rise as a result of the tax. This is due the high demand for housing which allows the market to absorb the costs. Alternatively, if there is a downturn in the property market, the additional cost of the tax can undermine project viability, reduce housing supply, reduce employment in the property development, building and construction industries and reduce the industry's contribution to the economy. In practice, land owners will delay development until the tax can be absorbed or passed on.

OPTIONS FOR SUSTAINABLY FUNDING NEW TRANSPORT INFRASTRUCTURE

While our submission has argued against 'value capture' as that phrase us currently understood in the Australian debate, we do believe there are methods to fairly and equitably obtain contributions from beneficiaries of new transport infrastructure. We will use as our case study a major new metro rail project across a city like Sydney. We suggest two broad revenue raising approaches based on geographical areas. We consider these approaches to be most effective as they seek to be equitable and do not create distortions in the market. New levies on the purchase of new homes will cause a distortionary effect on new home prices versus old home prices even though new homes will still benefit from the new infrastructure.

CONTRIBUTION LEVY 1: Broad Based Levy across the Metropolitan Area (i.e. Metropolitan Sydney)

The approach here is that the whole city gets a benefit from new infrastructure so a small contribution from all residents and businesses on an annual basis for a fixed number of years will raise significant funds over time. The collection mechanism would be either through an extra levy (a 'Sydney Metropolitan Transport Levy') on council rates for say 20 years or through a land tax. The Cross Rail project in London is raising funds through a levy on all business rates for 30 years. An alternative metropolitan wide collection method could be through an increase in Land Tax and applying this to all properties over a fixed period of time. The rate or land tax levy could be increased in some areas closest to new infrastructure.

CONTRIBUTION LEVY 2: Regional/ District Infrastructure Fund

Sydney's metropolitan area is divided into 6 districts or regions. Some regions / districts may need to raise more or less revenue for infrastructure, depending on growth in population size and the level of infrastructure needed to service the population. The Regional / District

Infrastructure levy would be a small contribution from all new development approvals in the region, similar to local government contributions levied under section 94 of the *Environmental Planning & Assessment 1979* (local infrastructure contributions), but would be used for regional infrastructure. The income to the funds would vary depending on market conditions but over time significant funds could be raised

CONTRIBUTION LEVY 3: Individual sites and precincts

The developer and the approval authority would agree on a density uplift that related to an Infrastructure Contribution through a Voluntary Planning Agreement (VPA). This would be a one off payment that would be allocated to a District Infrastructure Fund to be expended on specific transport infrastructure projects. The VPA payments would be separate from Section 94 contributions for local infrastructure or public domain improvements. It is important that the contribution/ levy be at a level that did not threaten the viability of a project. The amount raised will therefore be variable related to location, site conditions, extent of uplift and current market conditions.

c. ***Considering means, including legislative and administrative actions, by which government and the private sector can best utilise value-capture funding mechanisms***

The three methods of raising infrastructure funds outlined above would need state government legislation to establish the regulatory framework. Clearly, local government would need to be actively involved in the process.

Value capture is an inherently difficult tax to administer fairly and equitably. One of the key findings of the Independent Inquiry into the Long-Term Transport Master Plan was that value capture taxes are frequently disputed as they '*tend not to be transparent*' and there is '*considerable scope for arbitrary, ad hoc administrative decision making.*[3]' This adds significantly to the uncertainty regarding outcomes and commercial risk and ultimately causes the cost of capital to rise.

The random nature of government imposed levies has created considerable uncertainty. The 2010 Federal report on tax, *Australia's future tax system: Final Report* (the Henry Tax Review) notes that '*where developer charges are set in an ad hoc fashion or are subject to unexpected changes, they can create certainty around new developments. If infrastructure charges are increased after a developer has bought land from its original owner, they cannot be factored into the price previously paid for the raw land. In this case, the charge would lower the expected return from the development. In return, general uncertainty about charging is likely to discourage development activity, which could reduce the overall supply of housing*[4]'.

[3] Independent Public Inquiry, Long-Term Public Transport Plan for Sydney (2010) *Independent Public Inquiry into a Long-Term Public Transport Plan for Sydney: Final Report – Themes and Recommendations, 26 May 2010*, submitted to and published by *The Sydney Morning Herald.*
[4] Australian Government (2010) *Australia's future tax system: Final Report.* www.taxreview.treasury.gov.au

The Henry Tax Review concluded that development levies were only justifiable when they reflected the avoidable costs of development. The report explained that *'where infrastructure charges are poorly administered'*, particularly where they are complex or set too high, *''they can discourage investment in housing, which can lower the overall supply of housing and raise its price[5].'*

d. *Considering the appropriate roles of each of the three levels of government in establishing sustainable value-capture funding mechanisms for planning and infrastructure construction*

The current system of identifying necessary infrastructure and the collection of revenue and allocation of funds for the delivery of infrastructure between the three levels of government is currently dysfunctional and there is a clear need for urgent reform, at the Federal, State and local levels.

The issue of infrastructure funding should be made part of an inter-government debate, addressing the jurisdictional, economic and legislative reforms required to develop an equitable, efficient and effective method for raising revenue across all levels of government and applying these to agreed infrastructure projects. The Council of Australian Governments (COAG) (now disbanded) provided an appropriate forum for these discussions and an alternative organisation or committee could be formed to take on this role.

The introduction of any value capture tax must be considered from a holistic perspective. It is crucial that value capture is examined in the context of the entire taxation reform debate. Work must be done on the relationship between the federal government and the states and the associated fiscal pressures.

