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## CONTENTS



### *Resurgence of Value Capture*

*Professor Martin Locke discusses the potential benefits of active value capture for major transport projects, where such mechanisms can offset the increasing cost of infrastructure funding.*

The concept of value capture has been widely discussed over the past decade as a potential supplement to inadequate availability of funding for infrastructure. It seems intuitively obvious that the development of transport links leads to an uplift in land value and some of that value can be captured and used to relieve pressure on funding. However, there has been a persistent reluctance to implement so-called active value capture mechanisms. Concerns such as deterring development through the imposition of additional taxes and the difficulty in accurately predicting the impact on land values, have stifled the widespread application of value capture initiatives. For example, the Sydney Metro City and Southwest business case included discussion of a Special Infrastructure Contribution ("SIC") as an active value capture mechanism as a potential option but the SIC has not been introduced.

Advocates of value capture have been left frustrated at a time when pressure on funding capacity is intensifying as a result of COVID-19. However, there have been three specific events over the last few months that indicate the tide is turning in favour of a resurgence of value capture.

Western Sydney Aerotropolis SIC

An active value capture mechanism in the form of a SIC has been proposed for the Aerotropolis as part of Sydney Metro Western Sydney Airport. The SIC is stated to be "an important part of integrating land use and infrastructure to ensure the Aerotropolis will be a great place to live, work, study and do business." The SIC is proposed to seek contribution from developers in line with zoning changes and uplift in the value of the land brought about by infrastructure investment. Due to the significant investment by the State and Commonwealth governments in transport infrastructure, a two-tier SIC rate is proposed, including an NDA charge (based on net developable area) and a Station Precinct charge. The Station Precinct charge will apply to development in the vicinity of two Sydney Metro stations and will recover some of the State and Commonwealth governments' investment in the proposed Sydney Metro Western Sydney Airport project. The Station Precinct charge will apply to land within approximately 1.2km of the proposed Western Sydney Aerotropolis and Luddenham stations and land zoned Mixed Use and Enterprise. The Station Precinct charge is calculated as a percentage of the cost of carrying out the proposed development. The proposed contribution rate for Mixed Use developments is 2%. The NSW Government has estimated that the proposed SIC for the Aerotropolis may enable up to $1.1 billion to be collected by 2056 to support the project.

While the potential offset is relatively modest compared to the $11bn cost of the entire new rail line and six stations, the decision to proceed with the SIC is to be congratulated and represents a major step forward.

NSW Productivity Commission Review of Infrastructure Contributions

The NSW Productivity Commission has recently published its final report following a review of infrastructure contributions in 2020. The review is highly critical of the existing system and proposes several ground-breaking reforms, including a recommendation that the beneficiaries of major transport infrastructure investments should contribute to cost for rezoned properties within station service catchments. The report contains a host of insightful observations and statements including:

- lack of an efficient approach to infrastructure cost recovery has caused significant land value uplift around major projects. This tends to reduce the benefits to the State of public investment and is an inequitable transfer of wealth from taxpayers to certain property owners.
- for land value uplift to be genuinely contained and taxpayers to gain substantive benefits from their investment, an active value capture approach is required.
- sale of development rights is an innovative way of opening development opportunities on government land while helping to defray costs of State investment. It is not, however, a comprehensive solution to the problem of funding and delivering state infrastructure in a timely and coordinated way.
- Support for value capture—potentially through a betterment levy—was shared by stakeholders, who criticised the current operation of special infrastructure contributions.
- Bureau of Infrastructure, Transport and Regional Economics (BITRE, 2015) surveyed land value changes for more than 100 projects, finding that heavy rail, light rail and bus rapid transit investments result in an average uplift in property prices of 6.9 per cent, 9.5 per cent and 9.7 per cent respectively.
- To more efficiently and equitably deliver transport services, a transport contributions plan should be adopted by Transport for NSW based on the following principles:
- charges are justified on the basis beneficiaries of major infrastructure through expanded development capacity should pay as it generates uplift in land value
- the objective is to recover development-associated costs accruing to the State
- charges should apply to properties within a service catchment—such as metro stations—and benefit from additional development capacity created as a result of the investment
- apply on a per dwelling basis for residential development and a per square metre of floorspace for net additional commercial, retail and industrial development
- funds should be applied to the underlying project.

