

Infrastructure Funding Models Study

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Parramatta City Council

By



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Executive Summary

The Parramatta CBD is expected to receive a significant amount of development in the future. This will likely include developments accommodating thousands of new residents and workers. These developments will generate increased infrastructure demands.

The costs of the new and enlarged facilities to meet these demands will be met from a variety of funding sources. The contributions developers pay to the local council will be a primary source.

This report examines the opportunities for Parramatta City Council to extract contributions from the future CBD developments. It examines the conventional contributions mechanisms that are available as well as the opportunities for implementing alternative or innovative tools such as value sharing.

A 3% section 94A levy currently applies to development on land throughout the CBD area. The section 94A mechanism has historically been preferred because of its simplicity and low risk of legal challenge.

An analysis of projected income from a mix of conventional section 94 / section 94A approaches showed that:

- Continuation of the current 3% section 94A levy would yield the lowest income of all the approaches (\$165 million)
- Combinations of section 94 contributions and section 94A levies on different developments would yield higher levies (between \$193 million and \$232 million)
- A 4.5% section 94A levy on all new development would yield the highest income of all the options (\$247 million).

The impacts of the various options on the viability of mixed use development were examined. If Council was to implement a section 94A levy of 4.5% or a new section 94 contributions plan, some Parramatta CBD projects would move from being viable to being on the cusp of achieving the necessary development benchmarks to make them worthwhile to proceed.

Council has estimated that the future CBD infrastructure upgrades will cost at least \$835 million.

Application of a section 94A levy to future development, even at the 4.5% level will only yield a fraction of the income needed to meet this cost. As a result, GLN Planning investigated alternative or non-traditional contributions schemes that are operating in other development areas in Sydney. We tested the potential for so-called 'value sharing' schemes to provide additional funds to meet the infrastructure costs, and also tested the impacts of a 'Phase 1 / Phase 2' value sharing scheme on the viability of hypothetical CBD developments.

Our investigation of these alternative schemes concluded that:

- Significant additional development contributions to fund infrastructure could be received by Council through implementing a value sharing scheme.
- Phase 1 value sharing may negatively impact on viability of some projects as it introduces an unanticipated development cost. However whether the impact results in viability benchmarks being unable to be achieved will depend on the level of sharing and the time since the site was purchased. Our research indicates that a 10-20% level of Phase 1 value sharing could be tolerated in the current market.
- The larger developments – that is, developments above 12:1 – would remain viable with Phase 2 value sharing at any level. It would be unreasonable however to expect developers to tolerate Phase 2 value sharing to exceed 50%.

Optimum strategy using currently available contributions mechanisms

The optimum contributions strategy for the anticipated future development in the Parramatta CBD, using the current tools, is outlined below:

- (a) Continue the current practice of requiring developers to carry out works on and near their development sites where it is reasonable to do so.
- (b) Continue the current practice of consent authorities imposing a section 94A levy on all eligible development, but seek the support of the Minister for Planning to allow the maximum levy to be increased from 3% to 4.5%.
- (c) Continue to negotiate VPAs with developers to extract additional public benefits associated with new developments.

If on the other hand the Council was unsuccessful in obtaining the Minister's support for a maximum 4.5% levy, and Council still wanted to achieve a higher financial return than the current 3% levy, it could pursue a hybrid contributions strategy that allowed section 94 contributions to be imposed on mixed use development, and a section 94A levy on wholly non residential (i.e. commercial and retail) development.

This approach however would be more resource intensive and may down the track potentially expose Council to legal challenge on the reasonableness of its contributions in individual development approvals. These risks however can be managed.

We therefore recommend that Council prepare a draft section 94A contributions plan that authorises a levy of up to 4.5% on future CBD development and seek the Minister for Planning's endorsement to amend the EP&A Regulation to allow the levy.

Council could then choose to impose a lesser levy on straight commercial office development in order to retain the Parramatta's competitiveness in the Sydney suburban office market.

In the event that Council is unsuccessful in gaining the Minister's approval for an increased levy, we recommend that Council pursue a mixed or hybrid contribution strategy of:

- (a) Section 94 contributions applying to all residential and mixed use development
- (b) A 3% section 94A levy applying to all development that does not include a residential component.

Strategy for implementing Council's value sharing scheme

Council is considering implementing a 2-phase value sharing scheme on developments in the Parramatta CBD area in order to help fund the significant CBD infrastructure upgrades.

If Council was to proceed with its value sharing scheme, based on our investigations of similar schemes and our assessment of viability impacts, we recommend that Council incorporate the following elements in the scheme:

- (a) Retain the 3% section 94A levy in preference to seeking the Minister's approval for a higher (4.5%) levy.
- (b) Develop, in consultation with the Department of Planning and Environment, a planning scheme that provides a choice for the developer between pursuing an 'as-of-right' development under current general planning controls and infrastructure contributions; or

pursuing a development under different planning controls that also have value sharing contributions attached to them.

- (c) Prepare a comprehensive infrastructure plan containing details of the different facilities and amenities that will be delivered using the proceeds from value sharing.
- (d) Prepare guidelines that contain details of the value sharing scheme and that show how developers can participate in the scheme.
- (e) Adopt a floor space value in the range of \$700 to \$750 per square metre of GFA for the purpose of assessing value to be shared.
- (f) Consider carefully the rate of Phase 1 value sharing that is implemented. Our investigations of hypothetical developments based on recent average sales data show that larger developments could absorb up to a 20% Phase 1 value sharing contribution and probably meet viability benchmarks. Sites recently purchased for smaller developments (ie. development that achieves 6.9:1 FSR including incentives) could potentially absorb a 10% Phase 1 value share. Developments on sites that have been held for several years would likely be able to absorb 20% or more Phase 1 value share regardless of the size of the development.
- (g) The Phase 2 value sharing rate be set at no more than 50%.
- (h) The arrangement for the developer to provide public benefits is achieved and formalised through the negotiation of a VPA between the developer and the Council.
- (i) Value sharing contributions that are paid by developers be held in a dedicated account that has accountability and reporting protocols that at least reflect the accounting requirements for section 94 and section 94A monies.

