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EQUITY AND EFFICIENCY:

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by

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Abstract

Under Section 94 Contributions Plans, local governments in New South Wales, Australia, can levy developers for amenities and services which require provision as a consequence of new development. Virtually all research on Section 94 has focussed on infrastructure services attendant on new development with almost no work on Section 94 as a means of mitigating adverse consequences of development. This paper examines the mitigatory use of Section 94 in the instance of replacing affordable housing using the case studies of the Waverley City Council and the North Sydney City Council.

Key Words: developer charges, housing, Section 94 contributions plans

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In common with their counterparts throughout the entire developed world, local governments in Australia have found themselves under increasing financial strain. Accordingly, with rate pegging, stringent Loan Council controls, and a real decrease in the value of grants from higher levels of government, Australian local government is not only finding it more difficult to fund new urban infrastructure, but also to maintain existing infrastructure. With its own revenue base severely constricted, the local government sector is placing greater reliance on 'user pays' methods of financing urban infrastructure. In New South Wales the most important example of a user pays funding mechanism is Section 94 of the NSW Environmental Planning and Assessment Act of 1979. In essence, Section 94 empowers local councils to levy developer charges on new developments for services and amenities rendered necessary as a consequence of these developments.

The application of Section 94 developer charges has proved controversial (see, for example, Simpson (1989), Dollery and Barnes (1996), and Neutze (1995, 1997)). The overwhelming volume of research in this area has focussed on developer charges for urban infrastructure contingent on new development, especially drainage, open spaces, roads, sewerage and water.

Very little effort has focussed on the equity aspects of developer charges in mitigating the effects of new developments on relatively disadvantaged groups. The present paper seeks to make a modest attempt to remedy this asymmetry by examining the use of Section 94 developer charges to replace affordable housing in Sydney when its availability has been reduced by new development.

In contrast to the United States, where "housing linkage fees" designed to deal with the problem of reduced housing for disadvantaged groups contingent upon new development are settled largely by means of negotiation between developers and local authorities, two municipalities in NSW Australia provide concrete examples of attempts at creating a systematic and objective method of assessment of levies for affordable housing. Whilst there is undoubtedly a good case for mitigatory developer charges, such as those for affordable housing, we show that some important conceptual problems arise in these attempts to provide an objective legislative method of calculating the magnitude of developer charges. These problems appear to be generic in nature and thus have a significance for local authorities everywhere who seek to impose mandatory methods of determining mitigatory levies.

The paper itself is divided into three main parts. Section one provides a brief contextual discussion to the nature and evolution of developer charges policy in New South Wales. Section two examines and evaluates key issues in the determination of developer charges for affordable housing in the

Waverley Council and North Sydney Council. The paper ends with some brief concluding remarks in section three.

Developer Contributions in New South Wales

In terms of Section 94 of the New South Wales (NSW) *Environmental Planning and Assessment Act* of 1979 local governments acquired the legal rights to levy developers for the provision of infrastructure, services and amenities attendant upon some new development. However, due to various legislative complications associated with Section 94 of the Act, these levies, known colloquially as "developer contributions", have only been fully utilised since 1989. Moreover, in accordance with a recommendation of the 1989 Simpson Inquiry, as of 17 December 1992 local governments were required to have a complete Section 94 Contributions Plan in place before they could impose developer contributions. A Contributions Plan should "... contain an implementation program for contributions and a fiscal strategy to enable efficient, economic and equitable administration of Section 94" (Department of Planning, 1992, p.1).

A great deal of time and effort has been invested in improving the procedures involved in the implementation of Section 94. The NSW Department of Urban Affairs and Planning produced a *Section 94 Contributions Manual* over 1992/1993 which has been widely used by all the parties involved. Moreover, some research has also been directed at the efficacy of contributions levied under Section 94 (Barnes and Dollery, 1996) and various proposals put forward for improving on existing methodologies, including the adoption of an *ad valorem* tax by small councils (Barnes and Dollery, 1996). [See also, for instance, the Industry Commission (1993) and Kirwan (1991)]. Recently a new *Section 94 Contributions Plans Revised Manual* was prepared for the NSW Department of Urban Affairs and Planning by Scott Carver Pty Ltd (1996). This has now been transformed into a new *Section 94 Contributions Manual* by the NSW Department of Urban Affairs and Planning in 1997, which provides guidelines as to how municipal councils should administer Section 94 policy.

Section 94 Charges in North Sydney and Waverley

Two Sydney municipalities, Waverley and North Sydney, levy Section 94 charges to replace affordable housing when its availability is reduced as a result of development. Both councils have had a history of involvement in low income housing - North Sydney since the mid-1970s and Waverley since the early 1980s - and both councils had Section 94 levies for housing in place before the Simpson Inquiry reforms of Section 94 practice (Cox 1995, Bishop 1995).

