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Wednesday 3 March 2014

Dear Alison,

IPART draft report on benchmark costs for local infrastructure

Thank you for providing the Property Council of Australia with the opportunity to comment on IPART's draft report on benchmark costs for local infrastructure (November 2013).

The Property Council is the nation's peak representative of the property industry. Our 2,200 members are Australia's major investors, developers and owners of commercial, residential, retail, industrial, retirement living and hotel assets worth over \$320 billion.

We support the Government's review of local infrastructure contributions. IPART's report provides a standardised methodology for the costing of infrastructure in local infrastructure plans based on commercial pricing, and a fair governance framework.

It is critical that NSW finds the right balance in infrastructure charging. The delivery of critical infrastructure to meet a growing population is increasingly unaffordable for industry, and financial management across local government is inconsistent.

Whilst the property and construction industry is responsible for assisting with the provision of additional services for the increase in local population created by development delivered, there are concerning gaps in the review that require urgent revision.

To prevent unnecessary financial obligations being passed through local charging, the methodology requires tightening to remove the real risk of double cost recovery, and deliver a balanced approach to valuing land.

Although the methodology outlines a standard model for costing infrastructure, the removal of the cap gives significant leeway to variation in final calculations. We believe that to counteract cost blowouts, greater auditing rigour needs to be built into governance levers.

The success of this review is based on a fair, reasonable and proportionate framework being developed, and we recommend that greater consultation with industry and professional experts is sought.

Please find below our areas of concerns and recommended solutions.

If you would like to discuss this submission further, please contact me on (02) 9033 1906 or gbyres@propertyoz.com.au, or Amelia Jalland (Senior Policy Advisor) on (02) 9033 1951 or ajalland@propertyoz.com.au.

Yours sincerely,



Glenn Byres
NSW Executive Director
Property Council of Australia

RECOMMENDATIONS TO BENCHMARK COSTS FOR LOCAL INFRASTRUCTURE

1. Establish a balanced framework to valuing land

Preferred valuation methodology depends on whether land is being bought or sold, its locality, local market conditions, and final use.

Both market value estimation and historical purchase price indexed to CPI pose merit, and the Property Council urges no one method should be mandated.

Instead, we recommend a market sensitive view is taken with flexibility maintained to allow the application of an alternative approach that is considered more appropriate.

Market value estimation

Market value estimation is most beneficial for land that has already been zoned, and is part of well a well-established open market for direct comparison.

Commercial and residential land is valued at regular intervals by the Valuer-General to establish the collection of rates and levies. It provides an established framework of valuation to draw upon.

However, we note that market estimation is contestable and independent assessment is vital to ensuring accuracy and balance.

Historical purchase pricing indexed to CPI

We appreciate that where greenfield areas are concerned, valuing land is more challenging. This is particularly the case where land is yet to be re-zoned for future purposes, or is zoned for 'special uses' and there is a limited comparable market base for market based valuation.

In this context, historical purchase pricing indexed at CPI provides market certainty. Industry believes that this encourages the development of difficult sites, as it removes any penalisation incurred from uplift in land value.

Although CPI escalation is a simple approach, many land parcels cannot be assessed accurately using this method. For instance, sourcing historic records for land that has been in council ownership for a number of years is challenging. There have been cases where parcels have been dedicated as part of subdivisions of former estates with no transfer price.

Also, CPI escalation is unlikely to provide a real 'valuation' as it is not reflective of the broader price movement of real estate markets. For example, CPI may still increase during a period of collapse and negative growth in the real estate land market.

Conclusion

The Property Council urges that a balanced approach to valuing land is taken. We recommend a market sensitive view is considered with flexibility built in for developers and councils to subject land pricing to review and negotiate final outcomes.

We reinforce that a council's assessment of land parcels should be conducted by an independent valuer to ensure greatest accuracy and prevent conflict of interest.

Where land is difficult to value - particularly in release areas - we do not support the concept of land being costed based on its forecast future value as a solution. Instead, we recommend that further review be undertaken based on consultation with industry and valuation experts to consider how this can be appropriately addressed.

We also understand that the Infrastructure Contributions Taskforce is reviewing the valuation of land dedicated as part of an in-kind agreement. We recommend that industry and valuation experts are consulted in-depth to inform a sensitive approach.

Re-making local infrastructure plans annually would result in significant additional administrative expense and instability in the planning system. IPART recommends that councils adjust benchmark costs using construction-based Producer Price Indices to reflect changes in pricing in future years.

As a result, we believe that a prudent formal review process be established to evaluate land values in finalised local infrastructure plans from year to year. This is critical given revising charges in lieu of re-making plans removes the need for public consultation of price changes.

We recommend that annual reviews are conducted by an independent audit team comprising independent valuers and market experts. We believe the team should work with councils to inform final figures for approval by the Department of Planning and Infrastructure.

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| Recommendation: | Consult industry and valuation experts to establish a balanced framework to valuing land. |
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2. Tighten the base cost model and its governance arrangements

The Property Council is deeply concerned by the inclusion of indirect costs, margin costs, and council on costs in the base cost calculation.

These costs overlap with business as usual administration overheads of running a council which should typically be covered by general revenue streams such as rates and DA lodgment fees.

Additionally, the base cost calculation should not include costs that are already established and accounted for in tenders and Section 94 contributions plans.