1. Introduction

1.1 Background

The Parramatta Central Business District (**CBD**) is located centrally in the demographic heart of the Sydney Metropolitan Area and performs a key economic, social and cultural role. The Parramatta CBD is of metropolitan significance as a regional employment centre, and it will continue to increase in importance as Western Sydney's population continues to grow.

A planning strategy adopted in 2015 by the Parramatta City Council (**Council**) sets targets for 27,000 additional jobs and 7,500 additional dwellings in the CBD area by 2036.

Significant growth in jobs and dwellings is expected to place further demands on Council to provide new infrastructure or augment existing infrastructure, such as open space, community facilities, and local road improvements.

Council has engaged GLN Planning to prepare an infrastructure funding model study to determine the most appropriate mechanism to fund and / or deliver new infrastructure to meet the demands of anticipated growth in the Parramatta CBD.

This study:

- Recommends a strategy to fund local infrastructure that utilises the suite of funding mechanisms currently available under existing legislation.
- Explores the opportunities for alternative funding mechanisms which may be appropriate to apply to future development in and around the Parramatta CBD.
- Is to inform the future direction of infrastructure funding for the Parramatta CBD Planning Framework Review.

1.2 Project objectives

The purposes of this project are as follows:

- Review the currently available contributions mechanisms in terms of potential income, impacts on development feasibility, and risks for implementation.
- Recommend a fair, appropriate and workable development contributions system to apply to development in the Parramatta CBD area.
- Investigate alternative and innovative infrastructure funding mechanisms and models, including specifically schemes that capture some of the uplift in value of development sites as a result of the additional floor space rights.
- Identify any legislative or other regulatory changes needed to implement the preferred infrastructure funding strategy.

1.3 Structure of report

This report is arranged as follows:

Part 1 (this part) provides an outline of the objectives and background of this project.

Part 2 discusses the planning and future development of the Parramatta CBD, including the infrastructure anticipated to be required to support the development.

Part 3 discusses the infrastructure contributions and delivery mechanisms currently available under the Environmental Planning and Assessment Act 1979 (**EP&A Act**) that could be applied to the Parramatta CBD developments, and a comparison of the projected income each of these regimes would generate based on the growth targets set for the Parramatta CBD.

Part 4 examines the development viability impacts associated with implementing the different contributions mechanisms currently available under the EP&A Act.

Part 5 discusses a commentary on alternative funding models for the delivery of infrastructure in the Parramatta CBD, specifically 'value sharing' schemes, including the associated advantages and disadvantages of these schemes. This part also tests the viability impacts of a value sharing scheme that has been proposed by Council.

Part 6 provides a conclusion to the study as well as a series of recommendations for Council's consideration to optimise the collection of contributions on development within the CBD whilst maintaining feasible development outcomes.

2. Development profile and infrastructure demands

Substantial new development is expected to occur in the Parramatta CBD in the future.

Planning policies are being prepared to cater for significant population growth requiring some 1.4 million additional square metres of gross floor area to be constructed in the area by 2036. Council's proposed planning controls facilitate additional floor space of over 2 million square metres on the assumption not all sites will turn over for development.

Council is currently investigating the infrastructure that will be need to support this level of growth.

Council's approach is that the future development should meet most or all of the cost of the infrastructure upgrades through development contributions.

The formulation of an effective infrastructure funding and development contributions strategy is inextricably linked to the type, amount, and rate of development expected to occur in an area. This part of the report therefore describes the anticipated development for the Parramatta CBD.

2.1 CBD development framework

2.1.1 Background

In recent years Council has undertaken studies of future development opportunities in the Parramatta CBD.¹

The objective of these studies was to review the current planning framework and identify opportunities, constraints and market conditions impacting on development; and from this develop draft planning controls and recommendations to ensure Parramatta will fulfil its role as Sydney's western CBD.

These studies and previous resolutions of the Council formed the basis of the Parramatta CBD Planning Strategy. This strategy was adopted by Council in April 2015.

Key actions in the strategy will inform a Planning Proposal currently being prepared by Council to amend the planning controls for the CBD include the following:

1. Expansion of the CBD boundaries
2. Increase in floor space ratios (**FSRs**) to predominantly 10:1 and 6:1 across the CBD
3. Implementation of density bonuses above these FSRs for developments that achieve design excellence and high environmental performance
4. Removal of any height controls, except in some key areas
5. Investigation of potential sun access controls to key public spaces
6. Expansion of the 'Commercial Core' around Parramatta station
7. Setting an employment growth target of 27,000 additional jobs and residential growth target of 7,500 additional dwellings by 2036 for the CBD
8. Investigation of infrastructure needs, including funding mechanisms
9. Promotion of tower slenderness and design excellence.

¹ Draft Parramatta City Centre Planning Framework Study (2014) and the Draft Parramatta Auto Alley Planning Framework Study (2014)

A number of technical studies have been undertaken to give effect to these key actions, including this infrastructure funding models study.

In order to address point 8 above, the economic analysis undertaken by SGS Economics and Planning proposed a 'value capture' mechanism be applied to land or development which benefits from any uplift as a consequence of modified planning controls (e.g. increases in FSR). This study considers the ability to apply such a mechanism under current NSW legislation including relevant NSW examples, and whether legislation changes may be required to enable value sharing to be established as a viable infrastructure funding mechanism.

At the time that it adopted the CBD Strategy, Council decided that it would seek the Minister for Planning's approval to impose a higher section 94A levy of 4.5% on all development throughout the CBD as the primary means of funding CBD infrastructure upgrades. Also at that time Council considered that value sharing could be a funding mechanism that could apply to only those sites where extra development rights were permitted beyond those allowed under the CBD Strategy.

Since that time, information has been prepared showing that the cost of CBD infrastructure upgrades is likely to exceed \$800 million, and that a conventional section 94A levy is unlikely to generate sufficient income to cover that cost. This study therefore examines the potential development viability impacts of value sharing on developments complying with the densities allowed under the CBD Strategy.

2.1.2 Parramatta CBD Strategy

The CBD Strategy applies to the area shown in **Figure 1** over page.

A single Planning Proposal to give effect to the Parramatta CBD Planning Strategy is due to be completed by the end of 2015 and placed on exhibition by mid 2016.

