

# **NSW Planning System Review**

## **IPART Submission on the Green Paper**

**Submission**  
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## Executive Summary

### Background

- ▼ IPART welcomes the opportunity to respond to the NSW Government's planning system Green Paper. The Green Paper is proposing broad ranging changes to the way that planning occurs in NSW. The Government intends to release a White Paper containing draft legislation in November 2012 and proposes to enact a new Planning Act in early 2013.
- ▼ We note that this is an ambitious timetable and we expect that there will need to be a staged approach – with an initial broad legislative framework and aspects of policy refined over time. It will be important that there are mechanisms in place to maintain stability and certainty while the program of change is being implemented.
- ▼ Our response to the Green Paper focuses on the Government's proposed reforms for the provision of infrastructure as these relate most closely to IPART's functions. In particular, we provide commentary on Change 16 'Contestable Infrastructure Provision' and Change 18 'Fairer, simplified and more affordable system for infrastructure contributions'.
- ▼ In February 2012, we provided comments on the Issues Paper on the NSW Planning System Review, which preceded the Green Paper. A copy is available on our website.

### Issues

The responsibilities for providing infrastructure servicing new developments in NSW are complex and currently involve the State Government, local government, state government organisations eg, water authorities, private sector developers, and suppliers of infrastructure.

There are many influences on land supply.

The Green Paper acknowledges that high and inefficient infrastructure costs have contributed to delays in the supply of housing. We agree with the Green Paper's assessment. Infrastructure charges have recently increased and are high in parts of Western Sydney.

Recent policy changes such as the hard cap on development contributions may have slowed down housing development by making councils uncertain about how they can fund infrastructure.

Development contributions should be based on the principles of beneficiary pays, cost reflectivity, transparency and simplicity.

Consistent application of these principles will ensure that development takes place over time where it is of greatest benefit to the community. Application of these principles may lead to high development contributions in high cost areas such as the north west of Sydney. The government may have to modify application of the principles if it wishes development to occur in the high cost areas in the short term.

The Green Paper proposes funding options to address these issues. A limited amount of local infrastructure would be funded through development contributions and the rest through a regional open space fund. Most items of regional infrastructure would be funded through Growth Infrastructure Plans. However, not much detail is provided about these plans or how they will be funded.

IPART suggests the following directions for reform, which encourage development in the most cost effective locations, while sharing costs more broadly where there are wider benefits from infrastructure and development:

- ▼ Providing price signals to developers about the cost of infrastructure to encourage efficient development and providing greater certainty to councils by:
  - replacing the existing hard caps on local development contributions by soft caps that trigger a review of infrastructure costs
  - introducing simple Sydney Water and Hunter Water developer charges limited to recovering the direct costs of connecting to the network.
- ▼ Limiting the amount of infrastructure that can be funded through development contributions:
  - maintaining an essential works list (or similar)
  - maintaining review of plans by IPART to ensure independence and transparency.
- ▼ Removing the Special Infrastructure Contribution (SIC), with the State Government directly funding core state government responsibilities.
- ▼ Sharing the costs of some infrastructure for new developments across a region where the benefits are not limited to the local area.
- ▼ Sharing the costs of some infrastructure between existing and new developments where the benefits are widely distributed.
- ▼ Considering a contribution towards the cost of infrastructure in greenfield areas funded through a levy on councils in metropolitan Sydney. This is particularly important if planning policy restricts or prohibits infill development in established urban areas, thereby requiring development to take place in greenfield areas.
- ▼ Considering other financial factors that affect land supply, such as stamp duty and other taxes.

- ▼ Ensuring accountability of development contributions through transparent reporting of councils' section 94 expenditure and revenues.
- ▼ The Green Paper notes that contestability in infrastructure development is important to planning reform. We support the adoption of contestability for the provision of infrastructure and have identified some of the core elements of an effective contestability framework. These include:
  - improved clarity about the assignment of responsibilities for decision-making
  - enforceable frameworks for consumer protection and for the negotiation of third party access
  - reform of current funding arrangements.

We would welcome the opportunity to develop these further. We are well placed to assist with the development of a framework for contestability (Change 16) and providing input on the infrastructure contributions system (Change 18).

## 1 Introduction

### 1.1 NSW Planning System Review

In July 2011, the Minister for Planning and Infrastructure announced a full review of the planning system in New South Wales (the planning review). The Minister appointed Tim Moore and Ron Dyer as Joint Chairs of the NSW Planning System Review Panel. The planning review focuses on rewriting the State's main planning law, the *Environmental Planning and Assessment Act 1979* (EP&A Act).

The Review Panel released an Issues Paper entitled *The way ahead for planning in NSW?* for public comment on 6 December 2011. IPART provided a response to the Issues Paper in February 2012.

A report by the Joint Chairs of the NSW Planning System Review Panel, (hereafter the Moore and Dyer report) was released on 14 July 2012. The Moore and Dyer report contains detailed recommendations for a new planning system.

In parallel with the Moore and Dyer report, the Government also released a Green Paper—*A New Planning System for New South Wales*. The Green Paper is the Government's response to the Moore and Dyer report. The Government describes the Green Paper as the 'blueprint' for fundamental changes to the planning system. The Green Paper provides an outline of how the Government intends to deliver those changes.<sup>1</sup>

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<sup>1</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 3.

## 1.2 IPART's relevant functions

IPART is the State's independent pricing regulator for utility services. We also licence the key water and energy retail businesses, administer the Energy Savings Schemes, set local council rates and are now starting a series of reviews into reducing the burden of regulation. We are, in addition, an economic and policy think tank for the Government, similar to the Productivity Commission at the Commonwealth level.

IPART has several functions that are relevant to the planning review:

- ▼ Directly related to the planning review, we review selected local government section 94 development contributions plans on behalf of the Minister for Planning and Infrastructure.
- ▼ Indirectly related to the planning review, we:
  - have a role in setting local government rate revenue by determining the local government rate peg (ie, the maximum allowable increase in councils' general income) and council applications for special rate variations (both under delegation from the Minister for Local Government)
  - set the maximum prices that specified utilities can charge for their water and wastewater services
  - set the methodology used to calculate the contributions payable by developers to Sydney Water, Hunter Water, Gosford City Council and Wyong Shire Council for the provision of new water, wastewater, stormwater and recycled water infrastructure (though, in December 2008, the Government decided to set some, but not all, of these charges to zero)
  - make recommendations to the Minister for Finance and Services about the licensing of private sector water infrastructure providers under the *Water Industry Competition Act 2006* (WICA) and monitor the compliance of licensees
  - have recently been asked by the Government to examine key areas of regulation, or sectors subject to regulation, including local government compliance and enforcement activity.

Given our experience, we consider that we are well placed to comment on aspects of the Green Paper.



### 1.3 Our submission

In the Green Paper, the Government is proposing transformative changes to the planning system in NSW. The thrust of these changes is a significant shift to a more strategic and streamlined system that facilitates economic growth and upfront community participation. This change is based around fundamental reform in:

- ▼ ‘Community Participation’ – to engage communities as an integral part of making key planning decisions that will affect the growth of their communities.
- ▼ ‘Strategic Focus’ – evidence based strategic planning in terms of planning effort, community and stakeholder engagement and decision-making.
- ▼ ‘Streamlined Approval’ – a performance based system in which duplicative layers of assessment have been removed, decisions are fast and transparent, and code complying development is maximised.
- ▼ ‘Provision of Infrastructure’ – a genuine integration of planning for infrastructure with the strategic planning of land use so that infrastructure that supports growth is funded and delivered.<sup>2</sup>

The timetable is tight with the Government proposing to issue a White Paper/draft legislation later this year, inviting further community input. In early 2013, the Government intends to present the new legislation to the NSW Parliament.

This submission provides IPART’s comments on the Green Paper. We have focussed on the ‘Provision of Infrastructure’ reforms, as these relate most closely with our role in reviewing section 94 development contributions plans, and our other roles as noted above. Our comments on the proposed changes are contained in the following sections:

- ▼ Section 2 discusses how development contributions and other factors may impact on land supply.
- ▼ Section 3 sets out the need for reform of existing funding arrangement for infrastructure servicing new development.
- ▼ Section 4 analyses 2 of the proposed infrastructure changes in the Green Paper (specifically Change 16 ‘Contestable Infrastructure Provision’ and Change 18 ‘Fairer, simplified and more affordable system for infrastructure contributions’).
- ▼ Section 5 presents directions that IPART considers to be important for reform of infrastructure funding and promotion of contestable infrastructure delivery.

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<sup>2</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 3.

