IPTI Xtracts
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Sydney councils in fast-growing areas could gain power to lift rates

Councils in fast-growing parts of Sydney would be given greater powers to increase rates to help meet the needs of their surging populations under a proposal by the Berejiklian government.

The exposure draft, released by NSW Local Government Minister Shelley Hancock for consultation from Monday, proposes changes to the way rates are calculated following recommendations from the pricing regulator.

Mrs Hancock said the changes were aimed at providing councils with a "fair, equitable and flexible" way of apportioning rates that pay for infrastructure and services like road maintenance and childcare centres.

The release of the draft begins more than a month of consultation over the Christmas holiday period. The government is taking feedback until February 5. It hopes to introduce legislation to Parliament early next year.

Mrs Hancock said under the proposal, rating income growth would be aligned with population growth to help councils provide for growing suburbs while protecting residents from "unfair" rate rises through the rate pegging system.

"Some councils, particularly in Sydney's growth corridors, have faced a substantial increase in population while their rating bases have come under significant pressure with higher demand for new or upgraded local infrastructure and services," she said.

"We have commissioned [the Independent Pricing and Regulatory Tribunal] to develop a methodology to allow for population growth to be taken into account when it sets the annual rate peg which caps council rating revenue increases each year."

The draft bill also allows 17 councils created from the forced mergers in 2016 to harmonise their rates over four years, instead of the previous deadline of July 2021, to protect ratepayers from "excessive and sudden" increases.

Georges River Council in Sydney's south is one local government area that has proposed increasing the amount of money it collected in rates in order to help the council "meet the cost pressures of a growing population".

The council's own community consultation on its proposal found residents "think it is unfair that council's rate income is not permitted to increase consistent with development and population growth".

It prompted the Greens and the organisation representing NSW's 128 councils to renew their push to abolish the rate peg, which is the maximum percentage amount by which councils can raise their general income each year.

Local Government NSW president Linda Scott, who is a City of Sydney Labor councillor, said a ratings formula that recognised the impact of population growth was an improvement, but any increase to rates would be limited by the peg. She said many councils faced financial crisis as they tried to provide infrastructure and services.

"The rigidity of NSW’s current ratings system and its one-size-fits-all rate peg has deprived communities of vital local infrastructure for far too long," she said.

"These reforms don’t go far enough to solve underlying financial sustainability issues, so we are looking at a Band-Aid rather than a cure."

Greens MP David Shoebridge said the "modest changes for greater rating flexibility and rate increases that track population growth are a small step forward, but what's really needed is an end to rate capping".

"Local councils have been at the frontline in helping their communities survive fire, floods and a pandemic and these proposals go nowhere near far enough to allow them the financial independence and resources they need," he said.

The consultation guide on the draft legislation said the government would not consider further changes to the rate peg “at this time”.

NSW councils have long complained about the policy of rate-pegging, also referred to as rate-capping, arguing it constrains their ability to carry out critical works.

The IPART set the 2020-21 rate peg at 2.6 per cent, with many councils having already applied the full peg.

Why we need a betterment levy in NSW: better late than never

The NSW Productivity Commission in November released its final report on the Review of Infrastructure Contributions in NSW (PC Review). It controversially ruled out capturing a share of windfall gains made from rezonings or the granting of additional development, even though this is widely used in voluntary planning agreements (VPAs) and state infrastructure contributions (SIC).

