

14 January 2020

Ms Cindy Callendar
Board Secretariat and Policy Officer
Precinct Design
Department of Jobs, Precincts and Regions

By email: cindy.callander@ecodev.vic.gov.au

Dear Ms Callendar

Affordable Housing in Fishermans Bend

I write in relation to the Department of Jobs, Precincts and Regions' (DJPR) continuing work on developing Affordable and Social Housing Guidelines for Fishermans Bend.

I note that the proposed Guidelines will seek to assist stakeholders meet the policy of providing 6 per cent Affordable Housing and delivering the goals of the Fishermans Bend Framework.

The Minister for Planning recently established the *Planning Mechanisms for Affordable Housing Ministerial Advisory Committee* (MAC), to which the Property Council of Australia made a submission. I **enclose** a copy of that submission for your reference.

We urge DJPR to delay any decision in relation to Affordable Housing in Fishermans Bend until the outcomes of the MAC process, and the Government's response, are known. It is important for both community and industry certainty that the two processes do not differ.

If you have any questions, please contact me on (03) 9650 8300.

Yours faithfully,



Cressida Wall
Executive Director, Victoria
Property Council of Australia

Submission to the Planning Mechanisms for Affordable Housing Ministerial Advisory Council

The Property Council of Australia (Victorian Division)

Introduction

The Property Council of Australia welcomes the opportunity to provide a submission to the Planning Mechanisms for Affordable Housing Ministerial Advisory Council (**MAC**).

Housing plays a significant role in Victoria's social and economic prosperity. Lack of affordable housing can lead to homelessness, poor health and lower rates of employment and education.

Affordable housing requires the cooperation of both government and industry and must remain viable for all parties. Noting this, the Property Council supports a model that provides appropriate incentives to encourage the development of new affordable housing stock. This approach, rather than a mandated approach, has the greatest potential to achieve the outcome that both government and industry desire – an increase in much needed affordable housing throughout Victoria.

About the Property Council

The Property Council of Australia is the leading advocate for Australia's property industry – the economy's largest sector and employer.

The property industry accounts for 13 per cent of Australia's GDP, employs 1.4 million Australians – more than mining and manufacturing combined – and helps secure the future of 14.8 million Australians who invest in property through superannuation funds.

In Victoria, property contributes \$45.1 billion to Gross State Product (12.4 per cent), employs more than 331,000 people and supports more than 400,000 workers in related fields.

The Property Council's members drive the economy. They conceive, invest in, design, build and manage the places that matter most to Australians – our homes, shopping centres, office buildings, industrial areas, retirement villages, education, research and health precincts, tourism and hospitality venues and more.

The Property Council's Victorian Division has more than 500 members representing all aspects of the industry. Its members are architects, urban designers, town planners, builders, investors and developers.

The Property Council supports smarter planning, better infrastructure, sustainability, and globally competitive investment and tax settings which enable its members to make a lasting contribution to the economic prosperity and social well-being of Australians.

The Property Council has long been actively involved in ongoing discussions on affordable housing and is a member of the Affordable Housing Industry Association Group.

Mandatory inclusionary zoning

The Property Council opposes mandatory inclusionary zoning on private land. We recognise that the provision of appropriate levels of affordable housing is reliant on several complex policy and

market factors. It is not realistic to expect this issue to be solved by the property industry alone, particularly given chronic and repeated under-investment in social housing by successive governments and the issue of affordable housing being one which has emerged incrementally and which governments have not solved.

In many Australian jurisdictions, legislators (particularly elected representatives in local government) appear to be contemplating a form of inclusionary zoning. The Property Council's members are increasingly required to include affordable housing in their developments and these policies have been created in an ad-hoc manner, often with no consideration of project economics.

Mandatory inclusionary zoning operates as a tax on at-market dwellings and can result in consequences that are counter to the policy objective to provide more affordable housing.

Mandating affordable housing requirements in private developments poses significant commercial disadvantage to landowners who had purchased land at high prices, unencumbered by inclusionary zoning requirements. Mandatory inclusionary zoning effectively devalues sites currently held with the consequence that either:

- sites may not be sold or developed, limiting housing supply and further hampering affordability; or,
- the additional costs will be borne by other purchasers in the development through increased purchase prices in order to maintain project economics and secure finance.