Whilst this is only a recommendation, the report not only endorses the widespread application of value capture but specifically requires Transport for NSW to develop an implementation plan for contributions for every major infrastructure project. In terms of the design of the plan, the report suggests:

- contributions emphasise certainty rather than cost-reflectivity, requiring flat charges for development type; variation in demand could be reflected in variation in charges for residential, retail, commercial and industrial zones and take into account density.
- opting for a flat rate provides a transparent, consistent, and certain approach and avoids the practical implementation difficulties of a systematic approach to benefits capture identified.
- contributions would be modest and have a minimal impact on feasibility.

The report provides an implementation plan setting out the process for further consultation prior to Ministerial Determinations by 1 January 2022. The report was finalised after the initial release of an issues paper and extensive consultation through roundtables and targeted discussions, although Transport for NSW is not identified in the report as a stakeholder in the public consultation process.

The report emphasises an efficient and comprehensive approach to cost recovery through improved state contributions rather than a shift to benefits capture. Reform and the recommendations are heavily influenced by the objectives of certainty and simplicity and avoiding complexities of implementation and administration. This is reflected in the recommendation of a flat rate with contributions set at a modest level. This outcome reflects the trade off against (i) imposing a higher charge that deters development and (ii) calculating a contribution rate that is based on a specific valuation of the land value uplift. This raises questions as to (i) whether the contribution flat rate will be set at a meaningful level and (ii) the prospect of continuing inequitable treatment of beneficiaries of land value uplift as a result of the homogeneous approach.

The report recognises that a complete shift away from assessing land value uplift is not appropriate in stating that Transport for NSW in setting the scale of the transport contribution should apply higher charges where costs and benefits are relatively higher. This appears to suggest that there will be a continuing requirement to assess benefits. As noted above, the contribution for the Western Sydney Aerotropolis was set at 2% for mixed use developments; it is reasonable to assume this rate was determined after a benefits assessment was undertaken. Perhaps the methodology could be published to provide standard guidance. The Productivity Commission also identified in its earlier issues paper that current policy allows special infrastructure contributions to help fund the cost of transport interchanges but not the cost of the rail lines in between. Is this anomaly to be clearly corrected moving forward?

There has been widespread discussion over the past decade of the difficulties and inconsistencies in assessing land value uplift, resulting in a failure to build consensus, bureaucratic procrastination and political hesitation. My personal view is that the report helps progress the debate by at least recommending the implementation of a specific active value capture mechanism rather than resort to passive value capture.

Sydney Metro West – Pyrmont Station

Sydney Metro has previously used integrated station developments as a mechanism to capture value, whereby developers have been required to contribute to station costs in return for receiving over station property development rights. Sydney Metro has recently announced the addition of Pyrmont station as part of the Sydney Metro West project. As part of that announcement, Sydney Metro indicated that a value share contribution mechanism will be applied to the Pyrmont Peninsula once the Sydney Metro West project opens. This mechanism will require some commercial property owners that benefit from increased land values associated with the new station to make an annual contribution to offset the cost of building the station. A one-off Transport Special Infrastructure Contribution will also be applied to certain new developments in the Pyrmont Peninsula in advance of the station opening. The quantum of contributions has not been disclosed at this stage.

Financing Faster Rail Report

Mention should also be made of the release of the Financing Faster Rail Report in December 2020 following the Parliamentary Inquiry under the chairmanship of John Alexander. John Alexander has championed the introduction of value capture and notes in his foreword that previous recommendations to establish a value capture model have either been ignored or given token acknowledgement. The report provides a good commentary on the issues and summarises the different perspectives of influential market participants. But many of the views expressed are contradictory and further work needs to done to reconcile differences and reach a consensus. There are high level comments from experts about the need to act fast and sad stories about value escape. The recommendations focus on the need to value land before announcements and develop a fair and equitable infrastructure levy mechanism. But without strong leadership to build a consensus on the design of the value capture mechanism, these recommendations stand the risk of being ignored again.

Outlook

The decisions to proceed with the Aerotropolis SIC and the Pyrmont station contributions plan indicate renewed political appetite for facing up to the challenge of dealing with landowners and developers and curtailing windfall gains on land value uplift. Moreover, funding can be raised in an equitable manner to offset in part the increasing cost of major transport infrastructure projects. The Productivity Commission now provides a well-argued framework for implementing a systematic approach to value capture through the proposed transport contributions plan. Is 2021 set to cement the resurgence of value capture and put an end to value escape?

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