The cost base model is vulnerable to double cost recovery, and counteracts IPART's intention that *'local infrastructure contributions reflect the efficient cost of providing infrastructure and be affordable'*.

As a result, areas of double cost recovery must be identified and removed from the model to prevent unnecessary financial obligations being passed through local infrastructure charges.

Furthermore, we recommend that cost calculation rules are developed from the outset to guide charging and prevent cost creep. The rules should be a high order policy for 'reasonable and fair' infrastructure standards which all delivery agencies are required take into account.

We do not support double cost recovery and recommend that further review of the base cost is undertaken in consultation with industry to identify and remove areas of overlap.

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| Recommendation: | Review the base cost formula to remove double cost recovery in indirect, margin and council on costs. And, develop high order rules to prevent cost creep and deliver fair and reasonable standards. |
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3. Cap the contingency allowance

Industry believes a mid-point range for the calculation of contingency in the base cost is appropriate.

If a more conservative approach is adopted, then costs will be recovered in Section 94 agreements, other levies, or tenders at significantly higher charges than the actual cost of works. This would result in poor value for both public interest and industry's capacity to deliver growth infrastructure.

However, to prevent the risk of over-estimation of contingency and unnecessary additional charging, we recommend that a cap be built in. For example, a council can only charge up to the maximum cap if they can demonstrate the overrun; and that the overrun is beyond their control.

Although this framework may lead to increased challenges, it provides a prudent threshold for cost calculation.

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| Recommendation: | Cap the contingency allowance in the base cost and set a prudent framework for cost calculation where overrun must be demonstrated. |
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4. Set a stringent review framework from the outset

We support the proposed governance review framework for benchmark costs by the Department of Planning and Infrastructure and believe greater stringency is required.

Undertaking benchmark costing is a significant exercise and demands expertise, ongoing revision and consistency in attention to detail. As councils will be required to self-adjust benchmark costs to reflect current price indices, it is critical that a strong review cycle is established from the outset.

We believe that the Department should approve all local infrastructure plans and associated benchmark costs for finalisation. We support the concept that a council must provide justification in the instance they have deviated from the benchmark costs.

And, we recommend that the Department be awarded audit review powers to assess non-compliance, and oversee cost re-calculations.

We recommend the first IPART review period of benchmark costs occur within two years instead of four as proposed, with a standard review period of three years thereafter.

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| Recommendation: | Provide the Department of Planning and Infrastructure with audit oversight to review of costs and re-calculate benchmarks where a council has deviated from benchmark guidelines. |
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| | And, undertake the first IPART review period of benchmark costs within two years, with a standard review period of three years thereafter. |
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5. Develop a robust dispute resolution system

Given the uncapped nature of local contributions, all cost estimates must be contestable and subject to independent review.

We support the development of a strong dispute resolution system for local benchmark costs, with streamlined rigour in decision-making processes and timeframes.

It is crucial that the potential for disputes is mitigated from the outset. And as noted above, this would be best achieved by delivering benchmark methodology that is fair, reasonable and proportionate.

We believe clear and transparent pathways are necessitated to ensure benchmark costs are competitive and appropriately priced. And as a result, it is vital that the dispute pathways avoid risk of conflict of interest, and additional red-tape delays.

Robust governance arrangements must be formulated to ensure council internal review processes resolve disputes in the first instance. We recommend that where a dispute occurs, an independent auditor specialising in infrastructure charging oversees the resolution and makes recommendations for consideration.

If the dispute remains unresolved, we believe that it should then be referred to the Department of Planning and Infrastructure to oversee further independent auditing and review instead of an Independent Hearing and Assessment Panel or Joint Regional Planning Panel.

IHAPs and JRPPs do not have expertise in infrastructure benchmark costs. They would require training and additional resourcing to assess local contribution matters in conjunction with their existing responsibilities. And, this would add delay and cost to decision-making.

As the Department is responsible for overseeing the development of growth infrastructure plans, it is appropriate that the Department's review powers also include dispute resolution mechanisms.

We support the report's recommendation that the Minister could refer matters concerning the application of benchmarks and costs methodologies in local infrastructure plans to IPART for resolution.

However, we believe further review should be undertaken to determine the final port of arbitration. We believe the role of the Land and Environment in assessing contributions disputes needs to be determined in consultation with legal experts and industry.

Recommendation:

Develop an efficient dispute resolution framework with clear time-frames for decision-making and transparent assessment. The pathways should comprise:

- An independent auditor to oversee an internal dispute resolution between the council and developer. The auditor should assess areas of concern and make recommendations for consideration.
- If the dispute remains unresolved, the Department of Planning and Infrastructure

should review the recommendations made by the auditor, conduct a full review if needed, and determine the resolution.

- If matters cannot be resolved, the Minister could refer matters concerning the application of benchmarks and costs methodologies in local infrastructure plans to IPART for resolution.
- And, determine the role of the Land and Land and Environment Court as the final arbitrator. This requires in-depth review with legal experts and industry.

6. Leverage industry's expertise on an ongoing basis

We greatly appreciate the opportunity to work with IPART and the State Government to develop a fairer local infrastructure contributions framework.

We understand the complexity and sensitivities in developing benchmark costs. We recommend that an industry advisory panel is established on an ongoing basis to provide commercial expertise on calculations of items, and reviews of costs.

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| Recommendation: | Establish an independent industry advisory panel to draw upon commercial expertise on item charging and reviews of costs. |
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