The Planning Proposal will among other things include provisions that increase the maximum FSR and height controls applying to residential development. The proposed FSRs will be generally 10:1 throughout the CBD area, with some exceptions. There is proposed to be no FSR limit on non residential or office development.

The Planning Proposal will continue to prohibit residential development in the B3 Commercial Core.

The location of the B3 Commercial Core zoned land is shown in **Figure 2**.

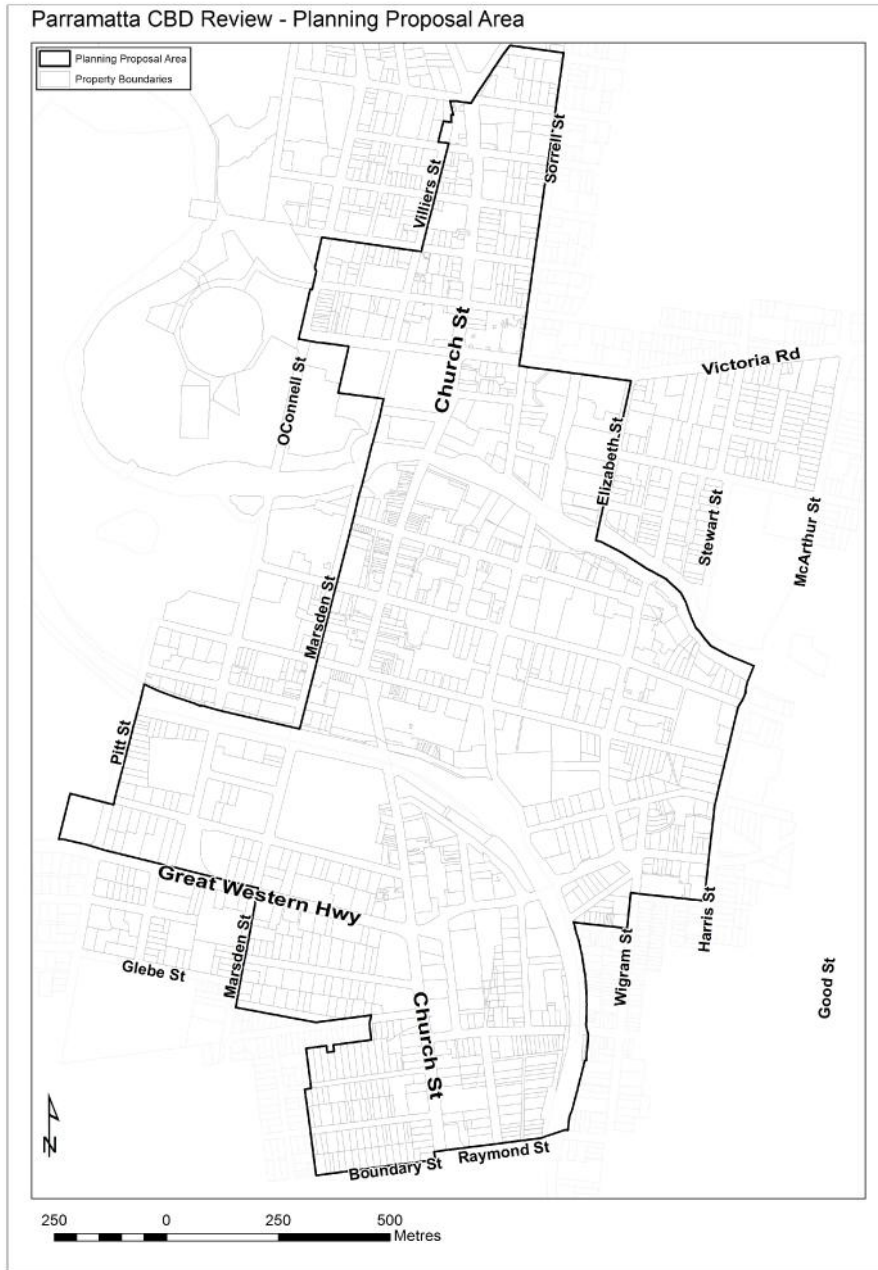
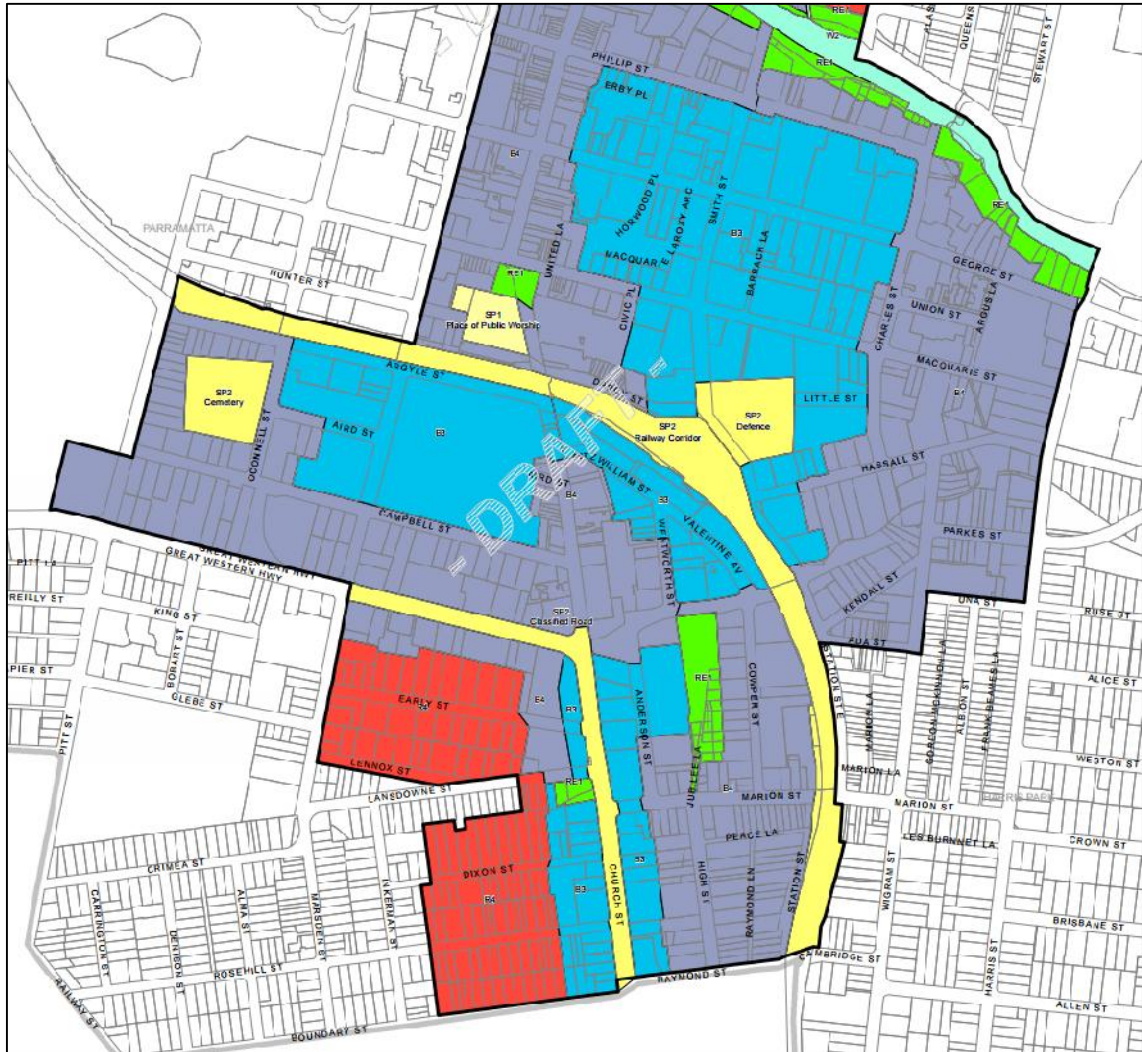