Studies have shown that increased "fees", including costs associated with inclusionary zoning, can have significant negative effects on land prices¹ and have found a significant negative correlation between those fees and the number of new homes built.²

Landowners should not be subject to changes in regulation which subsequently prevent or constrain their ability to develop or deal with that property. To do so fundamentally alters the premise upon which the land was purchased and amounts to a tax on that landowner. Changes in government policy to this effect create sovereign risk and discourage both individual and institutional investment in Victoria.

Notwithstanding the Property Council's position on mandatory inclusionary zoning on private land, we acknowledge that there may be limited circumstances in which mandatory inclusionary zoning may be appropriate. This is the case where it:

- a. occurs on Government land;
- b. is clearly identified in any master planning or bid documents issued by Government; and
- c. is not imposed after a procurement process.

¹ Ihlanfeldt and Shaughnessy, *An empirical investigation of the effects of impact fees on housing and land markets* (2004).

² Skidmore and Peddle (1998).

Rather than mandating affordability taxes, the Property Council instead recommends an approach whereby the private sector is appropriately incentivised to provide affordable housing. Not only does this represent a fairer outcome for private landowners, it is more likely to provide greater amounts of affordable housing stock.

Economics of a project

Housing requires capital and attracting capital in an increasingly global marketplace is competitive. There are several hurdles that must be met and two key decision points when determining whether to invest in a property development:

1. the initial decision by a board or investment committee to pursue an opportunity via a competitive process or by securing the site; and
2. the decision by the funders to move into the full delivery phase of a project – typically called financial close and occurring after design, site development approvals, pre-leasing or sales, a suitable end valuation, and an offer to fund have all been procured.

These two points are typically more than nine or 12 months apart, but both rely on key decision makers having the confidence in the forecast project outcome relative to the profitability shown in the feasibility model available at the time.

Development groups and institutions typically report overall profit margins of less than five per cent for the business as a percentage of turnover, even when things go to plan. This indicates that while a developer's profit might appear to have scope for adjustment, in reality there is little capacity for this to occur if developers are to retain the ability to take on new project investment.

It is also important to note that the profit margin is the bank's 'insurance' to ensure that they can recover their debt funding if the project profitability turns sour. Without this margin or buffer, the cost of debt funding projects rises significantly, again threatening the viability of the project.

There are two distinct phases in the decision to move to full delivery phase of the project, post-land acquisition:

- pre-Financial Close where most or all activity is funded by equity; and
- post-Financial Close where debt funding becomes available to fund further activity, often repay equity already invested, and spread project risk to include the funding providers.

'Financial Close' is that point in a project where sufficient certainty has been gained in the commerce and timing of a project such that the banks or other funding institutions will provide non or limited recourse debt funding to allow the physical delivery of the project to occur.

Financial Close requires the satisfaction of 'conditions precedent' and a range of project activity. For private sector development, these are nearly always:

- securing an offer to fund the project from banks and financial institutions
- achievement of a suitable project valuation to the satisfaction of the funding entities
- achievement of the required level of pre-leasing or pre-sales revenue for the project
- resolution as to cost and timing of satisfaction of conditions of development approval
- achievement of a development approval (or similar as appropriate) for the project
- negotiation and agreement of infrastructure charges and developer contributions to local government and statutory agencies and utility providers

- resolution of the design of the project including stakeholder negotiation and consultation as required by planning legislation and planning assessment processes
- acquisition of the site, development opportunity or development / purchase rights
- board and finance committee approvals to bid for a project or development opportunity; and
- due diligence and research into the pros, cons and unknowns of the project opportunity.

If Financial Close is not achieved, as is quite often the case due to valuation or profitability shortfall, a great deal of the 'soft' costs identified above are generally lost as the project is dropped, reconfigured for a varied use and scale, or left to participate in the next 'up' cycle of the market when the land use, design and configuration of the project is typically changed due to changed market conditions. This loss eats into the overall returns in a company and is effectively amortised over future projects (and taken out of the margin of projects which achieve a higher than expected margin).

This loss will often run over a period of one to two (or more) years and needs to be funded using equity or cash – being the most tightly held and valued segment of funding in any project.