The basic idea underlying both programs is that if development of a residential area means that the area ceases to be used for residential purposes, or if it remains a residential property but 'there is a net loss of housing or any loss of low to moderately priced accommodation', then a Section 94 developer charge will be levied (Waverley Council 1996:19). The revenue collected is then applied

towards the cost of each councils' affordable housing programs. Typically, the projects in each program involve joint ventures with the Department of Housing to augment the supply of housing for aged, disabled, or low income tenants. North Sydney Council has published figures on the loss of affordable housing through development applications between 1984-85 and 1994-95 (Cox 1995:23). The figures fluctuate from one year to the next, but for the ten years from 1984-85 to 1994-95 the average annual loss was 91 bedspaces per year. Between 1990-91 and 1994-95 the annual average loss was 89 bedspaces per year (Cox 1995:23). The North Sydney Council reported that development pressure prior to the Sydney Bicentennial in 1988 had led to acute losses of low income bedspaces in boarding houses when these were converted to tourist uses. Concern has been expressed that this trend will accelerate in the period preceding the year 2000 Sydney Olympic Games (Cox 1995:26).

An implicit assumption of the local government claim that replacement housing is necessary is that there is insufficient excess capacity in the existing low income housing stock to absorb the losses created by development. In this respect, Cox (1995:25) examined the rental housing vacancy rates in North Sydney and confirmed a rate below the three per cent deemed by the industry to represent a situation of no excess capacity.

The Method of Calculation of Charges

The methods of calculation of charges by each council are broadly comparable. Waverley Council (1996) calculated the average replacement cost of a bedroom in Waverley in 1992 and indexed this amount to 1995 prices. In joint ventures with the Department of Housing, the Council normally contributes 20-30 per cent of the total replacement cost of a bedspace. For 1995, the Waverley Council's cost contribution towards replacing bedrooms was estimated to be $24,514 per bedroom (or 25 per cent of the estimated full replacement cost). The developer is not required to contribute the full amount of Council's share in the cost of replacing a bedroom, but only 25 per cent of this amount (i.e. 25 per cent of council's 20-30 per cent share in the cost of replacing a bedspace). That is, for every bedroom new development removes, the developer charge will replace only one quarter of the Council's costs to replace that bedroom. The actual contribution rates specified in the 1996 Contributions Plan are $6,144 per bedroom lost for developments where the property is no longer used for residential purposes, and $3,993 for properties which remain residential but are strata titled and/or upgraded. The latter figure is calculated at 65 per cent of $6,144 since Council's research indicated that change to strata title caused a loss of about 65 per cent of rental accommodation. Thus, for example, for a block of six two-bedroom flats, if approval was given for strata subdivision, the levy would be $47,916 ($3993 $\times$ 12). Alternatively, if approval was given for demolition of the flats and replacement by a commercial building, the levy would be $73,728 ($6,144 $\times$ 12).

For North Sydney Council, the actual derivation of a rate is less clear. The contribution rate is described as also being based on 'a proportion of the construction cost of a one bed unit' (Cox

1995:19). The rate as at July 1995 was $1710 per bedspace lost, although an increase to around $2500 per bedspace lost was foreshadowed (Cox 1995:55). The latter rate was estimated in 1995 to be one-fifth of council's actual cost of replacing a bedspace (McNeill 1998:295).

The fact that the contribution rate is only one-fifth of the cost to Council of replacing a bedspace for North Sydney, and one-quarter of the cost in the case of Waverley, appears to be a generous discount, and it is quite possible that this is the impression both councils wish to convey by expressing their contribution rates in this manner. However, the extent to which the levies are in fact concessional, in the sense that developers are levied for something less than the actual incremental cost which will be incurred by the councils in responding to the need created, will depend on whether it is council policy to actually replace each bedspace lost on a one to one basis. In fact, it appears that the replacement rate is something less than this. The Waverley Council Plan does not provide any information, but figures supplied by North Sydney Council to Cox (1995:45) indicate that the existing Council policy has been to supply one bedspace (funded by Council in combination with other housing authorities with whom they enter joint venture arrangements) for every seven bedspaces lost. On this basis, the revenue from the current levies will actually enable the council to upgrade slightly its replacement rate policy since the levies are based on a one to five replacement rate, *ceteris paribus*. The conceptual difficulty here is that the marginal capacity cost of responding to the need created by development will depend on council policy: that is, it will rise if council's replacement rate rises. The current situation in North Sydney Council might be construed as upgrading the standard of policy (or charging more than the current marginal cost based on existing policy) in which case the council's levies may be susceptible to legal challenge as being unreasonable. However, this is not an aspect which has been raised in the literature.