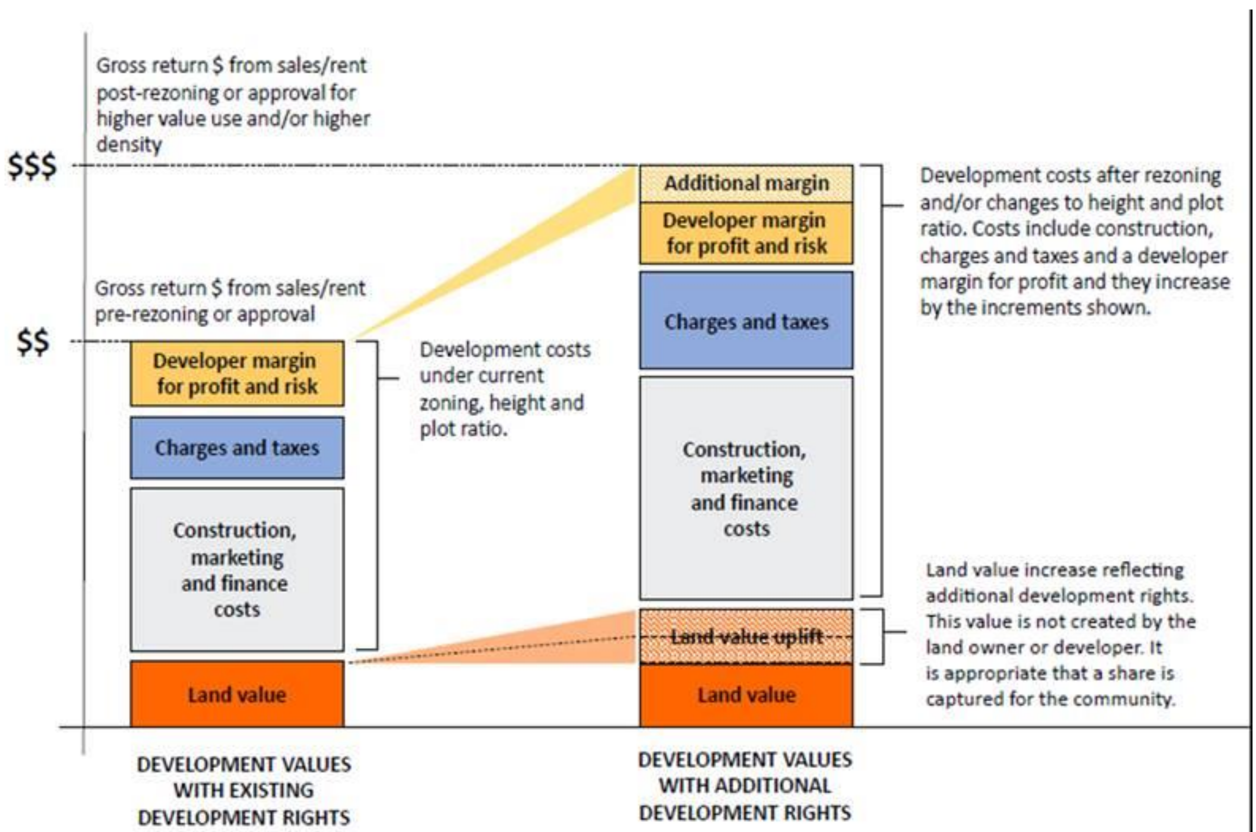
Value uplift is community property

Planning controls ration access to development rights for the benefit and amenity of the community, and enable those with access to them to gain the value of social infrastructure, amenity, access to city services and jobs, etc.

The increase in land value associated with changes to planning controls – also known as planning gain, 'betterment' or a 'windfall gain' – represents the value of the rights granted to property owners that allow for development to take place, which are, until then 'owned' by the community (see the orange segment in the below graph).

No less a source than the minister for planning and public places in NSW concurred with this view when he said in a Committee for Sydney webinar that, "in our system, like in most planning systems around the world, the state has effectively nationalised most development rights".

Planning decisions are made in the public interest and the value of land is strongly shaped by planning decisions (see an article by Mike Brown, Rolling the dice on planning at Star casino and its giant proposal for a very Sydney example). Therefore, the value uplift that planning decisions generate is an unearned windfall gain to the developer granted on behalf of the public.



Estimating the value of planning approval graph. Source SGS Economics & Planning

Given that the value uplift associated with the granting of additional development rights through planning decisions is conceptually community property, the community has a legitimate claim to this value. To this extent, value capture is not just a valuable funding mechanism, but fundamental to equity and placing the public interest at the forefront of planning.

The capture of this windfall gain has typically been described as a betterment levy; more recently it's been conceptualised as a development licence fee or sale of community development rights.

Value capture has the potential to significantly increase infrastructure funding in NSW, by up to $8 billion a year, dwarfing the $1.3 billion raised in all other state and local contributions. Some politicians believe "governments have either been negligent or incompetent in not seizing this opportunity".

Local communities often complain that the current infrastructure funding arrangement can result in the costs of growth being borne by existing residents, while the benefits accrue to few landowners in the form of windfall gains.

Arguably this disparity has been one factor that has led to community pushback against "overdevelopment" and a reduced social licence for new development in existing urban areas.

A robust value capture mechanism could reduce the tax burden on households paying for new infrastructure and dramatically reduce the "honeypot" incentives for industry to "capture" the planning system. It could put an end to an array of political scandals regarding government overpaying for land (Western Sydney Airport and Parramatta) and political resignations which have claimed the scalps of more than a dozen former MPs in NSW (here and here).

