Professor T. **Parry**
Independent Pricing and Regulatory Tribunal
P.O. Box Q 290
QVB Post Office
NSW 1230

December 4, 2003

Dear Professor Parry,

On behalf of a group of Pittwater residents, whose names and addresses are in the attached appendix, and who hold a "Domestic Waterfront Tenancy", we wish to make a preliminary submission to the Tribunal on the above subject. In discussions between our advisors and your officers, it was agreed that a more detailed economic based supplementary submission would be made shortly.
In making this preliminary submission, however, it is necessary to begin with a review of the rather dry legal nature of waterfront tenancies, and thus how the IPART review must take this into account in carrying out its task.

We then wish to address the following terms of reference of the Tribunal:

- The proposed formula
- Aligning rental returns to reflect and maintain their market value
- Ensuring that rents cover, at a minimum, administration costs
- Equity and owner's ability to pay etc.

In addition, we will then address a review into this subject carried out by Waterways in 1991, and as a result, suggest a possible alternative approach to achieve an equitable result that will also satisfy the authorities' needs **as** well **as** address residents' concerns.

WATERFRONT TENANCIES

While waterfront tenancies have a common legal basis, they can vary according to the circumstances of each case and the terms of each legal instrument granting certain rights or entitlements.

The description, 'waterfront tenancies', is not a legal term but a term of art referring to a range of legal arrangements under the ***Crown Lands Act 1989***. The Issues Paper (Discussion paper DP71 of October 2003) contains terms that may be misleading and tend to create predetermined impressions about the nature of waterfront tenancies. These impressions could cause bias in the process of the review with the potential for findings and conclusions that may contravene administrative law principles or have potential impact on the deliberations of the ultimate decision maker.

The Review needs to ensure that the legal basis for waterfront tenancies is fully comprehended and that the potential for bias or the **taking** into account of irrelevant considerations, are avoided. Also, the Review needs to take into account all relevant considerations in relation to waterfront tenancies. This includes viewing all relevant files and

documents held by Government and relevant legislation in addition to submissions and other evidence.

The nature of waterfront tenancies is not simple. However, the basis for establishing a proper rent review process will require careful examination and assessment of all materials to determine a fair and equitable system to comply with the requirements for market value rentals under the ***Crown Lands Act 1989.*** The elements for market value requirements under the Crown Lands Act need to be formulated for purposes of the Act. These elements are not necessarily the same as those applying to lands under the ***Real Property Act 1900*** even though Crown lands may be brought under this Act in accordance with section **13D.** This provision applies to Crown lands and lands acquired from the Crown.

Crown Lands Act management principles

The principles of Crown land management are expressed in section 11 of the ***Crown Lands Act 1989:***

- environmental protection principles be observed in relation to the management and administration of Crown land
- natural resources **of** Crown land (including water, soil, flora, fauna and scenic quality) be conserved wherever possible
- public use and enjoyment of appropriate Crown land be encouraged
- multiple use **of** Crown land be encouraged where appropriate
- Crown land should be used and managed in such a way that both the land and its resources are sustained in perpetuity where appropriate
- Crown land be occupied, used, sold, leased, licensed or otherwise dealt with in the best interests of the State consistent with these principles.

These principles need to guide the Review to ensure the most appropriate formula is devised to deliver fair and equitable rents for waterfront tenancies, recognising the burdens contained in permissive occupancies, term leases and licences.

Scope of the review

The terms of reference for the review of rentals for domestic waterfront tenancies in New South Wales are fundamentally flawed. The description, "waterfront tenancies", misdescribes the technical, legal definition of these tenancies. As a consequence of this misdescription, ascribing a market value to waterfront tenancies is easily confused with the concept of market value for freehold title adjoining these tenancies. The term should only be used as a short-hand description of the legal definition.