Figure 1 Parramatta CBD Strategy area



Source: Draft Parramatta CBD Planning Proposal, 2016

Figure 2 Commercial Core zoned area

2.2 Current and anticipated development

The CBD area currently has the following development:

- Approximately 4,769 residential dwellings
- Approximately 1,188,312 square metres of commercial, retail and other non-residential development.

The CBD Strategy identified the following targets to 2036:

- 27,000 additional jobs
- 7,500 additional dwellings.

The following floor space, in absolute terms, would need to be developed to achieve these targets:

- 648,000 square metres of commercial floor space²
- 750,000 square metres of residential floor space.³

The controls proposed in the Parramatta CBD Strategy provide ample capacity for these targets to be met.

Table 1 shows the development capacity that will be allowed under the draft CBD Planning Proposal.

Table 1 Development potential under the CBD Planning Strategy

	Additional floor space yield (square metres)	Estimated potential additional job / dwelling yield
No residential allowed in Commercial Core		
Commercial	1,753,980	48,721 jobs
Residential	2,996,315	19,976 dwellings
TOTAL	4,750,295	

The CBD Strategy provides the capacity to achieve the planning targets for dwellings and jobs.

Council has also received numerous Planning Proposals that seek floor space potential above that allowed for in the CBD Strategy.

2.3 Anticipated infrastructure demands

Council is investigating the infrastructure needs that will be generated by the development expected to occur under the CBD Planning Strategy. This work is underway at the time of writing this report but initial estimates have indicated the value of infrastructure works to be in the order of \$835 million.

In discussions with Council officers, it is possible that the future infrastructure requirements for the new CBD development may comprise similar projects to those contained in the CBD Civic Improvement Plan that underpins the current Council's section 94A contributions plan. This plan applies to all CBD development with a development cost above \$250,000.

The Civic Improvement Plan includes the current types of projects:

- Aquatic centre and stadium minor works
- Car park refurbishments and lighting
- Cycleways and other cycling facilities
- Heritage Centre refurbishments
- Heritage conservation works
- Library resources, refurbishments and fittings

² Assuming an average density of 24m² GFA per worker.

³ Assuming an average of 100m² per dwelling.

- Local area traffic management schemes
- Parramatta Discovery Centre relocation
- Parramatta River foreshore improvements
- Pedestrian bridges
- Pedestrian safety facilities
- Playgrounds
- Public art
- Riverside Theatres refurbishments
- Roads and traffic upgrades
- Shared zones
- Streetscape works such as street trees, lighting and street furniture.

3. Conventional development contributions mechanisms

3.1 Introduction

Development contributions are requirements imposed on, or arrangements negotiated with, developers of land to provide land, works, and / or money for infrastructure that is generated by or that is related to new development.

Development contributions are:

- required to address the additional demands on infrastructure caused by new development;
- are usually imposed as conditions of development consent to mitigate the impacts of development on public infrastructure; and
- are a tool to address the provision of infrastructure where developers of land will not or cannot provide that infrastructure.

There are several available mechanisms available to councils to require developers to address the impacts on local infrastructure caused by their developments.

The mechanisms include contributions of land or money or works required in conditions of development consent, or in negotiated agreements with developers.

3.2 Comparison of available mechanisms

3.2.1 Consent conditions requiring works

These are conditions may be imposed by a consent authority on any development, and are authorised under section 80A(1)(f) of the EP&A Act.

A consent authority can require a developer to carry out works, either / both within and outside of the development site, relating to any matter referred to in section 79C (1) applicable to the development.

They are conditions for works to be carried out. Conditions requiring contributions of money cannot be authorised by section 80A(1)(f). Only conditions authorised by section 94 or section 94A can require contributions of money by a developer.

Section 80A conditions are not strictly development contributions, but they do work in conjunction with development contributions. For instance, section 80A conditions may include works that are already listed in a contributions plan, but if the works are also listed in a section 94 contribution plan the section 94 contribution for that development must be adjusted to reflect the works that are required in kind by the section 80A condition. No such adjustment is required where the development is the subject of a section 94A levy.

Generally speaking, section 80A conditions can only require works or activities to be undertaken that are *entirely required* by the development to mitigate that development's environmental impacts. It is usually therefore only works that are immediately proximate to the development site that can be the subject of a section 80A condition.