Sensible and overdue reforms

The NSW Productivity Commission Review recommended a number of sensible and overdue reforms and is likely to be much better received than the heavily criticised Green Paper (see Juliet Grant's article, Lazy economics uses planning as a scapegoat and Professor Peter Phibbs's Hacking a government report, here). These included a development of infrastructure contributions plans prior to rezoning, delaying the payment of infrastructure contributions until later in the development process, a direct land contribution and others.

An earlier draft of the NSW PC Review asked valid questions about the role of value capture in planning, particularly in the context of planning agreements and a betterment levy.

And the review makes some promising remarks that a betterment levy could help "defray costs of state investment" and align with "beneficiary pays principles" which are "central to an efficient contributions system".

Further, the Productivity Commission highlight that the "ad hoc and inefficient" approach to state infrastructure contributions (SICs) has led to an "inequitable transfer of wealth from taxpayers to certain property owners".

Ultimately though, in relation to value capture, the recommendations suggest a series of quasi-value capture approaches (we would include the fixed three per cent of construction costs levy, the modest per dwelling special infrastructure contribution for state infrastructure and the per dwelling new transport infrastructure zone charge in this category) without truly addressing the problem of the unearned increment and converting this into value for funding community infrastructure.

Value capture from increased zoning too readily dismissed

Notwithstanding some good analysis and recommendations, the PC Review too readily dismissed a funding mechanism that has broad support from the economics and planning disciplines and – judging from the submissions into the PC Review – basically all local governments, academics, NSW Government agencies, community organisations and infrastructure experts. A TS Eliot phase comes to mind: “We had the experience but missed the meaning.”

The PC Review made a number of arguments to dismiss the ideas of a betterment levy or development licence fee. These are unpacked below.

Value capture is not a bribe

In the absence of a transparent and comprehensive value capture system Voluntary Planning Agreements (VPAs) are currently a means for negotiating such contributions in NSW.

The PC Review quotes the concerns of one developer lobbyist that value capture in VPAs can lead to planning decisions being bought and merit being ignored. This perception that councils are simply selling floorspace or selling decisions is intuitive but is not borne out in the evidence.

Value capture simply means councils are putting a price on additional floorspace (equivalent to the marginal increase in land value associated with that floorspace), which would otherwise be given away for free. In the same way that as a nation we don’t give rights to minerals under the ground away for free, we shouldn’t give rights to development above the ground away for free.

The counterfactual isn’t “no value capture, no approval”, it is no value capture with approvals. The use of discretion and the ability to exceed existing planning controls is a long-established practice of the NSW planning system and there is no empirical evidence offered to suggest that value capture and planning agreements encourage ad hoc planning, including development application exceedances and spot rezonings.

Ultimately, industry makes these decisions – councils don’t invite industry to exceed their planning controls.

In fact, a mechanism for clear value capture contributions creates transparency and certainty in the community that planning decisions aren’t being “made behind closed doors”.

Development proposals in NSW go through a rigorous and independent assessment process, including independent local and state planning panels which eliminates the possibility of decisions being ‘bought’.

In this regard, the PC Review recommendations to increase public scrutiny and transparency of Voluntary Planning Agreements (VPAs) is fully supported.

In any case a comprehensive and transparent mechanism for value capture would be a routine part of the development process, based on pre-scheduled rates or a clear formula, and quite separate to the approvals process.

The SGS Economics and Planning submission suggested that funds received from a development licence fee could be centrally collected by Treasury with a share redistributed back to councils, possibly based on relative growth levels.

Value capture through VPAs is not simply a cash grab

The PC Review suggests that value capture negotiated through VPAs is a cash grab to fill council coffers for recurrent revenue, with no evidence.

The issue of substance here isn't related to value capture. The issue is that contributions received by councils from VPAs (or from any other future value capture mechanism) should be used to fund explicitly identified council priorities for example in community infrastructure strategies and/or capital works programs.

In relation to contributions received through VPAs these should be subject to clear state guidelines to ensure transparency in the rate or formula used to calculate value, clear separation in the approvals and VPA processes, and up-front and transparent infrastructure planning.

Far from a cash grab, by not capturing value uplift, a perverse outcome has seen the government paying twice for infrastructure in some areas. For example, in North-West Sydney a new train line and significant upzoning has proceeded – significantly increasing land values – at the same time local contributions were artificially capped; despite a significant component of the costs within these plans being land acquisition.

So as the land values rose from government's investment in infrastructure and upzoning, the government paid more to fund the difference between the contributions cap and the total amount.