## 2 The impact of development contributions and other factors on land supply

The NSW Government aims to increase the supply of land for residential development and improve housing affordability. The Government also aims to facilitate the development of land to support growth in jobs.

The adequate and timely provision of infrastructure for new development is a key element in ensuring that the Government can deliver on its housing and employment objectives. Essential infrastructure provides access, ameliorates the impact of flooding and ensures occupants' needs for energy, water, community facilities and open space are met.

The Green Paper proposes changes (under the broad direction of 'Provision of Infrastructure') that address these objectives to some degree. In particular, it proposes that the existing system of infrastructure contributions be simplified and made more equitable to support the rapid supply of housing and improve housing affordability.<sup>3</sup>

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### Box 2.1 Housing prices capture the value of infrastructure

When home buyers purchase a house, whether it is an existing house or a new house, they are buying:

- ▼ land
- ▼ a dwelling
- ▼ access to infrastructure.

The combined price of these 3 components is set by the market. The value of infrastructure in established areas has been incorporated into the purchase price of the property and people buying in established areas are paying a price that includes this value.

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### 2.1 Impact of development contributions on land supply and housing affordability

The Green Paper acknowledges that high and inefficient infrastructure costs have contributed to delays in the supply of housing and reduced competitiveness of house prices.<sup>4</sup>

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<sup>3</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 6.

<sup>4</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 68.

It is difficult to predict and measure the impact of development contributions on housing affordability and the supply of land for housing, as it depends on the incidence of the burden of these charges, particularly in the short to medium term. In other words, who effectively pays the development contribution: the land owner, the developer, the eventual home buyer, or a combination of all 3.

Box 2.2 describes how the relative elasticities of demand and supply for land and housing determines who bears the burden of development contributions, and how this impacts on land supply and housing affordability.

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### **Box 2.2      The incidence of development contributions**

Depending on how the burden is shared, development contributions can result in:

- ▼ an increase in house prices (home buyers bearing the cost)
- ▼ developers absorbing the charges (developers bearing the cost)
- ▼ a decline in the price of undeveloped land (land owners bearing the cost).

In the long run, if the costs are borne by developers or land owners, this can result in a decrease in the supply of housing, and in turn, an increase in house prices. If costs are borne by home buyers, demand may be dampened or substituted to a different location.

The actual burden of development contributions depends on the relative elasticities of demand and supply for land and housing. Where choices are limited, the party with the least responsiveness (greater inelasticity) to price ends up with a higher burden. If either the demand or supply is perfectly elastic or inelastic, the entire burden is borne by only one party.<sup>a</sup>

Where demand for housing is elastic, the developer will be less able to pass costs forward onto home purchasers, and will have to absorb more of the development contributions. In the longer term:

- ▼ the developer will seek to shift the costs back to owners of the undeveloped land, through a lower price for this land, or
- ▼ if the developer is not able to shift the costs of development contributions in this way, then the reduced profit margins may mean that the developer exits the industry, thus reducing housing supply, or
- ▼ the developer may switch to developing in areas where the demand for housing is more inelastic, for example where there are few substitutes (possibly infill areas with particular desirable attributes).<sup>b</sup>

If the developer is able to push back the cost of development contributions onto land owners, through reduced land prices, this can result in a reduced willingness for land owners to sell, thus restricting the land available for housing.

If home purchasers are less sensitive to price changes (more inelastic) then the developer is more able to pass the cost of development contributions on in the form of increased housing prices.

<sup>a</sup> SGS Economics and Planning, *Developer Contributions – Potential Impact on House Prices and Housing Affordability*, September 2011, pp 8-9.

<sup>b</sup> Ibid, p 11.

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## **2.2      Other influences on land supply and housing affordability**

For many years the government has had a policy of greater development in infill areas than in greenfield areas. This policy encouraged infill and consolidation of development around transport nodes and centres to take advantage of existing infrastructure.

Over the past 30 years, approximately 70% of new dwellings in Sydney have been built in the existing urban areas, compared with 30% in greenfield development on the fringe of Sydney.<sup>5</sup> While this partly reflects planning policy, it is also likely to reflect preferences of the majority of buyers to live closer to the middle and inner areas of Sydney for access to employment.

Nevertheless, there are concerns about the current rate of development in outer areas of Sydney.

The planning system has an important role in ensuring that there is an adequate supply of zoned land for development in both infill and greenfield areas.

Both the State Government and local councils have important roles to play and the views of local communities can have a significant impact on zoning decisions. The Green Paper aims to ensure that community consultation occurs at an early stage of the process and that the community is presented with clear choices about the location and nature of higher density development.<sup>6</sup>

However, it is important to acknowledge that there are many other factors that influence land supply for development and housing affordability. Some examples are listed below:

- ▼ Fragmentation of development areas into multiple lots - where potential development areas are currently owned by multiple owners or fragmented into multiple lots, this can delay development of an area and make it more costly to develop.
- ▼ Coordination of environmental or regulatory requirements - numerous different laws, regulations and policies of the Commonwealth, State and local governments may 'set aside' land for various purposes. This may occur without an overall coordination of policies or without consideration of decisions by other agencies. We note that work commissioned by the NSW Land and Housing Supply Coordination Taskforce in 2010 showed that requirements for the provision of riparian corridors and other uses that sterilise land for development have an impact on the total cost of development.
- ▼ Market-based factors - these include developers' access to finance, their appetite for risk, the 'stickiness' of land owners' price expectations and home buyers' preferences about taking on debt and housing types and locations.

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<sup>5</sup> Metropolitan Development Program 2008/09, *Report Residential Forecasts 2008/09 – 2017/18*, p 1.

<sup>6</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, pp 19-21.

- ▼ Taxation arrangements – taxes at the local, state and federal level can influence people’s housing choices and affect land supply for redevelopment. For example, stamp duty on the purchase of homes increases the transaction costs of moving. This could discourage existing residents on large lots from relocating when it might otherwise suit them. This could act as an impediment to the consolidation of low density residential areas for higher density development.

It is important that the Government continues to focus on the full range of factors that influence land supply and housing affordability. In our response to the Issues Paper, we suggested that the Government could convene and maintain an expert group for the purpose of monitoring housing trends and identifying suitable strategies to support housing affordability. We note the establishment of a Cabinet Sub-Committee to oversee these issues. This committee provides a basis for pursuing this work from a whole-of-government perspective.

### **3 Need for reform of infrastructure funding**

This section highlights our view on some of the problems with the existing system for funding infrastructure required to support new development. Specifically, these are:

- ▼ the existing system is complex and may differ from location to location
- ▼ the cost of infrastructure for new development has increased
- ▼ ad-hoc changes have led to uncertainty for councils and developers which can lead to delays in development
- ▼ capped contributions for local infrastructure and the setting to zero of some water developer charges have reduced price signalling and created inequities between development areas.

Each of these issues is discussed below.

#### **3.1 The existing system is complex**

The responsibilities for providing infrastructure servicing new development are currently shared between the State Government, local government, water authorities and the private sector. The system of funding the infrastructure provided by these various groups is fragmented, resulting in inequities in the allocation of the costs depending on the location of the land and the ultimate owner of the infrastructure.

The range of funding mechanisms currently in place includes:

- ▼ Direct (on-site) developer responsibilities
  - Depending on the location and type of development, responsibilities may include: construction of subdivisional roads, gutters, footpaths and dedication of land for these purposes; connection to existing networks for potable water, sewage, energy and telecommunications; and on-site stormwater quality treatment.
- ▼ Section 94 and section 94A contributions for local infrastructure:
  - These contributions are levied by consent authorities (local councils) under the *Environmental Planning and Assessment Act 1979*.
  - Section 94 contributions require the preparation of a contributions plan that identifies the relationship between the expected types of development and the demand for additional public amenities and services created by that development.
  - Section 94A contributions are an alternative to section 94 contributions and are fixed at a certain percentage of the cost of the proposed development.
- ▼ Infrastructure contributions for water and sewerage infrastructure (often known as 'developer charges'):
  - Water and sewerage developer charges for Sydney Water and Hunter Water have been set to zero since 2008. However, all other developer charges, including for out of sequence development in Sydney and the Hunter Region and for areas outside of Sydney and the Hunter Region, are still in place.
- ▼ Special infrastructure contributions:
  - Special infrastructure contributions (SIC) are made by developers to the State Government towards the cost of regional and state infrastructure.
- ▼ Voluntary planning agreements:
  - These are agreements entered into by a planning authority (such as the Department of Planning and Infrastructure or a council) and a developer. Under the agreement a developer agrees to provide or fund (either directly or through works-in-kind) infrastructure that services new development.

