Independent Pricing and Regulatory Tribunal

IPART
New South Wales

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Ms Carolyn McNally
Secretary
Department of Planning and Environment
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Dear Ms McNally

SUBMISSION TO THE DRAFT VOLUNTARY PLANNING AGREEMENT POLICY

Thank you for the opportunity to make a submission into the Government's proposed changes to the Practice Note concerning Voluntary Planning Agreements (VPAs).

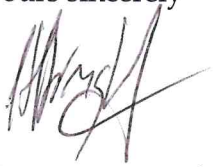
We understand that the Practice Note is useful to guide the VPA negotiation process, protect the integrity of the planning system, and facilitate more effective and timely planning outcomes for the community. With these objectives in mind, our submission:

- Recommends introducing a guide for the starting point of negotiations between councils and developers, whereby councils capture 50% of the uplift in land value from a rezoning decision to fund community benefits. This would provide a price signal to stakeholders and support investment and innovation, subject to feasibility and negotiation between councils and developers in the context of the development.
- Supports the involvement of third parties in an advisory or dispute resolution capacity, and notes that IPART would be well placed to provide this advice.

Further guidance as to the reasonable middle ground regarding the extent of benefits included in VPAs would help resolve an underlying tension in the Practice Note between councils not seeking windfall gains but being able to pursue a developer's profit to the point of development feasibility. In addition, our submission supports the new emphasis on strategic infrastructure planning. We note that VPAs should provide for mutually beneficial outcomes between parties, where possible.

Our submission, endorsed by the Tribunal, is attached. If you wish to discuss our comments further, please contact Lucy Garnier, Executive Director on the details above. We look forward to continuing to work with the Department on matters concerning VPAs and contributions plans.

Yours sincerely



Hugo Harmstorf
Chief Executive Officer

ATTACHMENT A - IPART SUBMISSION TO THE DRAFT VOLUNTARY PLANNING AGREEMENT POLICY

IPART is well placed to comment on the changes to the policy concerning VPAs. We have a number of roles in the regulation of local government in New South Wales:

- We set the rate peg to establish the maximum amount NSW councils can collect in general revenue and assess applications for special variations from councils.
- We review section 94 contributions plans for the NSW Government if development contributions are above the relevant cap, and the council is seeking gap funding from a special variation or through the Local Infrastructure Growth Scheme.
- We review a range of other matters and, since 2014, we have reviewed local infrastructure benchmark costs, local government regulation, whether councils are 'fit for the future' and most recently, in 2016, the rating system for NSW.

With regard to VPA policy, we have liaised with your Department and mining-related stakeholders about a proposed third-party role for IPART to assess VPAs concerning mining proposals. We would support such a role for IPART.

We are also currently conducting a review of social and affordable housing rent models in NSW, noting that in the current framework, VPAs can be used as a mechanism by councils to achieve affordable housing objectives.

Strategic infrastructure planning and public consultation

We support the emphasis in the Draft Practice Note on strategic infrastructure planning and improved public consultation relating to proposed VPAs.

In general, policy objectives of the planning authority can be achieved more effectively when implemented at the strategic planning level. Key examples are when there is inclusionary zoning and a certain proportion of affordable housing is required in each development; or when affordable housing bonus schemes are clearly articulated in planning instruments or controls, rather than relying solely on negotiations or ad hoc bonus schemes to achieve these objectives.

Ideally, strategic planning should identify the planning outcomes and priority infrastructure needs for the community and then councils can seek to negotiate VPAs with benefits aligned to these outcomes and needs. Stakeholders to the NSW Planning System Review in 2011 raised concerns about the lack of relevance of the benefits in VPAs to the community, and this approach would assist in addressing this issue.

Ensuring that explanatory notes to VPA are in plain English should assist the community in understanding the benefits in agreements.