Typical uses of section 80A conditions include requiring developers to carry out the following:

- new and upgraded road access to the development site
- perimeter footpaths fronting the development site

- drainage (inter-allotment, reticulation and trunk types)
- creation of easements on a development site
- traffic management devices to enable access to a development
- provision of support services (for example for seniors housing developments)
- environmental monitoring activities
- making satisfactory arrangements with utility / energy infrastructure providers (including, for example, rights of way).

The works can be of a public nature (i.e. be provided on public land) and could also be transferred to a council or other public authority ownership following completion. They could also be works on private land and which will remain on private land.

Councils should use section 80A conditions for the delivery of development-generated local infrastructure wherever it is reasonable and practical to do so, in preference to delivering that same infrastructure via section 94 or section 94A contributions. This is because it shifts the responsibility of provision (and therefore risk of any cost overruns) entirely from the council to the developer.

3.2.2 Consent conditions requiring money and / or land

While section 80A conditions of consent can require works from a developer, sections 94 and 94A conditions of consent can require the payment of money and / or the dedication of land free of cost for the provision of local public amenities and services, provided these are set out in an operational Contributions Plan. Voluntary planning agreements under section 93F of the EP&A Act can require any combination of works, land and money but these are voluntary arrangements. Planning agreements are discussed in section 3.2.3.

Section 94 contributions can be monetary or land contributions required by councils from developers for the provision of public amenities and services. Section 94A levies are monetary contributions only.

Table 2 below compares attributes of the two alternative types of development contributions that may be imposed as conditions of consent by consent authorities.

Table 2 Section 94 contributions and section 94A levies comparison

Section 94 contributions	Section 94A levies
<p>Nexus necessary – developers pay their fair share of the cost of public work.</p> <p>A section 94 contributions plan defines the consequences of development in terms of its generation of needs for specific local infrastructure, and then authorises the development to make land or works contributions consistent with the development's share of demand for that infrastructure.</p>	<p>No nexus necessary – developer pays a tax</p> <p>Section 94A levies are simply a flat rate tax on development. Council must spend the tax revenue on the delivery of local infrastructure identified in the contributions plan that authorised the levy.</p>

<p>Development only pays a reasonable contribution towards the cost of infrastructure in any particular case</p> <p>Despite the provisions of a contributions plan, a council must still consider the circumstances of each development to determine whether it is reasonable to require the contribution in that case, and whether the contribution authorised by the contributions plan is reasonable in that case.</p> <p>However, a Council can only impose a contribution condition in accordance with a Contributions Plan. This is because a condition may be disallowed or amended by the Land and Environment Court on appeal if it is considered to be unreasonable in the particular circumstances of the case (s94B(3)).</p>	<p>Levy does not necessarily have to relate to the specific demands generated by the development</p> <p>A contributions plan authorising a section 94A levy must include a statement about the relationship between expected development and infrastructure demand. But that relationship or connection does not need to be reflected in the plan's works schedule.</p> <p>Provided a plan, duly prepared in accordance with the EP&A Act and EP&A Regulation, authorises the levying of development then that is all that is required. No assessment is required of whether it is reasonable to require the levy in the particular circumstances of the development.</p> <p>The reasonableness of a condition cannot be disallowed or amended by the Land and Environment Court on appeal (s94B(4)).</p>
<p>Works schedule in a contributions plan determined on basis of demand</p> <p>To satisfy the nexus argument, the Section 94 contributions plan works schedule must be linked to expected development. It must therefore be derived from needs analyses and studies that determine the nature and scale of local infrastructure that will be required to meet future development.</p>	<p>Any works schedule acceptable</p> <p>Preparation of a section 94A contributions plan works schedule is more straightforward. It may, for example, relate to a council's prevailing capital works priorities. Levies received may be directed toward funding part or all of the cost of individual items in that schedule. There does not need to be a connection between the contribution rate and works items, but facilities still need to be provided in a 'reasonable time'.</p>
<p>More complex calculation</p> <p>To fulfil the nexus requirement the calculation of a section 94 contribution can be complex. As indicated above, the appropriateness and reasonableness of the contribution must be considered. This involves, in the case of each application, for example, determination of any credits for previous demand and the use of indexed rates.</p>	<p>Simpler calculation</p> <p>Calculation is more straightforward. The levy is calculated as a percentage of the cost of the development, and this relies on an accurate development cost report.</p> <p>Clause 25J of the EP&A Regulation provides particulars on the matters that must (and those that must not) be included in the calculation of the cost of development for the purposes of calculating the levy.</p>
<p>Determination of existing demand is necessary</p> <p>S94 contributions must be reasonable and relate only to the net increase in demand for infrastructure occasioned by the particular development. To establish the net increase in demand, the consent authority must account for any existing demand that exists on the development site.</p>	<p>No determination of existing demand</p> <p>As there is no need to establish a nexus between the development and the infrastructure the subject of the levy, there is no need for an assessment of existing demand.</p> <p>The flat rate tax levy, if authorised by the contributions plan, can apply each time the same parcel of land is developed.</p>

<p>Intensification of use relevant</p> <p>As the nexus must be established in order to calculate the net increase in demand for infrastructure, the level of intensification of a use is a necessary component of this assessment.</p>	<p>Intensification of use relevant</p> <p>Despite the fact that nexus need not be considered, for applications relating to refitting or refurbishing premises, Council must establish whether or not there is proposed to be an enlargement, expansion or intensification of the use. Clause 25J of the EP&A Regulation provides that 'where the development involves an enlargement, expansion or intensification of a current use of land', the costs of fittings and furnishings should be included in the cost of work.</p>
<p>Settlement of contributions liability can be made through money, land or works</p> <p>The contributions that are imposed are payment of money, or the dedication of land, or both. The liability may be settled through these methods, or it can be settled by the developer providing works-in-kind or material public benefits.</p>	<p>Settlement of contribution through money only</p> <p>A s94A condition can only be for a monetary contribution and can only be settled by the payment of that contribution, unless a Planning Agreement is entered into.</p>
<p>Residential development contributions are capped</p> <p>In the case of land in the City of Parramatta LGA, residential section 94 contributions are capped at \$20,000 per dwelling, in accordance with the Direction made by the Minister for Planning in August 2012. No cap applies to non-residential development.</p>	<p>Levy rates must not exceed prescribed maximums</p> <p>Under the EP&A Regulation, levies for all types of development in the Parramatta CBD are capped at 3 percent of the cost of development. The maximum levy that can be imposed on development elsewhere in the Parramatta LGA outside of the CBD area is 1 percent.</p>
<p>Contributions may only be applied to 'essential works' in certain circumstances</p> <p>Where a council has prepared a contributions plan that authorises a section 94 contribution above the cap:</p> <ul style="list-style-type: none"> the contributions plan will need to be reviewed by IPART; and the contributions that are collected can only be directed towards items on the 'essential works list'. 	<p>No 'essential works' limits on types of works that may be the subject of levy funding</p> <p>The 'essential works' limitation does not apply. In accordance with s94A(3) money that is collected must "be applied toward the provision, extension or augmentation of public amenities or public services (or towards the recouping the cost of their provision, extension or augmentation)."</p>