### 3.1.1 Complexity in the provision and funding of water infrastructure

The funding of water infrastructure for sewerage, potable water and recycled water is particularly complex. The present arrangements for levying developer charges are as follows:

- ▼ If the development is in the Sydney or Hunter region and the infrastructure will be owned by Sydney Water or Hunter Water, the funding of the infrastructure depends on whether the timing of development is in line with the Government's release strategy.
  - If the timing of the development is in line with the Government's release strategy, the utilities' other customers fund the cost of water and sewerage infrastructure provided by the relevant public water utility.
  - If the development is not in line with the release strategy, then some of the costs are recovered from the developer using a method determined by IPART.
- ▼ If the development is on the Central Coast and the infrastructure will be owned by Gosford City Council or Wyong Shire Council, the costs are recovered from the developer (consistent with IPART's determined methodology).
- ▼ If the development is in regional NSW and the infrastructure will be owned by the council-owned local water utility, some of the costs are recovered from the developer (using a methodology developed by the NSW Office of Water that has been reviewed by IPART).
- ▼ If the infrastructure will be retained by the developer or corporation licensed under WICA, then the full costs of water infrastructure are incurred by the developer and costs can be recovered through up front charges and/or periodic charges set by the licensee.

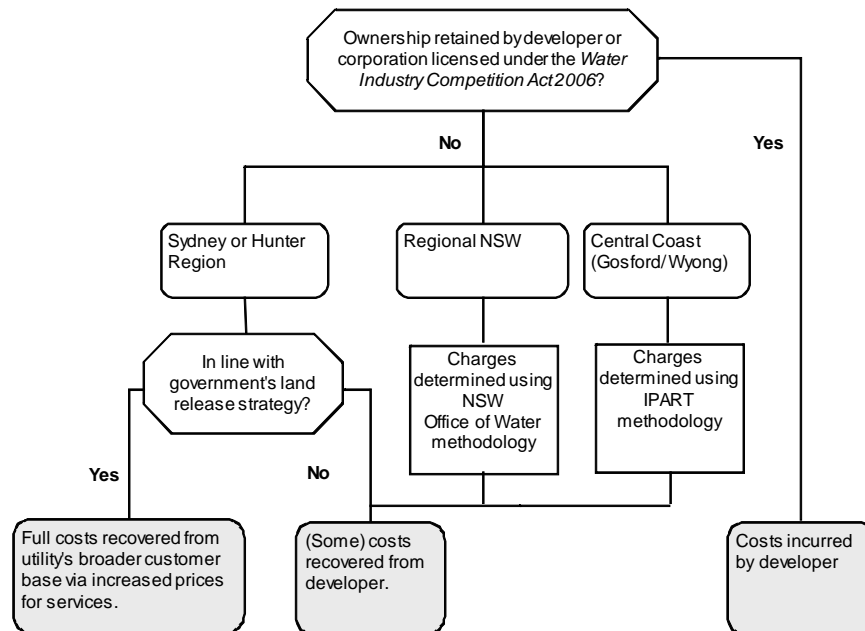
These arrangements are summarised in Box 3.1.

The complexity of funding arrangements may have an impact on contestability. Contestability is further discussed in Section 5.5.

IPART strongly supports reducing the complexity of the current funding arrangements.



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**Box 3.1      Funding of sewerage and water infrastructure for new development**

**Note:** In 2007 IPART undertook a review of the NSW Office of Water's Developer Charges Guidelines for Water Supply, Sewerage and Stormwater. The Minister for Primary Industries has approved IPART's recommendations and these are being implemented by the Office of Water.

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### 3.2      The cost of infrastructure for new development has increased

The Government has taken explicit decisions to cap development contributions because of the increasing costs to developers. These increasing costs are considered one of the reasons for low rates of housing development.

Increases in the cost of providing infrastructure for new development are attributable to several factors, such as:

- ▼ An increased scope of public facilities services desired by residents of new residential development or required by councils or government.
  - The Green Paper notes that development contributions at a local council level have evolved significantly over the past two decades from the provision of baseline facilities immediately required to support growth, such as roads and drainage, to the inclusion of more extensive community infrastructure, such as community centres, and recreational facilities.<sup>7</sup>

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<sup>7</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 74.

- ▼ A tendency for local councils to provide infrastructure that exceeds the standard required in order to avoid recurrent costs in the future or to provide direct benefits from development to existing residents.
  - In its submission on the Issues Paper, the Urban Development Institute of Australia NSW (UDIA) noted that the expansion of contributions plans to fund substantial tracts of open space and the over-specification of infrastructure requirements have caused a significant increase in the quantum of charges and significant disparities between contributions plans in different Local Government Areas.<sup>8</sup>
- ▼ The requirement for a portion of Sydney's growing population to be located in 'greenfield' areas which typically cost more to service, using traditional infrastructure approaches, than existing urban areas.
  - Data from Sydney Water Corporation indicates a higher cost of servicing greenfield than infill development.

### **3.3 Ad hoc changes have led to uncertainty for councils and developers delaying infrastructure and development**

Over the past few decades, the method of funding infrastructure that services new development has changed considerably in NSW. Some of the changes are summarised in Box 3.2.

There have been frequent, sometimes ad hoc, changes. The changes may have reduced certainty for developers because the amount they are required to pay for infrastructure has changed several times and subsidies offered by the State Government have been time-limited.

In recent years, the State Government has responded to a slowdown in the rate of residential development in metropolitan Sydney by reducing some of the contributions. The SIC has been reduced, some developer charges for Sydney Water and Hunter Water were set to zero and section 94 contributions for councils were capped at \$30,000 for greenfield areas and \$20,000 for infill areas.

There is evidence that the local contributions caps policy has created uncertainty for councils and communities about the source of funding for infrastructure for new development. If a council faces uncertainty about funding then it is not likely to quickly process contributions plans or deliver the infrastructure. This can, in turn, lead to delays in development.

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<sup>8</sup> Urban Development Institute of Australia NSW, *Submission to the Planning System Review - Response to the Planning Issues Paper*, March 2012, p 16.

The Hills Shire, Liverpool, and Penrith Councils have all stated that they are facing increasing budgetary pressures due to funding restrictions from the cap on development contributions, with potential shortfalls of \$100m, \$90m, and \$55m respectively.<sup>9</sup>

The Hills Shire Council agreed not to exhibit draft contribution plans for the Box Hill precinct as it considered it futile when the necessary funding was not available. Liverpool Council has stated that it is unable to continue developing the East Leppington precinct, and that there are further funding shortfalls for the Austral and North Leppington precincts. Penrith Council has stated that ratepayers could face paying massive increases to pay for the funding shortfall for the Werrington Enterprise Living and Learning Precinct.

Councils affected by the section 94 development contributions caps are able to seek a 'special variation' to their rates revenue. If councils have a significant gap in funding as a result of the caps and seek to cover the full funding gap from future ratepayers in the development area, the magnitude of the rate variation will, in some instances, be very high. This may deter home buyers from purchasing in the area, or subject new residents to high ongoing costs.

The magnitude of the rate variation would be lower if it was levied on all ratepayers in the Local Government Area. However, existing residents may have already contributed to development contributions in the past or may perceive that contributions are embedded in the amount that they have paid for their house. This, in turn, may create resentment from existing home owners and an 'anti-development' backlash, which could limit councils' willingness to approve new development.

To date, no council has sought a special rate variation to fund the shortfall in meeting the cost of contributions plans infrastructure.

Alternatively, councils affected by the section 94 development contributions caps were able to apply for funding from the Priority Infrastructure Fund (PIF). The PIF was a transitional measure intended to ensure that councils were able to recover the difference between the contributions rate contained in a contributions plan (that is assessed as being reasonable by IPART) and the relevant cap. The PIF was set up in 2010 with \$50m to be available over 2 years (2010/11 to 2011/12).<sup>10</sup> Allocations of PIF funding were made to The Hills Shire Council and Blacktown Council for contribution plans that were reviewed by IPART in October 2011.

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<sup>9</sup> Hills News, *Council wary of giant deficit*, 3rd July 2012; South Western Rural Advertiser, *Growth hits hurdle*, 8th August 2012; St Marys Star, *\$1.8m shortfall despaired*, 28th February 2012.

<sup>10</sup> In July 2012, the Government announced that the PIF has being replaced with funding from the Housing Acceleration Fund. Guidelines for the allocation of the Housing Acceleration Fund to councils have not yet been issued.

Perversely, the removal of developer charges for water could also have had the effect of slowing down some developments in Sydney. Under current arrangements where there are no developer contributions, owners of land have 2 choices:

- ▼ they can wait for extended periods until the utility's network is extended to their land - whereupon the developer receives "free" infrastructure, because its costs are included in the prices paid by all of the utility's customers
- ▼ alternatively, they can negotiate to pay the full costs of the infrastructure to a service provider licensed under WICA (this may be higher than the previous developer charges for Sydney Water and Hunter Water).