Focus on increased transparency and probity

We recognise the need for transparency and probity in the VPA framework. Councils should be encouraged to adopt clear governance and probity procedures relating to the assessment of VPAs, including the merit assessment of any proposed public benefit. We note that the new framework advocates the existing framework's principles that planning decisions should not be "bought and sold" and that planning authorities should be able to freely exercise their responsibilities. The framework continues to guide a planning authority to publish its policies and procedures concerning the use of planning agreements, and make transparent to the developer how and when public benefits, as per the agreement, will be spent.

A new aspect of the Draft Practice Note is that councils should have access to an open book assessment to determine the development's profit and feasibility, if capacity to pay is identified as a concern by the developer. We acknowledge that this level of disclosure would enhance the transparency of negotiations, and might be necessary in some cases. However, the suggestion that a council is entitled to the developer's profit up to the point of the development's feasibility presents a fundamental tension in the policy framework with the principle that agreements should not be used explicitly by a council to capture windfall gain. This is discussed further below. We are particularly concerned about the different expectations that this might create in the process between developers and councils, in the absence of guidance about reasonable middle ground concerning the extent of benefits that should be included in an agreement.

Value capture – pursuing benefits to the point of development feasibility

Consistent with the existing framework, the Draft Practice Note states that the provision of planning benefits for the wider community through planning agreements involves capturing part of a development's profit.[1] This is commonly termed 'value capture' and, in practice, involves the developer providing:

- external public benefits (services and infrastructure) that meets the needs or additional demand arising from the development, thereby satisfying the nexus principle, and
- other benefits not "wholly unrelated to development"[2], which might include affordable housing for example, and which do not need to satisfy the nexus principle.

A share of the uplift from an increase in land value resulting from the rezoning of land can be used to fund the other benefits, up to the point that the development is still feasible.

A number of councils have specific value capture policies to establish how much of the uplift they can capture in a rezoning process, usually half of the uplift value, eg:

- The former Leichhardt Council had a VPA Policy whereby the council would seek 50% of the uplift value based on a rezoning of land.[3]

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1 Draft Practice Note 2016, p 14.
2 Draft Practice Note 2016, p 9.

- Parramatta City Council has included in its CBD Master Plan a policy of value uplift sharing whereby additional new FSR (floor space ratio) is to be 'purchased' by landowners based on 50 percent of the value of the uplift.[4]

One of the main features of the proposed Draft Practice Note is that it suggests that the council is entitled to value capture the profit to the point of development feasibility, supported by an open book assessment, if necessary.[5]

However, the Draft Practice Note states that the benefit is not supposed to be a tax on development, as does the existing Practice Note.[6] It now also explains that the council should not use VPAs to capture windfall gain as a result of planning decisions.

We consider that this new focus on encouraging the pursuit of net benefits to the point of development feasibility, on the one hand, and disallowing windfall gain, on the other, serves to exacerbate an underlying tension in the policy framework. Developers would not proceed with a development unless it is feasible. Where the net benefit to the community provided for by an agreement exceeds the need for additional services or infrastructure arising from the development, this does constitute a tax on development. And where these net benefits are expected to the point of development feasibility, this tax is maximised.

We acknowledge that the council must separately assess the proposal on its planning merits, and that the benefits must still be related to the development, at least to some extent. The decision to enter into a VPA is also a voluntary process for both parties. However, in our view, the policy, as proposed, could create an expectation by councils that they can pursue all profit up to the point of development feasibility because:

- It states that the method of apportioning infrastructure costs should ensure "the developer an entitlement to profit that enables the development to proceed",[7] which suggests that the council could pursue benefits up to this point.
- The test that benefits must be "not wholly unrelated to the development"[8] could apply to most services and infrastructure that a council provides in an LGA, once again placing no real limit on the extent of value capture that can be pursued.
- The increased focus on public participation, although supported, is likely to place increased pressure on councils to secure more public benefits for the community through the agreement.