Legal nature of waterfront tenancies

Waterfront lands are separate from adjoining freehold title lands. Waterfront lands are owned by the State Government in right of the Crown and they are administered under the ***Crown Lands Act 1989.*** Crown lands cannot "be occupied, used, sold, leased, licensed, dedicated or reserved or otherwise dealt with unless the occupation, use, sale, lease, licence, reservation or

dedication or other dealing is authorised by this Act or the ***Crown Lands (Continued Tenures) Act 1989.*** ***(Crown Lands Act 1989, s 6)*** In relation to waterfront tenancies, the Crown Lands Act deals with permissive occupancies provided under former provisions ***of*** the Act, leases and licences. In each case, a legal instrument has been entered into between the Government and persons who have taken up the permissive occupancy, term lease or licence.

The terms of permissive occupancies have been saved under the Crown Lands Act. According to section ***5,*** a tenure that is in force under a repealed Act immediately before its repeal remains in force subject to the provisions of the Crown Lands Act. Also, the terms of a permissive occupancy continue up to the end of the term of the period granted. Rents, royalties, security deposits and any other monies payable in respect of a permissive occupancy continue to be payable under the ***Crown Lands (Continued Tenures) Act 1989*** (Schedule ***2*** Part ***6).***

Similar provisions apply in relation to term leases granted under the Crown Lands (Continued Tenures) Act ***(Crown Lands (Continued Tenures) Act 1989,*** Sch 2 Pt 3). However, the ***Crown Lands Act 1989*** expresses that a lease comprising a disposition of Crown land by the Minister on behalf **of** the Crown, "is a lease even if exclusive possession of the land is not conferred on any person" (section 42).

While all relevant provisions of the ***Crown Lands Consolidation Act 1913*** may have been saved under the ***Crown Lands (Continued Tenures) Act 1989,*** it may be necessary to view the former Act to understand the administrative arrangements for permissive occupancies and term leases. **The** savings provisions **of** the ***Crown Lands (Continued Tenures) Act 1989*** continue the administrative arrangements in force at the time it was enacted.

Licences in respect of waterfront tenancies are issued under the ***Crown Lands Act 1989,*** Division ***4.*** According to section 45, a "licence may authorise the use or occupation of Crown land for such purposes as the Minister thinks fit."

Waterfront lands rentals

The determination of a suitable approach for setting waterfront tenancies' rentals needs to establish a workable formula that recognises the legal standing of the parties under permissive occupancies, term leases and licences. Over time, existing permissive occupancies and term leases may be replaced by licences under the ***Crown Lands Act 1989,*** If this situation occurs, the basis for an appropriate formula needs to recognise this potential development and the differences between each type of legal instrument.

The alignment of rental returns to market value requires the determination of "market value'' for waterfront tenancies. The Review needs to define the market to establish values applicable to the market identified in accordance with the ***Crown Lands Act 1989.*** The Crown lands management principles should govern the elements for determining market value applying to Crown lands. In particular, the principles of encouraging multiple uses of Crown land and the encouragement of public use and enjoyment of Crown land need to be taken into account in addition to Crown land being occupied, used, sold, leased, licensed or otherwise dealt with in the best interests **of** the State.

It may be found that there is more than one market value for the land depending on its value for the various uses established under the management principles. This needs to be examined carefully in terms of the Crown lands management principles.

Environmental considerations

The Crown lands management principles require the observance of environmental protection principles and the conservation of natural resources including water, soil, flora, fauna and scenic quality. These environmental considerations are managed under waterfront tenancies by persons having permissive occupancies, term leases and licences. The maintenance of waterfront tenancies is a burden that is accepted as part of the permissive tenancy, term lease and licence. Beneficiaries of environmental activity are the public of New South Wales and not merely limited to certain individuals. Any improvements made to the land such as jetties, pontoons or other constructions, are required to be removed at the expiration of the term.

Management of the local environment to preserve waterfront conservation values present major savings for Government. These should be estimated by the Review and recognition **of** these costs allocated in favour of persons with permissive occupancies, term leases and licences in assessing their rental values. Also, the costs of removing improvements and restoring the land need to be taken into account in calculating costs.