Faced with that trade-off, land-owners might decide to not develop land, with negative implications for housing affordability and the economy.

### **3.4 Capped contributions have reduced price signalling**

As noted above, section 94 contributions for local infrastructure are currently capped at \$30,000 per dwelling or residential lot in greenfield areas or \$20,000 per dwelling or residential lot in all other areas (although some exemptions apply). Additionally, most developer charges levied by Sydney Water and Hunter Water have been set to zero.

In the absence of the contribution caps, the levies required in some areas will be greater than others. This is because the cost of providing infrastructure and the nature of infrastructure that is required will vary. For example, costs are influenced by differences in topography and ease of access to pre-existing infrastructure networks.

Cost-reflective pricing provides a market signal for investment to occur where the cost of providing facilities is lower. A capped contributions regime removes this price signal for areas affected by the cap. This could lead to land with high development costs being developed when land with lower development costs could be available.

Although the section 94 contributions caps reflect some price differential between development of greenfield and other areas, the rationale for the level of the caps is not transparent. Further, the cap amounts were set in 2010 and have not been indexed for infrastructure price changes since then.

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### Box 3.2 A summary of recent changes to developer contributions

- ▼ Prior to the 1970s, in NSW, the state and local governments met most of the cost of public infrastructure that services new development. In the 1970s, Sydney Water introduced development contributions for water infrastructure, and from the early 1980s local councils began to collect development contributions for local infrastructure. In the mid-2000s, the State Government introduced the SIC for state infrastructure, but applied it only to certain development areas. The introduction of these contributions shifted costs from government in favour of a 'user pays' system.
- ▼ In 2008 the State Government announced changes to water infrastructure contributions levied by Sydney Water and Hunter Water. As part of the reforms, the contributions paid by developers for water supply, wastewater and stormwater development were set to zero for some developments. However, contributions for recycled water and out of sequence developments continue to apply for Sydney Water and Hunter Water. Developer charges for water, wastewater, stormwater and recycled water levied by Gosford City Council and Wyong Shire Council are not subject to the zero cap. Outside the greater metropolitan area other councils are also able to impose developer charges for these services.<sup>a</sup>
- ▼ In 2008 the State Government announced it would discount the SIC by increasing the State Government's share of funding from 25% to 50% until 30 June 2011. It also removed rail infrastructure and bus subsidies from the SIC. The SIC discount was extended until 30 June 2012. Following the 2012/13 NSW Budget, the State Government announced it was continuing the SIC discount. An expiry date was not announced.<sup>b</sup>
- ▼ In 2010 the State Government introduced 'hard caps', limiting the amount of section 94 development contributions councils could collect. Unless the Minister exempts a development, councils can levy development contributions to a maximum of:
  - \$30,000 per dwelling or residential lot in greenfield areas
  - \$20,000 per dwelling or residential lot in all other areas.
- ▼ Councils affected by the section 94 development contributions caps are also able to seek a 'special variation' to their rates revenue. To date, no council has sought a special rate variation to fund the shortfall in meeting the cost of contributions plans infrastructure.

<sup>a</sup> The NSW Office of Water has issued Developer Charges Guidelines for Water Supply, Sewerage and Stormwater, December 2002 pursuant to section 306 (3)(C) of the *Water Management Act 2000*. The Office of Water has recently issued a consultation draft of Revised Guidelines.

<sup>b</sup> Brad Hazzard MP, Minister for Planning and Infrastructure and Mike Baird MP, Treasurer, Joint Media Release, *NSW Government Extends Development (SIC) Levy Discount*, 28 June 2012.

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## 4 Green Paper reforms

This section analyses 2 of the proposed infrastructure changes in the Green Paper. Section 4.1 discusses Change 18 'Fairer, simplified and more affordable system for infrastructure contributions'. Section 4.2 discusses Change 16 'Contestable Infrastructure Provision'.

### 4.1 Funding infrastructure

The Green Paper outlines one option for a new development contributions framework which it says is under strong consideration.<sup>11</sup> The option proposes to use a combination of direct development contributions, indirect development contributions and a broader based levy. The 3 elements of the option are structured around different infrastructure types:

- ▼ development contributions (greenfield areas) or a fixed rate levy (infill areas) for local infrastructure identified in **Local Infrastructure Plans**
- ▼ a fixed nominal **Regional Open Space Levy** per residential development for local and regional open space and drainage, and conservation land
- ▼ development contributions (greenfield areas) or a fixed rate levy (infill areas) for regional infrastructure identified in **Growth Infrastructure Plans**.

#### 4.1.1 Principles for funding

As stated in our submission on the Issues Paper, a sound set of principles is required to answer the questions of what infrastructure should be provided, who should pay, and how they should pay.

The Green Paper identifies 13 principles for evaluating infrastructure levies for state and local government infrastructure. These principles aim to provide a fairer, more transparent, and more efficient scheme for the future.<sup>12</sup>

We consider that the overarching principle should be that beneficiaries of the infrastructure should pay. In some instances this might mean that the costs of infrastructure for new development are shared with existing development. IPART's 2012 Sydney Water Determination provides an example of sharing costs between new and existing development on the principle of beneficiary pays (see Box 4.1).

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<sup>11</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, pp 76-77.

<sup>12</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 75.

Other important principles are:

- ▼ cost reflectivity - contributions or levies should reflect the efficient cost of providing infrastructure
- ▼ transparency and simplicity - calculating the contributions or levies should be clear and readily understood.

We are not convinced by the argument that is sometimes used that since property owners in more established suburbs have not paid development contributions in the past, those in greenfield areas should not pay them now. The value of infrastructure in established areas has been incorporated into the purchase price of properties in these areas, and purchasers of established housing are paying a price that covers this value (as discussed in Box 2.1).

However, there is an argument for sharing some of the cost of infrastructure required to service new development between residents in established suburbs and new development (both infill development and development in greenfield areas). This is discussed further in section 5.3.4 of this submission.

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#### **Box 4.1      IPART's determination for Sydney Water - an example of sharing costs with existing development**

In IPART's 2012 Sydney Water Determination, we applied the 'beneficiary pays principle' to determine the appropriate funding mechanism for drainage infrastructure in the Rouse Hill Development Area.

We decided that:

- ▼ Sydney Water's general sewerage customers (most Sydney properties) should bear the cost of drainage works. This is because this expenditure improves the quality of the water entering the Hawkesbury-Nepean river system and indirectly benefits Sydney Water's general customers
- ▼ The residents of Rouse Hill should bear the cost of drainage land. This is because we considered that Rouse Hill residents directly benefit from the land purchases, as they help prevent their properties from flooding.

As a result, IPART determined a separate charge to fund the cost of drainage land payable by new residents of Rouse Hill for a period of 5 years and to fund the cost of drainage works via periodic sewerage charges. Application of these principles to the proposed drainage infrastructure meant that 70% of the costs, which is the cost of future land purchases, should be borne by the new residents at Rouse Hill and the remaining 30% should be recovered from Sydney Water's sewerage customers.

**Source:** IPART, Review of prices for Sydney Water Corporation's water, sewerage, stormwater drainage and other services from 1 July 2012 to 30 June 2016 - Final Report, June 2012.

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#### 4.1.2 The funding options proposed are similar to the current system

The following section compares the Green Paper proposal with the existing framework. We separately examine local infrastructure and regional infrastructure.

##### Local Infrastructure

The Green Paper option for a new development contributions framework is, in many ways, similar to the existing framework. At present, developers pay for local infrastructure, caps limit contributions and an essential works list is applied to new plans with a value above the cap.

The Green Paper proposes that some items of local infrastructure be funded through development contributions. The proposed arrangements appear to be similar to the existing provisions for section 94 development contributions and section 94A development contributions. The Green Paper does not indicate whether the existing caps on section 94 contributions will remain.

The scope of items included in the Green Paper's Local Infrastructure Plans is narrower than the scope of items on the current Essential Works List that applies to some section 94 development contributions plans. Under the Green Paper proposal, several essential works items (land for open space and land for local drainage) will be funded through a Regional Open Space Fund via a levy (see Table 4.1). The funding mechanism for open space embellishment under the Green Paper proposal is not clear.