Councils can apply a 'mix and match' approach in applying the conventional contributions types. They can adopt contributions schemes that authorise section 94 contributions to apply certain types or areas of development and section 94A levies to apply to other types or areas of development.

However, either a section 94 contribution or a section 94A levy may apply to a single development, but not both. Potential issues may arise where a mixed residential and non-residential development is proposed, and the council had adopted a contributions plan that authorised section 94 and section 94A contributions on different developments. In these cases,

the contributions plan would need to be clear about which of the contribution types applied to the development.

This is particularly relevant for the Parramatta CBD area where much of the future development is likely to have a mixed-use multi-storey character containing both residential and non-residential components. For example, if the development needed to address some of its car parking demand by making a cash contribution, in lieu of providing physical spaces, then the full costs of this are most often met by the consent authority imposing a section 94 contribution not a section 94A levy. If Council however preferred a section 94A levy regime for the CBD that reflects the current practice, then individual development parking shortfalls can be managed through other means (for example through a voluntary planning agreement).

3.2.3 Voluntary planning agreements

The preceding discussion relates to powers of consent authorities in requiring developers to do certain things at the point of development consent. Section 94 contributions and 94A levies comprise the mandatory contributions system.

Voluntary planning agreements (**VPAs**) are the discretionary contributions system in NSW. These are agreements that can be negotiated between developers and planning authorities. They cannot be imposed on a developer.

A VPA is a voluntary arrangement between a developer of land and one or more councils and / or other planning authorities whereby the developer is required to:

- dedicate land free of cost, or
- pay a monetary contribution, or
- provide any other material public benefit, or
- provide any combination of the above,

to be used for or applied towards the provision of a public purpose.

The VPA can be offered by a person lodging a DA or a section 96 modification to a DA, or by a person lodging a Planning Proposal.

Contributions can include dedication of land, payment of money, or the carrying out of works or any combination of these. The VPA between a council and a developer can, if the parties agree, authorise that section 94 contributions or section 94A levies not apply to development on the land covered by the agreement.

Other key features of VPAs include:

- Development consent can't be refused on the grounds that a developer refuses to enter into a VPA.
- May be registered on the title to land if the parties and all persons who have an estate or interest in the land agree to its registration.
- It is not necessary to establish a nexus between the development and the public purposes included in a VPA.

One of the main advantages of planning agreements is that they can enable flexible arrangements for the provision of local infrastructure in connection with new developments. With flexibility comes a responsibility to act fairly and consistently. Councils have a duty to act with probity and transparency in planning agreement negotiations and in the interests of the wider community.

Important principles underlying a council's use of VPAs are as follows:

- Planning decisions should not be bought or sold through planning agreements. The development should be acceptable on its planning merits and not rely on the developer's offer of public purposes as compensation for inferior urban outcomes.
- Planning agreements must be voluntarily entered into. The council's officers or representatives should not create an impression that a favourable planning or development decision is tied to successful negotiation of a planning agreement.
- The council should not allow the interests of individuals or interest groups to outweigh the wider public interest when considering a proposed planning agreement.
- The council should not seek benefits under planning agreements that are unrelated to particular development, nor should the council give undue weight to a proposed planning agreement when considering a Planning Proposal or a DA.
- The council should not improperly rely on its statutory position in order to extract unreasonable public benefits from developers.

Tensions regularly arise between Council's role as a planning / consent authority and as a beneficiary of infrastructure provided by developers. There needs to be discipline in managing these conflicts. Parramatta City Council manages negotiation of VPAs through its 2008 Planning Agreements Policy.

VPAs are now widely used in the NSW planning system to achieve many different public purposes associated with new development. They are most useful in the development process where both the planning authority and the developer see value in entering into an agreement that clarifies and improves on mandatory contributions requirements.

VPAs are an underpinning feature of value sharing schemes that are currently operating in certain development areas in Sydney (refer to discussion in section 5.6). If Council was to embark on its own value sharing scheme then it would likely also need to rely on VPAs to achieve the scheme objectives.

3.3 Estimated income from current mechanisms

We tested the potential income that could be generated by applying the different mandatory contributions mechanisms to the anticipated future Parramatta CBD developments, i.e. section 94 contributions and section 94A levies.

The following contributions strategies were tested:

1. Impose section 94A levies on development at the current rate of 3% of cost of development (this is the base case)
2. Impose section 94A levies on development at the higher rate of 4.5% of cost of development
3. Impose section 94 contributions on development
4. Impose section 94 contributions on all residential and the non-residential components of mixed use development, and impose section 94A levies on development comprising of only non-residential development at the current rate of 3% of cost of development
5. Impose section 94 contributions on all residential development and the non-residential component of mixed use development, and impose section 94A levies on straight non-residential development at the higher rate of 4.5% of cost of development

Options 1, 3 and 4 can be implemented by Council without Ministerial approval. Options 2 and 5 require the Minister's approval for a higher section 94A levy.

The income analysis was based on extracting contributions from the anticipated floor space that is required to meet the CBD Strategy housing targets. Section 94 contributions would be based on the net increase in floor space attributable to those targets; while section 94A levies would be based on both replacement and additional floor space.

All section 94 contributions attributable to residential development in the analysis are assumed to be \$20,000 per dwelling which is consistent with current State government policy. In the event that the section 94 cap was increased or removed entirely, the income from a section 94 approach would be greater.