Planning outcomes, development approval conditioning, and infrastructure charging regimes need to provide certainty to organisations in the critical phase of board approval to commit their organisation to a significant equity expense and exposure.

The overseas experience is not appropriate for Victoria

Inclusionary zoning has a long history overseas. In the United States, an inclusionary zoning policy was drafted in 1971 by Fairfax County, Virginia. Though struck down by the state courts as unconstitutional, its principles resurfaced in subsequent policies that were upheld in other parts of the country. In 1974, Montgomery County, Maryland enacted the first legally defensible inclusionary zoning policy. Today, more than 200 localities have similar statutes. California has statewide legislation that applies to all redevelopment areas.

In the UK, section 106 of the 1990 *Town and Country Planning Act* permitted localities to require developers to provide affordable housing. In 2004, London introduced a target for 50 per cent of new housing across the region to be affordable. The plan stipulates that affordable housing requirements be applied to sites with 15 or more residential units. London also has designated 31 Housing Zones with a high growth potential. Development in these zones is supported by government grants and loans to developers, Boroughs and Housing Associations and has a requirement for 30 per cent affordable housing delivery.

Given its long history in London, inclusionary zoning has been factored into land prices for nearly three decades. Without that long history, if London's inclusionary zoning policies were simply translated to a Victorian context today, it would pose significant commercial disadvantage to landowners who had purchased land at high prices, unencumbered by inclusionary zoning requirements.

While average figures are difficult to come by, we are aware that in London, the 50 per cent target is regularly not met and to some extent, is considered a stretch target.

As mentioned earlier in this submission, studies have shown that increased “fees”, including costs associated with inclusionary zoning, can have significant negative effects on land prices³ and have found a significant negative correlation between those fees and the number of new homes built.⁴ Ihlanfeldt and Shaugnessy’s study found an additional US\$1.00 of fees increases the price of both new and existing housing by about US\$1.60 and reduces the price of land by about US\$1.00 in Dade County, Florida. To illustrate this, mandatory inclusionary zoning that, in effect, subsidises affordable housing by adding (say) \$10,000 to the cost of the associated private dwellings would increase the price of new and existing housing by \$16,000 per dwelling, and reduce land values by \$10,000.

Despite London’s affordable housing targets, it still suffers from an acute housing shortage and has some of the world’s highest property prices. London house prices have risen considerably in real terms and relative to incomes.

The number of houses being built is rising at a slower rate in London than any other region in the UK. 40,735 energy Performance Certificates (EPC) — a legal requirement for a new home — were granted in London in the 12 months to June 2019.⁵ Across England and Wales as a whole, the total rose more quickly, by 27 per cent to 254,894, over the same period. The number of EPCs issued is seen as an accurate indicator of the underlying level of house building. The figures, compiled by estate agency Savills, suggest the delivery of new homes is still falling short of the 65,000 a year identified in City Hall’s new London Plan as the minimum needed.

Furthermore, the increasing inclusionary zoning obligations in London have been accompanied by a chronic under-supply of construction of new at-market housing. Current housing supply is about half of the 66,000 annual supply identified by the Mayor as being required for greater London.

In Victoria, attempts to promote affordable housing have been less uniform. There is no state-wide position on inclusionary zoning and, instead, this has been dealt with at municipal level on an ‘optional’ basis. Recently, Planning Scheme Amendment C309 has proposed a 6 per cent affordable housing component for developments in West Melbourne, while we are aware of a developer being “asked to contribute” 21 per cent affordable housing in the City of Moreland.

In 2018, changes came into effect to amend the *Planning and Environment Act* introducing an additional objective to facilitate the provision of affordable housing in Victoria.

While overseas jurisdictions use inclusionary zoning to secure affordable housing, there are differences in the definition of affordable housing, tenure of housing secured and the circumstances and approach to supplementary funding. These differences mean cities such as London, can reasonably require a higher proportion of affordable housing across a mix of tenures in comparison to Melbourne.

This approach is not appropriate for the Victorian context.

In Victoria, despite the recent downturn in residential property prices, projections indicate that housing supply will not keep pace with projected population growth over the next few decades. Any measures that serve to increase the production costs of new housing risk further constraining this supply and must be carefully considered. It is clear that any state-wide affordable housing

³ Ihlanfeldt and Shaugnessy, *An empirical investigation of the effects of impact fees on housing and land markets* (2004).