**Table 4.1 Comparison of existing and proposed funding of local infrastructure**

Local infrastructure	Existing development contributions	Green Paper funding mechanism
Transport (roads) - land	s94 contribution, subject to cap	Local development contribution
Transport (roads) - works	s94 contribution, subject to cap	Local development contribution
Drainage - land	s94 contribution, subject to cap	Regional Open Space Fund
Drainage - works	s94 contribution, subject to cap	Local development contribution
Open space - land	s94 contribution, subject to cap	Regional Open Space Fund
Open space embellishment	s94 contribution, subject to cap	Not clear
Community services – land	s94 contribution, subject to cap	Local development contribution

**Note:** The contributions caps apply to the total contribution, not specific infrastructure items.

**Source:** Department of Planning, *Local Development Contributions Practice Note for assessment of contributions plans by IPART*, November 2010. NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, pp 76-77.



## Regional Infrastructure

The Green Paper proposes that some items of regional infrastructure in high growth areas of NSW could be funded by development contributions. The proposed arrangements appear to be similar to the existing Special Infrastructure Contribution (SIC) framework (see Table 4.2).

Funding for regional open space and conservation areas, which are partly funded through the current SIC, has been transferred to the proposed Regional Open Space Fund.

We note that for some expenditure items, funding is split between more than one source.

The funding mechanism for buses (land and capital works) and planning and delivery is not clear.

IPART considers that it is important that lines of accountability for providing infrastructure should not be obscured by a split in funding sources.

**Table 4.2 Comparison of existing and proposed funding of regional infrastructure**

Regional infrastructure	Existing development contributions	Green Paper funding mechanism
Transport (roads) - land	SIC	Growth Infrastructure Plan
Transport (roads) - capital works	SIC	Growth Infrastructure Plan
Transport (buses) - land	SIC	none
Transport (buses) - capital works	SIC	none
Health - land	SIC	Growth Infrastructure Plan
Education - land	SIC	Growth Infrastructure Plan
Emergency services - land	SIC	Growth Infrastructure Plan
Regional open space - land	SIC	Regional Open Space Fund
Conservation land - land	SIC	Regional Open Space Fund
Planning and delivery	SIC	none

**Source:** Sydney's Growth Centres, *Environmental Planning and Assessment (Special Infrastructure Contribution - Western Sydney Growth Areas) Determination 2011*, Appendix 1; NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, pp 76-77.

### 4.1.3 Direct and indirect contributions

The Green Paper proposes two alternatives for recovering contributions towards infrastructure in Local Infrastructure Plans and Growth Infrastructure Plans:

- ▼ a contribution which is apportioned evenly across the defined area (often referred to as a 'direct' contribution), typically a greenfield release area or
- ▼ a contribution based on a percentage of the proposed capital investment value in carrying out the development (often referred to as an 'indirect' contribution), typically applied in areas where infill development occurs.

While direct contributions have traditionally been used, indirect contributions for local infrastructure (section 94A levies) were introduced in 2005. These indirect contributions are intended to be applied in areas, such as:

- ▼ rural and regional areas, where there are slow rates of development or development is sporadic
- ▼ established urban areas, where development is mainly 'infill' development and is also sporadic.<sup>13</sup>

Section 94A levies are calculated as a percentage of development costs. The method of calculating development costs is specified in clause 25J of the *Environmental Planning and Assessment Regulation 2000*.<sup>14</sup>

Councils are not required to demonstrate nexus between the development which is liable for the levy and the items being funded by the levy. However, the Minister for Planning and Infrastructure sets maximum rates for section 94A levies. The current maximum rates are shown in Table 4.3.

**Table 4.3 Rates of Section 94A levy**

Proposed cost of the development	Maximum levy (%)
Up to \$100,000	Nil
\$100,001-\$200,000	0.5
More than \$200,000	1.0

**Source:** Minister for Planning, *Section 94E Direction*, 10 November 2006.

IPART is not required to review section 94A contributions plans. However, we consider that it is sensible to limit the rate of indirect contributions unless councils (or other authorities that levy contributions) are able to adequately demonstrate nexus between the development which is liable for the levy and the items being funded by the levy.

<sup>13</sup> Department of Planning, Practice Note – *Section 94A development contributions plans*, December 2006, p 1.

<sup>14</sup> The cost of land on which the development is to be carried out is not included in the levy calculation.

#### 4.1.4 Issues not addressed in the Green Paper

The Green Paper includes a high level outline of a new proposal for funding infrastructure that is being given consideration by the Government. This proposal is indicative only, and has not been explained in detail in the Green Paper. There are also several key policy questions that are not canvassed in the Green Paper. These will need to be clarified in the White Paper.

Some of the key policy issues and our suggested position are outlined below.

##### Caps on infrastructure changes or levies

It is not clear whether the Government is proposing to retain any caps on development contributions or fixed rate levies.

We do not think that the current hard caps on section 94 development contributions should be continued in their current form. A more flexible approach would allow for more cost-reflective pricing – which would help to ensure that the lower cost developments occur first (or that, where higher cost sites are developed, the developers believe that buyers are prepared to pay a higher cost). This is discussed further in Section 5.

The policy rationale for setting Sydney Water and Hunter Water developer charges to zero should also be considered.

##### Special Infrastructure Contribution

It is not clear whether the existing SIC will remain or whether it will be replaced by the options proposed in the Green Paper.

We consider that all funding mechanisms for infrastructure required by new development, including the SIC, should be reviewed as part of the Government's planning system reforms.

##### Government subsidies

It is not clear whether the Government is intending to subsidise the cost of infrastructure required for new development, or if no subsidy is provided, how any funding gaps will be met.

The current low rates of housing development indicate that some additional subsidy could assist in accelerating land development.

### Funding infrastructure for non-residential development

There is no indication of any contributions or levies that will apply to non-residential development. We consider that the principles for funding infrastructure required for new residential development should also be applied to non-residential development.

### Collection and distribution of the Regional Open Space Levy

No information is provided on how the proposed Regional Open Space Levy will be collected or distributed. One option may be through a levy on ratepayers. It is also not clear how widely it will be applied.

### Direct developer responsibilities

The Green Paper does not discuss direct developer responsibilities such as construction of subdivisional roads, water reticulation and on-site treatment for stormwater quality. These responsibilities vary depending on the location and type of development.

We consider that to promote equity, the degree to which developer responsibilities vary should be reflected in alternative mechanisms for funding. For example, if developers have to provide on-site stormwater quality devices they should not have to pay the same local development contribution for stormwater quality management as developers that do not have to provide on-site treatment.

### Infrastructure not discussed in the Green Paper

The Green Paper does not discuss funding mechanisms for various other types of infrastructure that are required for new development including water supply infrastructure, sewage infrastructure, electricity infrastructure or gas infrastructure.

### Integration of funding and contestable infrastructure provision

The Green Paper does not discuss how funding arrangements will integrate with the Green Paper's proposal for contestable infrastructure provision.

We consider that any subsidies or cost sharing mechanisms should be equally available to all service providers, both public and private.

## 4.2 Contestable infrastructure provision

In NSW, water and electricity network infrastructure is primarily provided and operated by public utilities, or by the private sector under contract to a utility. Increasingly, water and sewerage services are being provided by private operators, and competition is intensifying in the retail electricity market. At present 19 licences have been issued to the private sector under the *Water Industry Competition Act 2006* (WICA) to provide water services and infrastructure.

The Green Paper outlines a number of reforms to support contestable infrastructure provision:

- ▼ embedding the principle of contestability into the core infrastructure planning and delivery process to maximise innovation, diversity, choice and best value
- ▼ subjecting all stages of infrastructure concept, design, construction and operation, to full contestability
- ▼ minimising cost, maximising efficiency and encouraging innovation in the planning and delivery of infrastructure through performance based planning
- ▼ enabling processes for transparent and ethical consideration of unsolicited proposals from developers on innovations (including planning agreements) to accelerate housing related and other infrastructure
- ▼ using special purpose vehicles to drive more innovation, including in-kind contributions to deliver more of our infrastructure requirements.<sup>15</sup>

IPART supports contestability in the provision of infrastructure because:

- ▼ it helps to encourage innovation
- ▼ it can lead to lower cost or less capital-intensive options for the delivery of infrastructure
- ▼ it can lead to more timely delivery of infrastructure
- ▼ it could reduce the bias of existing arrangements towards specific infrastructure solutions and providers which may not be efficient
- ▼ it provides a level playing field for competitive entry.

Our suggestions for promoting contestability are outlined in section 5.5.

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<sup>15</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 69.