From an industry perspective the developers of sites near new infrastructure seem to be targeted by all three levels of government to contribute funds for their favourite projects. The Commonwealth government is clearly looking at ways to recoup funds on major projects such as WestConnex, and the state government have also indicated that they are seeking some return on their investment via value capture. At the local government level, there is an increasing reluctance for councils to alter their planning controls to allow for additional growth and density, unless developers sign a 'voluntary' planning agreement, which extracts funds from developers in order to obtain additional floor space and height. While this may lead to better solutions in some cases, it is highly like that the community will become concerned that planning rules are up for negotiation on most sites. Ultimately, we believe that the state government must control levies for large infrastructure and local government contributions should be restricted to local improvements.

e. *Examining any international experiences of the delivery of high speed rail projects by value capture methods, and the impact of high speed rail on city and regional development*

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[5] Australian Government (2010) *Australia's future tax system: Final Report.* www.taxreview.treasury.gov.au

The funding for London's Crossrail project comes partly from a Business Rates Supplement that is applied across all businesses in London above a threshold rate value. This spreads the contribution across a very large geographical area on the basis that all businesses within the Greater London area will be beneficiaries of Crossrail. The rates supplement is for a period of 30 years, with the potential for another 30 years to fund Crossrail 2. The second income stream comes from the Mayoral Community Infrastructure Levy (CIL) which is a one off charge on all new development in greater London. A report by PwC into options for funding Crossrail 2 raises concerns about the Mayoral CIL:

'Applying even a very low Mayoral CIL rate will make certain marginal developments unviable; there is a risk that, by setting a rate too high, a significant number of development proposals may be unviable, damaging economic growth in London to an unacceptable degree.[6]'

The approach used for Crossrail with a broad based business rates levy over 30 years is raising significant funds. The Mayoral CIL will be inconsistent due to fluctuations in the property market and construction industry.

f. ***Examining methods of implementing value capture in both greenfield and brownfield developments ; and***

g. ***Examining ways to capture future value opportunity when reserving transport corridors.***

Government must develop creative and innovative ways to fund transport infrastructure rather than targeting the property development industry.

The Australian property development industry is already one of the most heavily taxed in the world. For example, developers in NSW are subject to affordable housing levies, local infrastructure fees under s.94 of the *Environmental Planning & Assessment Act 1979*, special infrastructure contributions, rates, stamp duty, and other property related taxes (as well as the Goods & Services Tax and company income tax). Developers may also be required to pay for infrastructure through voluntary planning agreements (which are becoming less and less voluntary as local councils become more opportunistic).

Conclusion

The Standing Committee on Infrastructure, Transport and Cities inquiry into the impact on property values of new transport infrastructure raises the potential for 'value capture' to contribute funds to the infrastructure. The Urban Taskforce is very concerned that the target of the value capture process seems to be the developers of new housing and that this will simply add costs to new housing that will increase even more the very high cost of housing in Australia. It appears that every layer of government wants to take a slice of the profits of most new housing projects. The Urban Taskforce estimates that up to 25% of the cost of new

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[6] Price Waterhouse Coopers (November 2014) *Crossrail 2: Funding and financing study*, https://www.pwc.co.uk/capital-projects-infrastructure/assets/crossrail-2-funding-and-financing-study.pdf accessed February 2016

urban housing is made up of taxes and levies on the developer and that these are passed on to the end purchaser.

A detailed report by PwC on funding mechanisms for London's Crossrail 2 raised significant concerns about the value capture approach contained in the Mayoral Community Infrastructure Levy (a compulsory per metre squared charge on all new development) used for Crossrail 1. "Applying even a very low Mayoral CIL rate will make certain marginal developments unviable; there is a risk that, by setting a rate too high, a significant number of development proposals may be unviable, damaging economic growth in London to an unacceptable degree[7]."

The Urban Taskforce understands that urban and rural infrastructure can be very expensive and that some contribution from beneficiaries can help reduce costs to the taxpayer. An obvious example is a toll road where there is an ongoing charge to users that helps offset initial costs particularly if collected over decades. The approach being discussed in Australia at the moment seems to be to tax the uplift in the value of land but this has many variables, is open to market fluctuations, and is difficult to apply evenly to disperse sites.

The Urban Taskforce has suggested three other approaches to raise funds for much needed urban infrastructure.

1. **METROPOLITAN WIDE TRANSPORT INFRASTRUCTURE LEVY**

This would be a small increase in the rates of all metropolitan businesses and residence for the benefit of metropolitan wide transport initiatives or the levy could come in the form of a land tax on all land. Both levies would be long term lasting for decades.

2. **REGIONAL INFRASTRUCTURE LEVY**

This would relate to infrastructure within a metropolitan area (Sydney has 6 districts) so some regions may need to raise more revenue than others. The Regional Infrastructure Levy would be a relatively small levy on all new development in a region similar to local government contributions levied under section 94 of the *Environmental Planning & Assessment 1979* (local infrastructure contributions), but would be used for regional infrastructure.

3. **INDIVIDUAL SITE AGREEMENTS**

An agreement would be made between a developer and the approval authority to allow an uplift in floor space and height as long as an infrastructure contribution was made to government to be allocated to transport projects.

The Urban Taskforce is concerned that current approaches to Value Capture seem to want to charge $200 per square metre (or similar) only for new housing. The Australian housing

[7] Price Waterhouse Coopers (November 2014) *Crossrail 2: Funding and financing study*, https://www.pwc.co.uk/capital-projects-infrastructure/assets/crossrail-2-funding-and-financing-study.pdf accessed February 2016

industry is slowing down, despite the need for more homes to meet demand, and the introduction of another significant tax on new housing will make some housing developments unviable (as predicted for the London Crossrail project). We have outlined some better ways to fund transport infrastructure but we stress that the federal government needs to be aware that there are many other levies, contributions and costs that are added to development in Australia from various levels of government. Value capture cannot be considered in isolation.