The detailed results of this analysis and the assumptions underpinning the projected income are contained in **Appendix A**.

The summary results are shown in **Table 3**. The income results are in 2015 dollars and do not account for escalation of development costs.

Table 3 Summary of estimated income from different combinations of available mechanisms

Option	Projected income (\$million)	Approval of Minister required?
1 3% section 94A levy (base case)	\$165.2	No
2 4.5% section 94A levy	\$247.7	Yes
3 Section 94 contribution	\$193.2	No
4 <ul style="list-style-type: none"> Section 94 contribution on all residential Section 94 contribution on non residential component of mixed use development 3% section 94A levy on straight non residential development 	\$206.6	No
5 <ul style="list-style-type: none"> Section 94 contribution on all residential Section 94 contribution on non residential component of mixed use development 4.5% section 94A levy on straight non residential development 	\$232.4	Yes

Continuation of the current section 94A levy scheme yields the lowest income. However, if the Council was permitted to impose a higher 4.5% levy, this would yield the highest income.

A section 94 scheme, whether operating alone or in conjunction with section 94A levies (options 3, 4 and 5), would yield a higher income than the current section 94A scheme. In the case of option 4, this is projected to yield some \$41 million more contributions than the base case. However, the preparation and administration of the section 94 contributions plan would require more Council resources than a flat rate levy. There is also the possibility of unreasonableness appeals being brought against Council for DAs approved under any section 94 scheme.

Option 5 could be rejected on the grounds that it requires the Minister's approval and a greater income would likely be received from just imposing a universal 4.5% section 94A scheme (option 2).

A value sharing scheme based on the increased land and development values as a result of the change in controls proposed in the draft CBD Planning Proposal (discussed in Part 5) presents Council with an opportunity to raise significant *additional* revenue from development in the CBD area.

3.4 Summary of opportunities and constraints of the conventional contributions mechanisms

A 3% section 94A levy currently applies to development on land throughout the CBD area.

In order to meet the extra infrastructure demands that will be generated by the development to be allowed under the CBD Strategy, Council has resolved to investigate increasing the section 94A levy to 4.5%.

Councils and other consent authorities can mandatorily require either section 94 contributions or section 94A levies from development to meet the cost of new infrastructure that is required for new development.

The section 94A mechanism is preferred because of its simplicity and low risk of challenge.

An analysis of projected income from a mix of section 94 / section 94A schemes showed that:

- The current 3% section 94A levy would yield the lowest income
- Combinations of section 94 contributions and section 94A levies on different developments would yield higher levies
- A 4.5% section 94A levy would yield the highest income of all the options.

VPAs are a discretionary mechanism for councils and developers to negotiate the provision of contributions and can be used on an opportunity basis to achieve better and / or more flexible contributions outcomes.

Council currently pursues an 'open for business' philosophy, and does not wish to impose a development contributions regime that discouraged investors in major development projects in the CBD. The impacts of pursuing different types and mixes of contributions mechanisms on the feasibility of development is examined in the following two parts of this report.

4. Conventional contributions development feasibility analysis

4.1 Introduction

At present, Council applies a section 94A levy of 3% on development costs to all development in the Parramatta CBD exceeding \$250,000.

This part of the report examines a range of alternatives to this business-as-usual approach in terms of the impacts on development viability.

This part discusses the following:

- key viability benchmarks used by the development industry
- approach taken to model viability of development
- impacts that various contribution frameworks would have on development within the CBD.

4.2 Land acquisition and viability measures

The cost to purchase a development site is already reasonably established in most areas based on subtracting from the net sale price of the apartments in a building, the known costs of development (including land, construction and development contributions, marketing, statutory fees and professional fees/costs) based on the existing planning controls.

The development feasibility will cashflow these costs and revenues with the aim of achieving a target Internal Rate of Return (IRR) of 20% and Profit Margin of around 20%.

IRR and Profit Margin are key benchmarks used by developers and their financiers to determine the viability of a development project (refer **Table 4**). Both IRR and Profit Margin are used to determine the amount that can be paid for the land to meet the benchmark returns for the development to proceed.

A development feasibility analysis will cashflow these costs and revenues with the aim of achieving a target IRR of at least 20% and Profit Margin of around 20%⁴.

Table 4 Development feasibility benchmarks

Internal Rate of Return	IRR is effectively the interest rate at which the net present value of costs (negative cash flows) of the investment equals the net present value of the benefits (positive cash flows) of the investment. IRR is calculated before interest (i.e. interest is typically not included in the calculation) and accordingly the longer the period for completion of a project before revenue offset costs, the more the IRR will be eroded.
Profit Margin	Profit Margin is calculated by dividing profit (i.e. forecast net revenue minus the total forecast development costs) by total development costs. The return on costs is typically expressed as an amount and a percentage and would be used by all developers and financiers to measure the investment and return of a particular project.

⁴ These targets are often referred to as a hurdle rate. These targets may be higher depending on various factors such as experience of developer, market conditions, risk of project etc. and are typically viewed by financial institutions when considering to finance proposed developments.

Both IRR and Profit Margin are benchmarks used to determine the amount that can be paid for the land to meet the benchmark returns for the development to proceed. Within any area developers will also measure the comparative value of an investment by calculating the 'site value' and comparing that to recent acquisitions. Site value is used as a ready reckoner and simply divides the number of dwellings achievable on the site by the proposed purchase price of the land.

The site value is relevant where the proposal incorporates residential dwellings. The planning controls in the Parramatta CBD require the inclusion of retail / commercial floor space in any mixed-use development. However, this retail / commercial floor space is often provided to the minimum required by the controls⁵ in order to maximize the floor space for residential apartments. A developer may simply 'net off' the projected revenue against the costs for construction of this floor space and car parking (i.e. costs will equal revenue), particularly if there is no pre-commitment by an anchor tenant or other user group to occupy constructed tenancies. This means that financial return of a project is almost exclusively determined based on residential yield.

4.3 Impact of an increase in contributions

As previously mentioned, a developer determines the price they can afford to pay to acquire a site based on the net revenue generated from development of the site less development and statutory costs and development margin (that represents the risk and reward of doing the development). The price a developer offers has to be enough to entice a land owner to sell.