## 5 Directions for reform

IPART suggests the following directions for reform, which balance efficiency with some cost sharing:

- ▼ providing price signals to developers about the cost of infrastructure to encourage efficient development
  - removing hard caps on local infrastructure contributions
  - introducing simple Sydney Water and Hunter Water developer charges limited to recovering the direct costs of connecting to the network
- ▼ ensuring that the cost of infrastructure paid by developers is reasonable
  - limiting the scope of local infrastructure contributions by applying an essential works list (or similar)
  - maintaining review of local infrastructure plans
  - establishing better benchmark costs
  - encouraging cost-effective design solutions
- ▼ identifying who should pay
  - identifying beneficiaries – localised and regional – and sharing relevant costs
  - state government to fund core state government functions
  - sharing costs between new and existing development
- ▼ considering a range of funding mechanisms
- ▼ promoting contestable infrastructure provision.

The Government faces a trade-off in the extent to which it wishes to encourage development in established areas with lower infrastructure costs (but where there may be community opposition to increasing housing densities), or wishes to encourage development in greenfield areas (which can be expensive). Greater contributions are required to develop in greenfield areas than in established areas and this may require larger contributions from the broader community of beneficiaries.

### 5.1 Provide price signals about the cost of infrastructure

As we have previously indicated, the cost of providing infrastructure varies from area to area. Development contributions that are appropriately set help to convey to developers and home buyers the cost of developing a particular site relative to its alternatives. Cost-reflective pricing is important because it provides a market signal for investment to occur where the cost of providing facilities is lower. That is, it encourages efficient development of land and the efficient provision of infrastructure.

When done well, strategic planning takes into account the relative cost of developing in different locations. It is important that price signals remain even after planning decisions have been made. For example, differential prices for infrastructure delivery in greenfield and infill can reflect the availability of capacity in existing infrastructure networks. If price signals are removed entirely, it is possible that investment decisions could be distorted towards locations with more expensive delivery of infrastructure.

IPART considers that price signals are distorted by:

- ▼ the existing caps on local development contributions
- ▼ the decision to set to zero developer charges for most Sydney Water and Hunter Water infrastructure for new development.

Therefore, we recommend that hard caps on local infrastructure contributions are removed (and replaced with soft caps) and that simple Sydney Water and Hunter Water developer charges are introduced.

However, we recognise that there needs to be a mechanism to ensure that the infrastructure costs are reasonable. Our recommendations for achieving reasonable costs are discussed in section 5.2.

### **5.1.1 Hard caps on local infrastructure contributions**

The proposal in the Green Paper does not indicate whether contributions for local infrastructure will continue to be capped.

As noted above and in section 3.4, IPART considers that the existing hard caps distort pricing signals and have created greater funding uncertainty for some councils. This may have slowed the rate at which contributions plans are completed and slowed infrastructure funding.

We consider that hard caps should be removed, but that there may be some benefit in retaining 'soft' caps on local development contributions. Hard caps set the maximum contribution that the developer pays. A soft cap is a threshold for triggering a review of the infrastructure costs in the plan by the Government or an independent body. The Government, or independent body, could then determine the amount of the contribution. If the maximum contributions rate in a Local Infrastructure Plan falls below the relevant soft cap, then the plan would not need to be reviewed. However, we consider that clear guidelines should be established to guide councils on what costs it is reasonable to include in all plans.

### 5.1.2 Sydney Water and Hunter Water developer charges

As previously discussed in section 3.1.1, the present system of recovery for the cost of new water infrastructure needed for land development is inconsistent across the State and between water service providers. It does not signal the costs of Sydney or Hunter land development. It creates poor incentives for provision of efficient infrastructure and acts a barrier to competitive entry.

To signal the relative costs of developing different areas and to facilitate competitive entry of new, efficient water infrastructure providers, these inconsistencies need to be addressed.

It is recommended that the Government support the introduction of a system of simple Sydney Water and Hunter Water developer charges that are based on the cost of connection of the development to the water and sewerage systems. This would:

- ▼ help to signal the costs of additional water infrastructure required to support development
- ▼ help to bring the arrangements for Sydney and Hunter Water closer to the arrangements in other areas of the State, where developer charges remain
- ▼ enable fairer comparisons of the costs of infrastructure provision by the established public water utility to connect to the traditional system and the costs of provisions by new entrants, for example to an innovative smaller scale solution.

It is important to note that this simple system would not recover the full cost of infrastructure. Rather it would only relate to the additional infrastructure needed to service a development.

The introduction of a simple system of water developer charges may also contribute to an acceleration in the pace of land development by changing the current trade-off faced by developers of either waiting until the utility's network is extended to their land or negotiating to pay the full costs of the infrastructure to a service provider licensed under WICA, as noted in section 3.3.

## 5.2 Ensure cost of infrastructure is reasonable

Over time, the cost of providing infrastructure for new development has increased. As noted in section 3.2, this can be attributable to several factors including an increase in the scope and standard of infrastructure included in local council contributions plans. The changes to the section 94 framework in 2010 were intended to address the Government's concern that rising development contributions were affecting the supply of residential land. In particular the government capped development contributions and introduced an essential works list and review of plans by an independent body (ie, IPART).



Going forward, we consider that the following measures could assist in ensuring that development contributions are reasonable:

- ▼ continue to limit the scope of local infrastructure contributions through an essential works list
- ▼ maintain a review of local infrastructure plans by an independent body
- ▼ develop benchmark costs with whole-of-government input
- ▼ encourage cost-effective design solutions.

### 5.2.1 Essential Works List

We consider that there is an ongoing role for an essential works list (or something functionally similar).

The Practice Note which details IPART's review function and the Essential Works List is currently being updated by the Department of Planning and Infrastructure. While IPART considers the Essential Works List is a positive initiative, we have suggested that some minor amendments be made. For example, we have recommended that:

- ▼ councils should be able to include administration costs incidental to items on the Essential Works List
- ▼ councils should be able to include the cost works for environmental purposes when the land serves a dual purpose with one or more of the existing categories of essential works (eg, open space or drainage)
- ▼ the practice note should reflect changes in the definition of 'base embellishment' for open space made in 2011.

The benefits of having an essential works list will be maximised if all contributions plans are subject to the same 'rules' and processes. Currently there are exceptions for certain plans and some of these are reasonable. For example, the Essential Works List does not apply and review by IPART is not required:

- ▼ in areas where (on 31 August 2010) development applications had been lodged for more than 25% of the expected development yield
- ▼ for Voluntary Planning Agreements (these agreements may include non-essential infrastructure).

However, they also do not apply where the maximum residential contributions rate in an existing or draft plan falls below the relevant contributions cap (ie, \$20,000 or \$30,000). We consider that there are good reasons for plans to be subject to an essential works list, even if the maximum contributions rate is below the relevant cap. For example, it is possible that the contributions in lower cost plans could move upwards towards the cap if they are not subject to an essential works list.

### 5.2.2 Maintain review of local infrastructure plans

We also consider that there are benefits in an ongoing review of councils' contributions plans by an independent body.

We note that the Green Paper is silent on independent reviews of plans. However, we note that the Moore and Dyer report proposes a sampling approach to the review of plans by a body other than IPART (Box 5.1). While we consider this may be reasonable, a continuing role for IPART would provide independence and transparency.

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#### **Box 5.1 Moore and Dyer's recommendations on State Government review of Local Infrastructure Plans**

Recommendation 53: Councils are to submit draft Local Infrastructure Plans (or amendments to them) to the Director-General of the Department of Planning and Infrastructure for review.

Recommendation 54: The Director-General may modify any such plan.

Recommendation 55: If the Director-General modifies a plan, the council may request the proposed modification be referred to the Planning Commission for determination.

Recommendation 56: A Planning Commission determination on a Local Infrastructure Plan is to be treated as would an application for a project determination.

**Source:** Moore and Dyer, *The Way Ahead for Planning in NSW: Recommendations of the NSW Planning System Review, Volume 2 – Other Issues*, June 2012, p 48.

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### 5.2.3 Establishment of benchmark costs

In our review of local contributions plans for certain councils in north west Sydney, we have observed variations in the costs and infrastructure standards from plan to plan. Some of this is explained by topography or other factors, but some simply reflect differences in approaches or differences in standards applied by individual councils.

We consider that there would be benefits of sharing information and establishing benchmark costs for infrastructure that services new development. It is suggested that the expertise of infrastructure agencies across government and in councils could be used to establish benchmarks.

IPART would be well placed to facilitate this analysis with whole-of-government support.

#### 5.2.4 Cost-effective design solutions

When reviewing contributions plans, IPART assesses whether the costs of the local infrastructure included in the plan are reasonable. We do not assess whether the costs are efficient.

In our recent reviews of plans we have come across some examples of where more cost-effective approaches could be used:

- ▼ A council uses a risk averse approach when dealing with excavated material when designing its contributions plan. While this approach is reasonable, we consider that there may be more efficient ways of disposing of excavated material than disposing the bulk of it at the local tip.
- ▼ Currently plans do not use stormwater management land for open space. This means that councils have to provide additional land to satisfy the requirements for each of these purposes.