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3 Leichardt Council, *Voluntary Planning Agreements Policy*, August 2015, p 15

4 This policy is consistent with the Draft Practice Note, assuming the development proposal otherwise complies with the planning controls or clause 4.6 of the standard LEP allowing for variations from the planning controls where there is an improved planning outcome. Parramatta City Council, *Parramatta CBD Planning Strategy*, April 2015, p 18.

5 Draft Practice Note 2016, p 14.

6 Draft Practice Note 2016, p 14.

7 Draft Practice Note 2016, p 14.

8 Draft Practice Note 2016, p 14.

One of the main benefits of a VPA is that it can expedite the planning process. Therefore, even though the framework precludes the planning decision from being influenced directly by the prospect of a VPA, the profitability of the project might be affected by the timing of the provision of enabling infrastructure, which can be controlled, to large extent, by the council as the planning authority.

Value capture – the impact on investment and innovation in development

Development entails a certain amount of risk by the developer, including in relation to rezoning and uplift of land. The rezoning process can result in winners and losers and while a developer might benefit from a rezoning of land in one instance, in another, they might lose through reduced land value or development potential. Where there are multiple proposals, the council is entitled to choose the one that provides the best return for council. The developers are not compensated when they have incurred the cost of acquiring the land in anticipation of development but the council does not 'up-zone' the site.

Open book assessment of development feasibility could incentivise councils to capture the portion of the development profit so that the proposal just meets the hurdle rate to continue. Therefore, the share of the profit due to the risk of the developer would be also captured by the council. This could create inefficiencies, in that it would not reflect an equitable sharing of the risk, which is almost entirely incurred by the developer. It also could discourage innovation. Taxes are most efficient when they do not distort decision making but in this case, it could reduce incentives for developers to pursue innovative or riskier projects since the returns would be the same. It might also lead to developers deciding to hold on to redevelopment sites instead of undertaking development, which could also result in a less optimal outcome where the project was otherwise beneficial to the community.

We recommend a focus on mutual benefit

To address these concerns, we recommend the Practice Note should encourage the pursuit of mutually beneficial outcomes and provide clearer guidance about a reasonable extent of value capture by councils. First, nexus should be addressed and the agreement should ensure that the developer mitigates or offsets any negative impacts from the development. Secondly, the agreement should ensure that the developer provides benefits to meet the additional demand arising from the development. This is often more practical to cost in a greenfield site, but could still be estimated, based on the apportionment of costs for new infrastructure, upgrades or maintenance of infrastructure (until a revenue stream is established), in an infill development setting. Beyond these benefits, the focus should be twofold:

1. Any other benefit "not wholly unrelated to the development"[9] is legitimate if:

9 Draft Practice Note 2016, p 14.

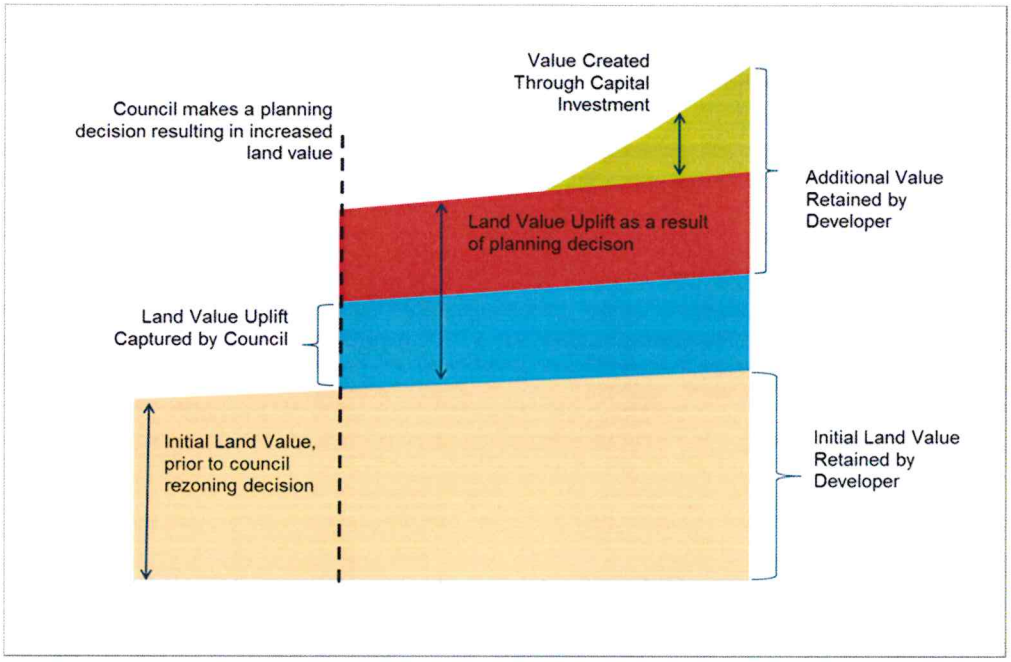
a) The provision for the benefit is made at the strategic planning level (and so contained in a planning instrument or control, or published council policy, such as a policy on affordable housing) or