⁴ Skidmore and Peddle (1998).

⁵ <https://www.homesandproperty.co.uk/property-news/london-housing-shortage-home-building-is-rising-at-a-slower-rate-in-london-than-any-other-region-a132876.html>

policy adopted in Victoria needs to be Victoria-specific to adequately deal with the realities of Victoria's economic and social circumstances.

Proposed Property Council of Australia principles

In light of the above, the Property Council sets out below the key principles that should underpin Victoria's affordable housing policy:

Government – not industry – has primary responsibility for affordable housing

1. It is the primary responsibility of governments to ensure that economic settings are appropriate to facilitate the supply of housing that meets the needs of homebuyers.

Inclusionary zoning should not be mandatory

2. Accordingly, inclusionary zoning on private land should not be mandatory. It cannot be the case that, although termed "optional", in practice the provision of affordable housing becomes an expectation when assessing planning approvals. In the context of any planning controls that are applied to give effect to affordable housing policy, the use of the term "should" in place of "must" will not itself mask any lack of flexibility in those controls.
3. If affordable housing requirements are mandatory, the only place for them to be imposed is in situations where they are:
 - a. on Government land;
 - b. clearly identified in any master planning or bid documents issued by Government; and
 - c. not imposed after a procurement process.

Where inclusionary zoning is applied, it should be consistent and easy to implement

4. Clear, consistent and implementable mechanisms for the delivery of affordable housing are critical to its success. These will provide certainty for Government, the community and the property industry.
5. For the community, clear implementation mechanisms are important to ensure that affordable housing is reserved for low-moderate income earners, and dwellings are not able to be immediately on-sold at market rates, ensuring that policy objectives are being met.
6. Similarly, clear implementation mechanisms provide certainty and confidence to the property industry. This removes a level of project risk and, ultimately, may increase the number of landowners willing to develop properties to increase affordable housing stock.
7. Key implementation measures must include (at a minimum) a central body responsible for the assessment of eligibility requirements (for example, HomesVic or the Office of Housing). Central oversight is critical. Developers should not be required to deal with differences in policy or interpretation across municipal boundaries. The provision of affordable housing should be provided with equal opportunity to succeed across Victoria, regardless of location.

Without appropriate government incentives, inclusionary zoning mandates will have negative effects on affordable housing

8. In the case of incentivised (not mandatory) inclusionary zoning on private land, appropriate incentives should be available to assist project feasibility and encourage uptake from the property industry. These incentives could include:
 - a. Up-zoning, whereby industrial land is up-zoned to residential or mixed-use in exchange for the delivery of affordable housing;
 - b. tax incentives, including:
 - i. land tax relief for dwellings offered for affordable housing; or
 - ii. a scheme similar to the national rental affordability scheme (NRAS) that encouraged large-scale investment in affordable housing through the provision of tax and cash incentives to providers of new dwellings (NRAS incentives included a Federal contribution in the form of a refundable tax offset per dwelling and a state contribution in the form of direct financial support or an in-kind contribution);
 - c. a fast-tracked system for planning approvals in respect of projects that include a component of affordable housing, removing an element of risk for developers and minimising costs and delays associated with the planning process;
 - d. floor space ratio and other design incentives, that reward developers prepared to offer a component of affordable housing with additional height, or that provide developers with flexibility in respect of design standards; and
 - e. clear parameters to define the number of affordable dwellings to be provided and at what percentage of market rent those dwellings must be offered, removing ambiguity in the negotiation of affordable housing agreements.
9. The Affordable Housing Industry Advisory Group's October 2017 paper, *Advancing Land Use Planning to Facilitate Affordable Housing*, provides a summary of planning provision concepts that consider appropriate incentives, to ensure the viability of projects with affordable housing components. An extract of that paper is set out at **Attachment A**.