TERMS OF REFERENCE

The proposed formula for rental returns

The proposed formula is as follows:

Rent (per sq metre) = 50% x SLV(per sq metre) **x 6%** per annum

Section **6A** of the Valuation of Land Act 191*6* (as amended) provides that **land below the high-water mark held under licence (or lease) from the Crown is deemed equivalent to freehold land and is included in the valuation of the adjoining land.** A letter from the Valuer General, LPINSW confirms this and is consistent with VG valuations including details of waterfront licence/lease.

In addition to the variance above, the formula proposed by the Department of Lands and the Waterways Authority has inherent problems for assessing a fair and equitable rent for waterfront tenancies. The Valuer-General's land value needs careful consideration to avoid the inclusion of items that apply to freehold tenure. The valuation process needs to be limited to Crown lands considerations only. The formula does not clearly express this limitation. Also, the alignment of the valuation process to North Coast licensing arrangements ignores the differences that arise in other locations such as the Northern Beaches area of Sydney. The differences need to be identified to assist the Review in determining an appropriate market value for rentals in the various locations.

The arrival of the formula in the Issues Paper is limited and possibly biased. The Issues Paper does not include details **of** the advice received from the State Valuation Office and Preston Rowe Paterson. Consequently, it is impossible to provide comment on this advice. This information should be made public by the Independent Pricing and Regulatory Tribunal to provide an opportunity for value comments on the underlying premise to the formula. In the alternative, it would be unreasonable and inequitable for the Review to take into account this advice and ignore other advice that could be made available if the advice from the State Valuation Office and Preston Rowe Paterson were made available publicly.

The reason given in the Issues Paper for supporting the use of the Statutory Land Value, ignores other possible mechanisms that could present a better value to waterfront tenancies

for rental purposes. The different nature of waterfiont tenures could be ignored when a common base "is determined each year for all properties throughout NSW'. A "straight-jacket" approach can be inefficient and wrong when applying to all lands throughout New South Wales. Modern computer technologies and more detailed information about land values in New South Wales should enable better and more precise outcomes for deriving values for different lands and their uses throughout the State. An easy administrative arrangement for valuing waterfront tenancies by lumping them into one system can produce inefficiencies and inequities where the parties lose and no-one wins.

The use of the term, "precinct SLV", is misleading. Waterfront tenancies are not precincts. They are lands under the Crown Lands Act. The Act does not use this term in relation to waterfront tenancies. The use of the word, "precinct", in the Act in relation to casino buildings, has no relevance. The misuse of the term could introduce irrelevant considerations that do not apply and must not be applied in relation to waterfiont tenancies.

Sydney Harbour and the CPI

We are led to understand that, on Sydney Harbour, the lease and licence fees per sq metre charged by Waterways, and the permissive occupancy fees per sq metre charged by Lands have been unchanged for between 10 and 12 years. CPI has not been applied.
Now, it seems that Waterways and Lands propose to increase those fees by an average of *500%* in one stroke. In some cases the proposed formula results in rental increases of up to 2000%.
Is this prudent management and stewardship of public land?
What would be IPART's response to an application for 500% across the board increase in ferry fares, bus and train fares or water, power and electricity charges? What would PART say to the same providors if they had held prices and charges unchanged for a decade?
What would be the likely finding of Fair Trading or a Rental Tribunal if residential tenancy rates were unchanged for 10 years and then increased 5 fold in the 11th year? What would tenants say?

Rental returns and market value

The Issue Paper states in the last paragraph on page 3 that, quote: "The Department and the Authority indicate a six per cent rate of return is consistent with analysis of investment returns from residential properties rented throughout NSW and court decisions".
The assessment of 6% rate of return is flawed. This rate of return is based on "investment returns from residential properties rented throughout NSW and court decisions". Waterfront tenancies under the Crown Lands Act are not residential tenancies. The market values applying to residential properties are irrelevant to the market values applying to waterfront tenancies. Also, the decisions of courts in relation to rental returns are necessarily limited by the facts of the particular cases. The extrapolation of rates of return derived by lawyers in particular court cases do not necessarily reflect market rates but endeavour to provide a solution to disputes about such matters. In any event, court decisions are not indicative of rentals applying to waterfront tenancies.