The Legal Context of Housing Levies and Section 94 Policy

The housing levies of both councils have been challenged in the Land and Environment Court. In Waverley's case the challenge occurred in 1989, while for North Sydney it appears there has been several challenges (see Simpson 1989:120 and Cox 1995:50-52). The levies in both councils have withstood these legal challenges. The complex details of these legal cases are not discussed here, but it appears that the principles in each case endorsed a point emphasised by Simpson (1989:120); namely, that if a nexus can be established with adequate documentation, then the challenges are less likely to be successful. For example, in a challenge to North Sydney Council in 1994, aspects of the case which reflected in the Council's favour (Bishop 1995:9-10) included the fact that the aims of the Council's housing policy were written in the Contribution Plan, also in the Local Environmental Plan, and in supporting Housing Policy documentation; that Council was able to prove to the Court that the development would result in the loss of low to moderately priced accommodation because the rent levels applying to the property were less than the median weekly rent for North Sydney; and that the amount of the levy (at that time $1600 per bedroom) was considered to be not

unreasonable because it was based on 'the actual cost of replacing one bedroom for every 15 bedrooms lost' (Bishop 1995:10).

It might be added that it seems unlikely that other councils will be able to emulate the success of the two Sydney councils as far as housing levies are concerned. It appears that the fact that the councils already had housing policies in place was important - it was only through this that an obligation could have been imposed on the councils to restore the negative impact of the development.

The 1997 Section 94 Contributions Manual does not include any advice or direct comment on levies for affordable housing. However, it does seem to discourage such levies in the following extract (New South Wales Department of Urban Affairs and Planning 1997:16):

> The proponents of impact mitigation programs argue that while there are benefits of new development (e.g. employment generation, housing diversity), there are also negative impacts which developers should mitigate. Such impacts include gentrification, displacement of poorer people, additional commuters on transport systems.
>
> Whereas s.94 is a contribution for the share of increased demand for public facilities created by development, impact mitigation fees seek to offset the negative impacts of development. Section 94 does not enable the negative impact of development to be compensated for through a form of development tax. For this reason, impact mitigation fees are excluded from consideration under s.94.

This extract illustrates some of the interpretative difficulties associated with Section 94 policy. It can be argued that, contrary to the statement in the extract, Section 94 does enable the negative impacts of development to be compensated because the housing levies of Waverley and North Sydney have withstood legal challenge. Moreover, if it were strictly true that Section 94 did not permit negative impacts to be compensated, then levies would not be possible for downstream drainage problems caused by development, or for road levies on mining development where heavy vehicle use will lead to a deterioration in the road standards for non-mining use. Not only does the Manual condone levies such as the mining levy, but it also suggests that this is an area where the reach of Section 94 may be extended to include recurrent costs. (Current practice is to include only capital costs in charges). For example, the New South Wales Department of Urban Affairs and Planning (1997:32) has observed that 'where as a result of development there is excessive wear and tear on roads, contributions may be sought for the ongoing maintenance of the road ...'.

In instances where it can be demonstrated that negative impacts of a development will impose a fiscal burden on council, there are strong equity and efficiency arguments for including these costs into the 'price' of development. A central theoretical pillar of environmental economics is the Pigovian tax (see Cropper and Oates 1992). This tax can have one of two effects. First, it can lead

negative externality producers to contract their activities to more optimal levels (an aspect focussed on by environmental economists). And secondly, it can create a fund which can be earmarked for restoration purposes (an aspect emphasised in Pigou's later writings - see Andersen 1994:4, 36-39). Moreover, as Lee (1988:291) has observed, the negative impacts 'act as prices on the undesirable side effects of development, and serve to internalize environmental costs that would otherwise be imposed on others as a result of the development'. For example, it does not seem reasonable to charge existing residents for road repairs caused solely by quarry trucks. Thus, there is an argument for retaining impact mitigation levies (or, more precisely, an argument for retaining *fiscal* impact mitigation levies, if we wish to distinguish these levies from the broader impact mitigation fees which apply in the United States (see Collignon 1991:118)). This is so provided that a clear nexus can be demonstrated between cause and effect.

Concluding Remarks

In sum, we can say that the calculation of the levies for affordable housing in North Sydney and Waverley gives the impression of having some 'science' to it but on closer inspection requisite pieces of information are missing in the Contributions Plans. The determination of the marginal cost to council of restoring the housing mix to the pre-development standard requires knowledge of councils' pre-development replacement rate policy. Neither council presents this as part of their calculation procedure. We have also noted that other councils are unlikely to be successful in levying charges for affordable housing, unless they have had a history of local council assistance for this purpose. Finally, the Section 94 Manual appears to discourage levies, such as the housing levies, but it can be argued that there may be good economic grounds for retaining them, and they do not appear to be inconsistent with Section 94 principles any more than some of the more common levies (such as drainage).

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