Rather than paying twice for infrastructure it would seem more sensible for the government to actually extract a return on the community's behalf through a value capture mechanism for the value it is creating (see here). It is not difficult to imagine the artificial capping of SIC rates as recommended by the PC Review creating a similar scenario.

Value capture underpins strategic planning by lowering the economic payoffs from planning decisions

The PC Review states that value capture in VPAs can create outcomes that are inconsistent with the "broader strategic land use plan for an area…[which] can undermine community confidence in the integrity of the planning system and leave developers facing uncertain negotiations with councils".

This argument assumes that developers didn't exceed existing controls before value capture VPAs were introduced; and secondly, it doesn't understand that a properly functioning value capture system reduces the incentive for developers to capture the system.

Value capture lowers the economic payoffs to private landowners from planning decisions. It flattens speculative land price inflation. In this way, value capture actually underpins a strategic plan-led system.

By supporting strategic planning (land use and infrastructure coordination), value capture reduces the diversion of resources from identified growth areas and hence limits what economists – including the Productivity Commission – term "coordination failure".

If there is a genuine desire to reduce ad hoc proposals undermining strategic planning and give the community confidence regarding exceedances, then the PC Review should have examined the cause and not the symptoms – the cause being the discretionary nature of the NSW planning system.

Removing value capture from VPAs won't stop developers seeking exceedance to existing controls – that would continue but with no shared value for the community.

Value capture does not mean planning controls will be overcooked or undercooked

The PC Review suggests that value capture provides governments an "incentive to create economic rent" by "additional zoning restrictions or delays in land release" without a reference to the vast empirical evidence, or even looking over the fence at the ACT – which has a 75 per cent betterment levy on any development intensification and upzonings (through its Lease Variation Charge) – and their highly coordinated land use and infrastructure planning.

Value capture does not suppress development potential. Councils are required to accommodate dwelling and employment targets set by the NSW government.

The review and updating of planning controls is done regularly by local government through the preparation of comprehensive, multi-disciplinary studies to ensure dwelling and employment targets can be met. The community is involved throughout the preparation of these changes and is comfortable with the certainty that the LEP provides.

Industry is welcome to provide evidence to support an exceedance but should not be the sole beneficiary of any uplift in value on the site as it sits beyond what was previously accepted by the community.

As mentioned above, the receipt of value capture contributions, if the mechanism sat outside VPAs, could be centralised with Treasury. This would put to bed any perception that the creation of value is linked to either the rezoning or approval process.

A way forward

Lastly, the PC Review makes an argument that a betterment levy failed in the past in Sydney because powerful landowners applied political pressure.

Certainly it has been said that policy capture is the only form of capture that has prevailed in Sydney planning history.

A former NSW planning minister suggested that some lobbyists “generalise the private ambitions of their small band of members to give the appearance of a broader philosophical and whole-of-industry view. In reality, it is a small band of speculators trying to hustle the government into making policy decisions that suited them”.

A standard percentage rate per dollar of betterment (value uplift), which would vary by location, could apply across the state. This approach automatically adjusts to local market conditions and ensures that the levy or development licence fee does not reduce the feasibility of a site for development.

It also means that SICs (or other) quasi value capture contributions could be abolished, meaning that developers would not encounter unanticipated contributions that render their approved development infeasible, especially in marginal cases where value gains from redevelopment are low.

Developers would never overpay for a site and indeed, the more a developer (or the government) overpays the greater funds that are raised for infrastructure contributions.

The PC Review dismisses a betterment levy or development licence fee because it claims it would be difficult to calculate or implement (how to measure the value uplift) despite the ACT doing it with success for 50 years.

As in many parts of the ACT, betterment levies can be pre-calculated based on typical betterment values in different local precincts where redevelopment is desired in the planning scheme.

The Valuer General’s property valuations provide the starting point for the calculation of this variable rate. An easily accessible schedule of rates a square metre applying to floorspace associated with new development rights would be available.

Such an approach would further reduce uncertainty in areas where development is desired in the planning scheme and reduce the number of times individual assessments of betterment are required.

Confidence in the planning system and its focus on the public interest is at the core of upfront, evidence-based planning.

If the PC Review doesn’t see a role for a betterment levy – either in VPAs or revamped SIC– then a value capture policy relating to changes in zoning and development standards should be implemented statewide, outside of and additive to the local infrastructure development contributions system, and constituted as a development licence fee.

Like the ACT system, the funds could be collected by Treasury and recycled back to the areas in question.

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