It is interesting to note the comment in the Issues Paper:

> "In the case of the Waterways Authority it also recognises that the Authority generally prohibits the use of its land for residences."

Applying values linked to residential property is clearly not relevant or applicable in determining values for rentals for waterfront tenancies.

The discount rate of 50% is arbitrary and has no basis for deriving an appropriate discount rate for waterfront tenancies. No reasons are given in the Issues Paper for deriving this discount rate.

The Review needs to acknowledge and take into account the formula used in existing term leases and licences for waterfront tenancies. This formula may be consistent for all term leases and licences but this is not certain. The formula governs existing arrangements for the rentals in relation to waterfront tenancies. If this formula is to change, the Review needs to identify and report on the costs to either amend all existing term leases and licences (and permissive occupancies) or to cancel these instruments and issue new legal instruments. This is likely to be a major cost impost on Government.

Rents to cover administration costs

This is a valid issue. In particular, I believe that it would be in the public interest for each relevant Authority to disclose it's administrative costs involved in issuing and then renewing an individual license or lease. This is additionally relevant to the fact that most licenses appear to be pro-forma documents although it is recognized that each agreement would be checked before execution.

The need for the Review to report **on** rentals covering administration costs should not be limited. The Review needs to examine administrative costs independently from the process of determining market value rentals. There is a risk that inefficiencies will be built into the system for the administration of the rental scheme. The outcome for administering the rental scheme needs to be transparent and accountable.

It may be necessary, following an examination of administrative costs, that the Review recommend a reduction of administrative costs or the reallocation of resources to effect a less costly administrative process. The administrative process and costs needs to be made more transparent in order to assess the real costs of administering the rental scheme. Staff operating the rental scheme need to be adequately skilled to avoid unnecessary training costs. *Also,* adequate resources need to be allocated by the administering Government agencies to ensure the efficient administration of the rental scheme.

In reviewing mechanisms for streamlining the administration **of** the rental scheme, the Review should examine other licensing arrangements. This could be easily effected by asking for copies of relevant licences under other legislation from the administering agencies. This approach would give the Review a wider base to assess the legal arrangements administered by the two agencies, Department of Lands and Waterways Authority. The legal arrangements administered by these agencies have evolved according to the legal bases and practices applying to these instruments. The experience of licensing regimes under other legislation would provide **an** opportunity to assess the existing regime for waterfront tenancies against other regulatory regimes.

By examining other licensing arrangements the Review would better understand the possible implications and/or ramifications that the imposition of a specific formula in one area could have in other areas covered by the Crown Lands Act.

The issues of equity need to be carefully considered and not be limited to landowners **who** have only water-based access. In some cases, landowners have more than one waterfront tenancy at the one location as a result of sequential agreements. Arrangements should be made to review **these cases** to alleviate unnecessary costs to landowners by reducing the number of waterfront tenancies at a single location.

Equity

Licensed or leased waterfront areas comprise both active and passive use components. Active use components are the purpose for the facility, and passive use components are those that are required to be able to utilise the active use components. They can be separated thus:

- Active use components
  - Vacant space: Berthing areas
  - Structures: Pontoons, Slipways etc
- Passive use components
  - Reclaimed Land on which no structures are permitted
  - Jetties required to get to the active component

Active use components

The formula proposed in the Issue paper is inequitable. It does not relate common components with regard to individual properties. Nor does it in any way relate rental valuations to facilities used by one property compared with another on the basis of facilities used, that is, "active use components". The real value that has relevance is the "boating usage" value of the recreational facility at a given property, not the area of land involved.

Passive use components

Neither the current rating method, nor the proposed rating method, take into account areas not required **by** the property owner, but included in the leased area. For example, foreshore land used by Sydney Water for burying sewerage mains and which is designated as reclaimed land for which the property owner has to pay a license fee.