We consider that there would be benefit if councils were required to use cost-effective design and engineering solutions when designing their infrastructure. We consider that this would help to reduce the contribution rates in the plans.

However, we note that achieving the most cost-effective approach may not be possible because:

- ▼ contributions plans for greenfield sites will usually include concept design and broad cost estimates with more precise cost estimates being developed before construction starts
- ▼ engineering judgements require a trade-off between reduced risk and increased costs, and therefore estimates within a range may all be reasonable.

#### 5.2.5 Ensuring accountability of development contribution revenue and expenditure

We note that the Green Paper includes as principles for development contributions:

- ▼ there must be a clear, transparent link between levy revenue collection and infrastructure programming and delivery
- ▼ levy revenue must not be hoarded or banked to consolidate an authority's financial position
- ▼ levy framework must be transparent and be able to be implemented efficiently.<sup>16</sup>

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<sup>16</sup> NSW Government, *A New Planning System for NSW: Green Paper*, July 2012, p 75.

We support these principles. As a minimum, councils should clearly report for each plan:

- ▼ the infrastructure being delivered – actual expenditure against planned expenditure
- ▼ the flow of funds (ie, revenue and expenditure)
- ▼ the balance within the account.

We note that under current statutory requirements, councils are already required to disclose information about the collection and expenditure of development contributions. While councils provide this information Note 17 of their annual financial statements it may be more transparent if councils could report this information separately.

The Green Paper indicates that a Task Force will be established to develop specific ways to improve the administration of levies and improve transparency.

### **5.3 Identify who should pay**

This section discusses the questions of ‘who should pay for infrastructure’ and ‘how should they pay’.

As stated in section 4.1.1, IPART considers that the cost of infrastructure should be met by those that benefit from the infrastructure. Beneficiaries of infrastructure can be delineated according to:

- ▼ geographic boundaries
- ▼ whether the beneficiaries are occupants of new or existing development.

We consider that:

- ▼ most ‘local’ infrastructure should be paid for by developers and passed on to the occupants of development – using development contributions
- ▼ some regional infrastructure (conservation land and works, regional open space, stormwater quality infrastructure and sewerage infrastructure) should be paid for by new and existing development across a defined region – the region could be:
  - a subsection of the local government area (LGA)
  - the whole LGA
  - a subsection of Sydney extending beyond one LGA
  - the whole of Sydney
- ▼ infrastructure that enables the delivery of core state government services (eg, regional roads, public transport, emergency services) should be paid for by all NSW taxpayers.

Some modification of the strict application of the beneficiary pays principle may be required if the Government wishes to encourage development in high cost areas.

The funding options set out in the Green Paper imply some cost sharing. However, the degree of cost sharing is not clear (eg, how much the NSW Government will contribute) and the rationale for cost sharing is not discussed. The following subsections provide IPART's view on how the costs for particular infrastructure types should be shared.

### **5.3.1 Infrastructure with localised benefits for new development**

The Green Paper's proposal for funding Local Infrastructure Plans would share the costs of some local infrastructure across new development in a localised area. This appears to be similar to the funding of local infrastructure through existing section 94 and section 94A development contributions.

This approach is sensible for infrastructure where the benefits are localised and accrue only to the new development.

Infrastructure with localised benefits for new development includes:

- ▼ on-site service reticulation infrastructure
- ▼ subdivisional roads
- ▼ local transport infrastructure (principally roads but also including footpaths and cycle ways)
- ▼ local open space (however these can be shared between development areas)
- ▼ land for community facilities (also able to be shared)
- ▼ stormwater quantity land and infrastructure
- ▼ sewerage, water and recycled water infrastructure (eg, extensions of existing mains to reach the development area).

Some of these types of infrastructure are currently not in local contributions plans because they are not provided by councils. On-site service reticulation infrastructure and subdivisional roads are provided directly by developers. Sewerage, water and recycled water infrastructure are provided by publicly owned utilities or, in a growing number of instances, by private providers, for example, WICA licensees. Stormwater quality infrastructure is also sometimes provided by publicly owned utilities.

### 5.3.2 Infrastructure with regional benefits

Sharing the costs of new development across a region is reasonable when the infrastructure provided has benefits that extend beyond local/precinct boundaries.

The Green Paper proposes to share costs with new development across a region through the Regional Open Space Levy and contributions for infrastructure in Growth Infrastructure Plans. The region over which the Regional Open Space Levy will apply is not specified.

Infrastructure for new development with regional benefits includes:

- ▼ conservation land and works
- ▼ regional open space
- ▼ stormwater quality infrastructure
- ▼ sewerage infrastructure.

These deliver environmental benefits (eg, water quality and air quality) to the Sydney region and existing residents are also beneficiaries of, for example, regional parks.

The Regional Open Space Levy and Growth Infrastructure Plans mechanisms are similar to the existing SIC, although they may vary in scope and geographic area.

### 5.3.3 Infrastructure that enables delivery of core state government services

Some regional infrastructure that services new development enables the delivery of core State Government services. For example, land for health, educational and emergency service facilities, regional roads and transport (buses). In Sydney's North West and South West Growth Centres such infrastructure is currently funded in part by the SIC.<sup>17</sup> The Green Paper suggests that the SIC will be replaced by development contributions towards similar types of infrastructure identified in Growth Infrastructure Plans.

We consider that infrastructure enabling the delivery of core state government services should be funded by all NSW taxpayers. That is, land for health, educational and emergency service facilities and regional roads and transport items identified in the proposed Growth Infrastructure Plans should be funded by all NSW taxpayers.

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<sup>17</sup> Currently the funding split between the SIC and the NSW Government is 50% each.

#### 5.3.4 Sharing costs between new and existing development

We note that the Green Paper does not discuss sharing costs of infrastructure for new development with existing development.

As discussed above, IPART considers that costs should be shared with existing development where existing development shares the benefits of the infrastructure.

There are a number of examples where new infrastructure costs are already shared between new and existing development. These include funding of:

- ▼ community facilities by local government
- ▼ public transport works by the state government
- ▼ some stormwater infrastructure in the Rouse Hill Development Area
- ▼ land for various public purposes through the Sydney Region Development Fund (see Box 5.2).

We consider that there may be potential for the cost of more infrastructure to be shared on this basis.

Further, there is a choice for the community about the extent to which development in Sydney occurs in infill or greenfield areas. As discussed in section 3.2, the costs of providing infrastructure are generally higher in greenfield areas. The extent to which development can occur in infill areas is partly affected by community opposition to higher densities for a range of reasons such as amenity, environmental issues, and perceived quality of lifestyle for existing residents. When development is required to occur in greenfield areas with higher costs, it may be argued that existing residents should contribute. A possible mechanism for such contributions is discussed in section 5.4.

It should be noted that if the Government chooses to accelerate development in greenfield areas, it will need to keep development contributions at a reasonable level. This means that the balance of the costs of delivery infrastructure will have to be met elsewhere.

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**Box 5.2 Sydney Region Development Fund**

The Sydney Region Development Fund (SRDF) was created under section 129 of the *Environmental Planning and Assessment Act 1979* for the acquisition of land in the Sydney Region.<sup>a</sup> Councils in Sydney currently contribute annually to the SRDF.

The SRDF is used to acquire land for planning purposes, including open space, throughout the Sydney region. It provides funding for the Metropolitan Greenspace Program.

The SRDF or something similar could potentially provide a mechanism for sharing costs between new and existing development. The Government would need to consider how the funds will be distributed to areas requiring infrastructure for new development (this may include the transfer of funds to non-council delivery authorities).

<sup>a</sup> NSW Department of Planning and Infrastructure, *Metropolitan Greenspace Guidelines 2012*, p 8.

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## 5.4 Consider alternative mechanisms for funding

After the question of ‘who should pay for infrastructure’ is addressed, the relevant question becomes ‘how should they pay’.

The Green Paper funding proposal mostly relies on direct development contributions and indirect development contributions. The proposal also includes a new levy. For some types of infrastructure required by new development, the Green Paper does not specify a funding source.

There are a range of mechanisms that are currently used for funding the infrastructure needs of new development. As discussed in earlier sections of this submission, these include direct developer responsibilities, periodic charges and general taxation.

All funding mechanisms currently in place should be considered in parallel with any reform of development contributions. This is important as it reduces existing inequities and prevents further inequities arising.