b) If it is agreed by the two parties. In this case, it is likely to have more chance of agreement if it is mutually beneficial. An example is when a developer might seek to provide a higher standard of service of infrastructure provision because of the upmarket nature of its development, or when a mining company is seeking to gain the support of the community for its mining proposal through various additional community facility benefits.

2. As a guide, it would be reasonable for value capture policies by councils to capture a 50% share of the land value uplift. This is illustrated in Figure 1.

- The 50% share would provide a possible starting point for negotiations, still allowing flexibility for developers and councils to negotiate different outcomes, depending on the context of the development.
- The share of the land value uplift captured by the council should exclude any benefits provided by the developer to address the impact of the development on service and infrastructure needs (which satisfy the nexus principle). Therefore, it would help to ensure that the additional capture of profit delivers broader benefits to the community.
- This approach, which reflects some councils' existing policies, would allow the council to capture a portion of the value for the general benefit of the community – explicitly as a tax on development – but allow the developer to gain an equal share of the uplift. This would better compensate developers for their risk.
- These policies should form part of the council's strategic infrastructure planning, thereby providing a clearer signal of the tax to developers.
- In circumstances where this share of the uplift compromises the development's feasibility, a lower share should be considered, supported by an open book assessment if necessary. This would ensure the development can still proceed when the proposal would otherwise be accepted in the planning assessment process.
- The Practice Note should provide guidance about how the value of the uplift would be measured. The uplift could be measured based on the value of the land immediately prior to the council decision, and the value of the land immediately after. Land values may include a speculative component, whereby a site's value increases when there is anticipation of a potential zoning. This could also be included in calculating the uplift as a result of the planning decision, which might result in the uplift being greater than the difference between the land value and what the developer actually paid for the site.

Figure 1 Proposed approach – 50/50 split of land value uplift



Data source: IPART

Involvement of independent third parties

We support the focus in the Draft Practice Note on the involvement of independent third parties in a variety of situations involving planning agreements, in a peer review, advisory or dispute resolution capacity. Third party assistance could expedite negotiations, prevent disputes and facilitate a more efficient planning process. In practical terms, a third party could:

- assess the validity of the relationship between the proposed benefits and a development proposal,
- consider qualitative costs and benefits such as the direct and attributable impact on a neighbouring property, in addition to quantitative costs and benefits such as the nature of the uplift, and
- assess the reasonableness of the assumptions underpinning development feasibility related to the costs, benefits and rate of return.

Under the proposed changes to the Practice Note and the underlying tensions noted above, we consider that the need for third party advice or dispute resolution could be high. A refocus in the policy towards mutually beneficial outcomes and more explicit guidance on land value capture policy could help to both reduce the incidence of disputes and aid an effective resolution or review process when required. IPART, as an, independent assessor, would find this type of clarity in the policy useful should we be asked to determine the reasonableness of benefits included in mining-related or other agreements.