Such land is being "assigned to" the property owner, and he is being charged for access to the land for which, as a member of the public, he already has rights to. The adjacent property owner gets no extra rights over such land. But the formula will charge him for it at rental rates for land that is zoned for residential use.

This is not equitable now, and would be up to five times, or more, worse under the proposed formula.

Statutory Land Values, by virtue of actual sale figures, already take into account the availability for (but not the quality **of)** the potential or actual waterfront usage. These SLV's are used to calculate State Government Stamp Duties that are levied whenever the property changes ownership. To now suggest that rental rates for the use of waterfront facilities will be based on an SLV that has **already** taken into account the value of the use of such facilities, is to suggest an inequity of gross proportions equating to no less than **taxation on taxation.**

There is, again, no equity in suggesting (in the formula) that the discounted return of three per cent is relevant to the **sale** of remnant land parcels etc. This is an attempt to relate sale results of **useful** land to rental rates of a recreational facility. A very important issue that is ignored in this comparison is that of exclusivity of use. Waterfront facility licenses do **not** grant the holder the exclusivity of use that is obtained by the purchase of a remnant land parcel.

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There are other issues that have not been addressed by the Issue Paper that have relevance to the issue of rental rates.

- **Cost of structures**
  The cost of the structures which enable the waterfront to be used are borne by the license holder, whether it is the original holder or a new purchaser who pays for the costs in the purchase price of the adjoining property as well as to the Government in the form of the extra Stamp Duty. The reviewed SLV indirectly takes the value of the use **of** these structures as properties change ownership. To then suggest that the holder pays rent to use his own structures is again inequitable.

  In addition, to take into account any appreciation in capital value to the owner, the State Government receives an increased Stamp Duty at each successive sale of the adjoining property. This already guarantees the Government a monetary return based on the increase of the perceived land valuation of the waterfront recreational facilities.

- **No new Buildings allowed**
  No buildings are permitted on the leased areas. This is a very different situation to land that is owned by the license holder.

- **Lack of exclusive use**
  A major condition of the license is that public access over the leased *area* below the Mean High Water Mark (this is the whole area of the lease) must not be restricted. The license holder does not have exclusive use of the leased area.

- **No Tenure and No Market**
  The Terms of Reference to IPART (4. Scope of the review, para 1, first point) tasks the Tribunal to consider ***"aligning rental returns to reflect and maintain their market value."***
  The current Waterways Lease* provides
  Clause 11 says that the **lessee shall not assign, transfer, sub-let, mortgage or share possession** With any person (there is not even an exemption in this clause for the lessor to give prior consent on sale of adjoining freehold)
  Clause **9** says that **before the end of the lease** term or any ensuing tenancy, the **lessee shall without notice from Waterways remove the lease structures at its own cost and without compensation**
  The combined affect of these clauses and the maximum term being **3** years, **is** that there is no tenure and no transferability. There is no market.
  How can there be a market if the lease cannot be traded, is **3** years and a typical jetty structure which cost $60,000 must be removed before lease-end?
  *standard wetland Deed of Lease issued by Michell Sillar solicitors for Waterways in 2003.

- **Self funded retirees**
  While mention is made **of** pensioners who hold tenancies, self funded retirees are in the same financial situation but Without the benefit of a pension.

- **GST**
  There is no GST applied to residential property rental. Equally, GST should not apply to domestic waterfront tenancies.

WATERWAYS 1991 APPROACH

We would like to draw to your attention the outcomes of a very similar review of waterfront rentals undertaken by the Waterways Authority ("Waterways") during November and December 1991. This review is not referred to in the IPART paper. The outcomes from the 1991 review are illustrative of issues which still pertain today to wetland rentals for residential use around NSW, whether from Department of Lands or from Waterways, and whether under lease, licence or permissive occupancy.
The same lease/licence structure with a maximum of 3 year term and conditions which give no right to transferability and which provide that structures be removed before end of lease or licence without compensation, still appear in Lands and Waterways documentation in **2003,** as they did in 1991.
The 1991 findings were not anticipated when the review was undertaken. We suggest the same **findings might** be identical, if not similar in 2003. They have been obtained from the then Managing Director of Waterways (Mr. Michael Chapman) who is prepared to verify the following by sworn statement or direct evidence to the Tribunal, if called upon.
Quote:

In 1991 Minister for Transport directed the Waterways Managing Director, Michael Chapman, to implement a rental pricing ***policy*** *for Sydney Harbour wetland which* ***recognized the increase in value that waterfront structures added to the appurtenant freehold.*** *This is similar to the terms of reference before IPART and the claimed linkage between freehold value and leasehold value.*
The 1991 review consisted of a mail-out to all customers, an invitation to comment and public meetings. ***The review resulted in the policy being dropped.*** *The findings were:*

(a) ***There is no causal linkage between freehold value and waterfront leasehold value.*** *In many cases the reverse is true – eg.. (the review found) some Rose Bay waterfront freeholds had very high values due to closeness to the CBD and direct views to the Harbour Bridge and Opera House. However these freeholds had no deepwater at the harbour frontage and therefore required long jetties which were accessible only at high tide (typical area of rented wetland required for jetty 16m x 1.5m = 24sq m), whereas similar size freehold allotments at Vaucluse, with no such views and lower freehold value per square metre, had deepwater at all tides and only needed very short jetties (3m x 1.5m = 4.5sq m of wetland rented for jetty). In summary, a Rose Bay jetty typically needed 500% more rented wetland than a jetty at Vaucluse, but the freehold value per square metre at Rose Bay was more valuable due to views and closeness to CBD.*

[Editorial note: this situation certainly exists on Pittwater, and likely exists on most Sydney waterways]

(b) Wetland leases were limited to 1 or 3 years (maximum) which is insufficient to amortise the cost of a $50,000 jetty with an average life of 50 years

*(c) **There is no "market" rent because the tenant was prohibited from sub-letting the facility to third parties and from transferring the lease on sale of freehold; the lease provided that all improvements must be removed prior to lease-end without compensation***

(d) The proposal is "moving the goal posts" --- changing the rules without a phase-in, and changing the reasonable expectations of property purchasers

*Mr Chapman was then directed to not proceed with the initial proposed policy **but to apply a rate per square metre of wetland based on the value of wetland, bay by bay (as opposed to the value of appurtenant freehold).** The rate was to be adjusted annually by CPI and a factor was to be applied according to the type of activity or development. Those activities included reclamation, swimming pool, boatshed, slipway, jetty and wetberth. The highest rental factor was for reclamation.*

In the same period, Waterways were negotiating and setting the wetland lease rates for the new Pulpit Point Marina residential complex at Hunters Hill involving around 100 berths and jetty facilities. There was no base value for the freehold as it was formerly an industrial site, an oil terminal. A valuer was briefed by Waterways to assess the wetland rate without regard to the adjoining freehold values. The valuer took into account issues such as the investment by the owner/developer, anticipated life of structures, length of lease, prohibition on use by non-residents and non-marketability of structures. This very detailed and comprehensive valuation was then used as the benchmark for residential wetland rates in Sydney Harbour, Middle Harbour and the Lane Cove and Parramatta rivers and Iron Cove.

Since 1993 Waterways has frozen these rates and has not adjusted or even applied CPI to them. I believe there are 8 different rates used by that are in turn modified by the amenity of the particular geographical location.

End of Quote

SUMMARY

The **199**1 based Waterways rental system on Sydney Harbour needs to be examined by this Review before any final formula is determined.

It is our contention in this preliminary submission that the SLV is not an appropriate mechanism for the determination of rental rates for Crown Land wetland.

Within this preliminary submission we have raised a number of issues and questioned the **scope** of the Review, all of which need to be addressed.

We will expand our propositions and make recommendations on an economics based formula that would achieve the desired outcome **of** the Review in our supplementary submission.

On behalf of the Pittwater waterfront residents named in the appendix,(appendix withheld).
Yours faithfully,

David Hall-Johnston