Development economics must be realistic

10. Like all business, property development requires a commercial return, sufficient to cover project risks. The extent of any required return (or margin) relies in part on equity investors and in part on external financiers and includes consideration of a project's risk profile.
11. In the absence of relevant implementation incentives, there are only two possible outcomes:
 - a. Developers will attribute the cost of the affordable housing to other dwellings in the development; or
 - b. Project Internal Rates of Return (IRR) will be insufficient to make the project viable, meaning the project does not go ahead and reducing supply in the market.
12. Either of these outcomes reduces housing affordability: the very issue that is sought to be addressed through these mandates. Where anticipated margins are insufficient to meet the expectations of debt or equity holders, a project cannot proceed. From the perspective of affordable housing, it means additional housing stock will not be built. Clearly,

affordable housing requirements that do not respect the commercial viability of a project, or that are unrealistic, will lead to outcomes contrary to their purpose.

13. The Greater Sydney Commission (GSC) has previously noted the importance of feasibility testing across a nominated area.⁶ It noted that it was critical to ensure that any affordable housing target does not impede the economic viability of projects delivering new housing.
14. The GSC said that details on viability testing assumptions and parameters will be agreed in partnership with the NSW Department of Planning and Environment. The viability testing will consider the feasibility of residential development, with a normal risk/return margin, including the cumulative costs of local, and where appropriate State contributions. Where required, the Commission will independently verify the viability of a recommended target and advise the government on where exceptions may be granted if it is clear a target would financially hinder delivery of a critical or major component of city-making infrastructure.

Setting a percentage

15. Setting a reasonable percentage for incentivised affordable housing is critical.
16. There is a big difference between a five per cent affordable housing component, with which developers might be able to deliver a commercial return while supporting the government's policy objectives, and 20 or 30 per cent component which is likely to render a project commercially unviable.
17. For more complex, high risk, highly competitive, or consumer-price sensitive projects, even five per cent may put viability at risk.
18. It is incumbent on the Government to be reasonable in determining any preferred percentage, in light of the need to consider development economics and project feasibility, and to avoid the unintended consequence of a lack of supply if the provision of affordable housing is not commercially viable for a developer.

The Property Council welcomes further engagement with the MAC. Please contact me on (03) 9650 8300 if you have any questions or would like any clarification on this submission.

Cressida Wall
Victorian Executive Director
Property Council of Australia

⁶ Greater Sydney Commission Information Note 4, Affordable Rental Housing Targets (Revised October 2017).

ATTACHMENT A – Extract from the Affordable Housing Industry Advisory Group's October 2017 paper, *Advancing Land Use Planning to Facilitate Affordable Housing*.

	Planning Provision	Potential zoning application	Minimum development size	Affordable housing contribution	Estimated \$ value to affordable housing / 100 units	Estimated # affordable dwellings / 100 units*	Estimated contribution to affordable housing supply per annum**
Priority, Independent Development Assessment Provision	<ul style="list-style-type: none"> • Voluntary (opt-in provision) • Application assessed by Independent (expert) Development Assessment Panel • Guaranteed assessment period (3 months maximum) • Removal of third-party appeal • Value share in form of contribution to affordable housing 	Mixed Use, Activity Centre and/or Residential Growth Zones	40	\$ value of land or translated into additional floor area contribution	\$130,000	0.3 units	Low
Additional Floor Area & Density Development Assessment Provision	<ul style="list-style-type: none"> • Voluntary (opt-in provision) • Provision of additional floor area • Application assessed by Independent (expert) Development Assessment Panel • Guaranteed timeframe (3 months maximum) • Removal of third-party appeal • Value share in form of contribution to affordable housing 	Comprehensive Development, Mixed Use, Activity Centre, and/or Residential Growth Zones	40	Delivered on site	\$1,250,000 - \$2,054,000 (70 - 200% uplift)	3.3 - 5.4 units	Moderate
Discounted (Affordable housing) Provision	<ul style="list-style-type: none"> • Sale of a percentage of units (within agreed locations or meeting agreed criteria) at discount to Market Value (in an affordable housing purpose (modelled on 30 per cent discount)) • Applied with sufficient advance notice to market for developments over 100 dwellings • Lower percentage to be sold in year one (modelled to commence on 1 per cent total stock) to incrementally increase over time. 	Comprehensive Development, Mixed Use, Activity Centre, and/or Residential Growth Zones	100	Delivered on-site	\$180,000	1 unit (Year 1) increasing to 5 units in Year 5	Moderate

*Based on feasibility assessment of 100-unit development

** Low is considered less than 100 dwellings, Moderate between 100 and 500 dwellings, High, over 500 dwellings. Subject to detailed analysis.