We also note that Government is currently reviewing the funding arrangements for emergency services. The Green Paper proposes that land for emergency services identified in the Growth Infrastructure Plan will be funded through development contributions. We consider that this cost should be met by the NSW Government. It is important that the outcomes of the current review of funding arrangement for emergency services are considered to ensure there is consistency on funding sources.

In addition, we consider that existing communities could make a contribution towards the provision of infrastructure in greenfield areas as discussed in the next section.



### Contributions from councils in established areas

When an existing community prefers to limit development in their area, thereby reducing the level of infill development that can take place, development is pushed to greenfield areas, where the provision of infrastructure is more costly.

There is an argument therefore, that councils in these established areas should pay a contribution towards the provision of infrastructure in greenfield areas. This could be in the form of a levy on all such councils or those that do not reach infill dwelling, population and employment targets, or incentives for councils that do.

IPART acknowledges that the basis for the relevant targets would need to be carefully considered, preferably with input from councils and developers. Consideration would need to be given to mechanisms for passing on these levies to residents.

## 5.5 Promote contestability

The Green Paper proposes:

- ▼ moving to contestable infrastructure provision as a way of enabling greater involvement of the private sector in the delivery of infrastructure
- ▼ linking strategic planning with the planning and delivery of infrastructure.

We strongly support this approach. The principle of contestability should be embedded in the planning process. This would enable contestability to be applied at all stages of infrastructure design, construction and operation.

As identified in the Green Paper, implementing contestability will facilitate cost savings and encourage innovation. It is our view that contestability provides additional benefits to the planning process:

- ▼ it will increase clarity and transparency in the specification of infrastructure outcomes
- ▼ it provides a framework for the robust evaluation of alternative infrastructure options and trade-offs
- ▼ it facilitates competitive entry, where efficient
- ▼ it may improve the design of the infrastructure solution and remove a potential bias towards traditional capital intensive solutions.

Stakeholders have further argued that contestability of infrastructure will stimulate innovation, competition and housing affordability.<sup>18</sup> Contestability would reduce a tendency to design solutions around an existing network which can provide constraints where an independent solution may prove more innovative and cost-effective.

### 5.5.1 Transitioning towards effective framework for contestability

Under current policy in NSW, there are a variety of mechanisms to facilitate competition and encourage consideration of private sector infrastructure provision to service land development. These include *Working with Government*, the procurement policies of government owned utilities and the *Water Industry Competition Act 2006*.

Implementation of contestability would strengthen and enhance the framework. IPART has the capacity to contribute to the design of the institutional and funding settings needed to support effective implementation of a robust framework for contestability.

We suggest that there are 3 central elements of an effective framework for contestability in the provision of infrastructure. In summary, these are:

- ▼ Increased transparency about the costs and benefits of the available options and greater clarity about who is making what decisions. This would enhance the quality of decision-making about:
  - what is the 'best' solution, including trade-offs made between the delays in land sale to new home-owners and costs incurred by developers; and
  - which entity should be engaged to deliver the services (eg, selection of the established monopoly or a new entrant).
- ▼ Enhancements of existing frameworks to protect consumers, including the customers of new service providers, and to negotiate third party access to the services of existing infrastructure to lower the costs of entry.
- ▼ Reform of the funding system to ensure that the proposals of private infrastructure providers can be fairly compared with the proposals of government owned monopolies.

#### 1. Increased transparency about the costs and benefits of the available options and greater clarity about who is making what decisions

To be effective, the contestability framework needs to be coordinated, transparent and trusted by the community, developers, infrastructure investors, local government, utilities and other stakeholders.

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<sup>18</sup> <http://waterspectator.com.au/welcome-nsw-planning-reform-pls-add-recycled-water/> accessed 28 August 2012.

Under the current policy settings it is often unclear which entity has responsibility for specifying the outcomes that infrastructure is to provide, or for making decisions about the selection of solutions and providers. The process of specifying the infrastructure required for a development and its procurement necessarily involves trade-offs. Poor decision-making or the exclusion of some options can increase costs through delays, duplication or by over-looking more efficient options.

As described in section 3.1.1, in relation to water infrastructure, the holder of land not serviced by the infrastructure of Sydney Water or Hunter Water makes decisions that affect the timing of land development and the entity that provides that service. This decision is made separately to the decisions of Local and State Government or the providers of other services.

We recommend that the planning framework clearly assign responsibilities for:

- ▼ Developing documentation to assist the process of specifying infrastructure outcomes and calling for bids to provide those services. The infrastructure requirements should be defined as outcomes, rather than inputs or specification of traditional assets, to allow innovation and alternative solutions to flourish. This documentation would be available to councils.
- ▼ Ensuring equitable access to background information for potential private infrastructure providers. Potential private infrastructure providers need equal access to planning information such as population and demand forecasts. Also, specifications about existing systems and other constraints for infrastructure are required to allow direct comparisons to be made between alternatives.
- ▼ Evaluating bids received for the provision of services from private and public providers. It is our view that councils should have a role in evaluating alternatives for providing water infrastructure to service land development where it impacts on the timing of the sale of land for housing.

## 2. Enforceable frameworks for consumer protection and third party access

Contestability needs to be underpinned by frameworks for consumer protection and access to the services of existing infrastructure. Consumer protection frameworks enhance community and stakeholder trust that new entrants will deliver quality services to expectations. Third party access regimes provide a framework for new entrants to negotiate use of the services of existing infrastructure to avoid duplicated investments and reduce other barriers to entry.

WICA provides the key elements of the consumer protection and third party access frameworks needed for contestability in urban development.

However, to facilitate contestability, we would recommend that these frameworks are enhanced by the development of improved arrangements for the management of the risk of supplier or retailer failures to enhance customers' and infrastructure investors' confidence in the system.

For essential services such as water and electricity, it is crucial that both private and public utilities deliver certain levels of service to customers. Service standards for supply continuity and safety, as well as consideration of affordability of supply are important in ensuring customers are protected. The current framework provides protection in most situations, but not all.

For example, in the event of the failure of a privately-owned network, there needs to be legislative provisions to ensure continued supply to customers of essential services such as water or electricity. The failure may require a Supplier of Last Resort (SoLR) and/or a Retailer of Last Resort (RoLR), depending on the type of failure and the nature of the system.

There is a well-established retailer of last resort system in place for grid supply of electricity in NSW. This system operated effectively when a small retailer was unable to continue operating as a retailer in 2009. For water, there is the skeleton of such a framework already in place.

We recommend that a robust RoLR and SoLR regime is established in water and electricity before contestability in infrastructure provision is fully realised. This would address concerns that customers could be exposed to risks associated with continuity of supply of essential services. The Department of Finance and Services commenced a review on this issue for WICA in July 2011. The findings from this review should also be considered for the regulation of island networks for electricity.<sup>19</sup>

### 3. Reforms of current funding arrangements

Implementation of contestability and competition is hindered by deficiencies in the current funding system and the absence of price signals about the cost of development. As illustrated in Box 5.3, these deficiencies create a strong bias against private sector infrastructure provision.

Reform of the funding arrangements identified earlier, including the introduction of a simplified system of water developer charges, would mitigate that bias and help to ensure that funding models do not distort the selection of the optimal infrastructure.

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<sup>19</sup> Island network are networks that are not connected to the main grid.

Contestability provides opportunities for specialist infrastructure investors to retain ownership of assets and not only construct them. This opportunity exists at present for water and sewerage assets, but could be extended to other local infrastructure. It provides an alternative source of funding for new infrastructure.

The infrastructure owner would invest on the basis of an ongoing income stream from property owners. Developers would no longer need to pay for the infrastructure up-front, or construct it and give it to the utilities or local authorities. It would require changes to policy areas and pricing by councils and major utilities.

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**Box 5.3      The difficulty of comparing Sydney Water and WICA projects**

For water infrastructure in Sydney Water's area of operations, infrastructure is prioritised in terms of its asset management plans and in response to NSW Planning's development schedule. Where development is in accordance with that schedule, the costs of new infrastructure are shared across the periodic water and sewerage charges of all of Sydney Water's customers.

Privately-funded WICA infrastructure can be delivered in accordance with this schedule, or at some other commercially advantageous time decided by the developer. The costs of infrastructure are ultimately recovered through the price of developed land and/or charges paid to the WICA licensees by service beneficiaries.

These differences in the current funding framework can create perverse incentives and distort the direct comparison between the two options.

For example, if the infrastructure is provided by a WICA licensee, then the efficient costs of delivering the infrastructure must be recovered from the resident of the development. If the infrastructure is provided by Sydney Water, where developer charges are currently set to zero, then the costs are spread across its wider customer base. Depending on the perspective of the decision maker, the pricing signal for the development may be lost.

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