Development contributions are typically treated by developers as a statutory cost that is factored into the development feasibility when considering the acquisition of land. They are one component that informs the value of land when acquiring a site.

Where land is acquired based on the existing controls, any changes to costs, including increased contribution costs, will either need to be offset against cost savings in the development (i.e. reduce the cost of construction by reducing the specification of works) or directly reduce the profits anticipated by the developer potentially making the project unviable.

When development costs change (such as an increase in material costs or a new development contributions plan being put in place) this will influence the acquisition cost a developer can offer a landowner. Where these cost changes are known to a developer prior to a development site being purchased, this will impact on the purchase price a developer is willing to offer to acquire the land. However, owners may well not want to sell their land if they think it is undervalued based on recent or previous similar sales. Similarly, significant increases in contribution costs for developing in a particular area can result in investment dollars and development activity moving to other areas with a lower cost base until these are exhausted or the market improves in the original area to enable higher offers.

Alternatively, where development costs change after the site has been acquired but before the development has been approved, these can have significant impacts on the ongoing viability of the project. Either the developer has to find a way to offset the increase in costs either by an increase in revenue (i.e. an increase sales prices or increasing yield) or a reduction in costs (i.e. specifying a lower standard of materials for construction).

Conversely, any Planning Proposal which significantly increases the development yield on a site will result in a windfall gain to the developer as the project will achieve more dwellings at no additional acquisition costs, unless the developer has negotiated through an agreement a higher

⁵ This is based on the permissible uses within the B3 Commercial Core and B4 Mixed Use zones of Parramatta City Centre Local Environmental Plan 2011 and Section 4.3.3.2 of Parramatta Development Control Plan 2011.

purchase price if the Planning Proposal is successful. These Planning Proposals are the catalyst that typically requires re-evaluation and redirection of expenditure of the capital works programme to provide for an unanticipated new population, and on occasion the outcomes of broader planning studies, particularly traffic.

As the acquisition of the land is typically the first step in any project, any subsequent increases in costs including changes to the contributions need to be communicated early to existing and potential developers.

4.4 Development viability modelling

In order to understand the impacts of implementing a new contributions framework within the Parramatta CBD, a suite of models have been developed based on a hypothetical development of a site within the CBD. These models have been used to demonstrate the impact the various contribution regimes will have on the viability of the development (i.e. project IRR and Profit Margin) as well as the contributions Council could expect to collect from this development. In all cases, the modelling has assumed the same acquisition price for the site based on the existing planning controls.

The models provide for a base case development outcome (this is assumed to be 10:1 FSR is applied under the CBD Strategy) and Planning Proposal uplift outcome (assumed 15:1 FSR applied) for each of the different contribution frameworks that could be applied.

The different contribution frameworks modelled include:

- 3% section 94A applied to development permissible under the CBD Strategy
- 3% section 94A applied to a Planning Proposal seeking an additional 5:1 FSR on top of the CBD Strategy
- 4.5% section 94A applied to development permissible under the CBD Strategy
- 4.5% section 94A applied to a Planning Proposal seeking an additional 5:1 FSR on top of the CBD Strategy
- Section 94 contribution based on \$20,000 per unit applied to development permissible under the CBD Strategy
- Section 94 contribution based on \$20,000 per unit applied to Planning Proposal seeking an additional 5:1 FSR on top of the CBD Strategy

As the basis for applying the base case and Planning Proposal uplift scenarios, a site of 3,000m² was adopted and included the provision of 5,000m² of mixed use floor (non residential) space with the remainder of GFA being developed as a mix of apartments including 1, 2 and 3 bedroom units (that resulted in an overall average apartment size of 100m²).

A full list of the other guiding assumptions and development yields informing the viability assessments is provided at **Appendix B**.

We reiterate that in this hypothetical development, the inherent value that contributes to the profit generated for the project is the residential component. Given the current buoyancy of the market for mixed use development in Parramatta, the cost of delivering mixed use component (non residential) has been netted out to match the expected revenue that could be generated from the sale of this space (as discussed earlier).

The contributions able to be collected and impacts on the viability of the hypothetical project are provided in **Table 5**.

Table 5 Development viability testing results

Scenario No.	Contributions option	Contribution generated	Developers profit	IRR	Margin
1	Section 94A @ 3% - Building controls as per CBD Strategy (base case)	\$3.17m	\$28.74m	20.0%	18.1%
2	Section 94A @ 3% - Planning Proposal for additional 5:1 FSR	\$4.69m	\$67.02m	30.1%	30.7%
3	Section 94A @ 4.5% - Building controls as per CBD Strategy	\$4.75m	\$27.13m	19.3%	17.0%
4	Section 94A @ 4.5% - Planning Proposal for additional 5:1 FSR	\$7.04m	\$64.63m	29.3%	29.3%
5	Section 94 (\$20,000 / unit cap) – Building controls as per CBD Strategy	\$5.46m	\$26.41m	18.9%	16.4%
6	Section 94 (\$20,000 / unit cap) – Planning Proposal for additional 5:1 FSR	\$8.66m	\$62.99m	28.7%	28.3%

Key observations on the viability of the tested hypothetical project against the various contributions options include the following:

- If the section 94A levy increased to 4.5% or if the Council implemented a \$20,000 per dwelling section 94 contribution, developments that are within the floor space limits of the CBD Strategy would remain on the fringe of the viability benchmarks. In other words, some developments would have marginal viability. This would occur until there was a market adjustment to the underlying land values of development sites in the CBD due to the increased contributions payable.
- In the short term, this additional contribution cost would either translate to either lower offers being put to landowners to acquire sites (which may stagnate the market as motivation to sell will be reduced) or, alternatively, increase the need for developers to pursue a Planning Proposal to improve yields to offset the proportion contribution cost applied to the development that is permissible under the CBD Strategy to remain competitive in acquiring sites.
- The above observations are relevant to developers who purchase land today. In the event that developers have 'land-banked' for a period of time (assume at least a year reliance on commercial rents to offset holding costs), development proposals in accordance with the CBD Strategy are likely to achieve well above the viability benchmarks, provided they include a residential component. This is due to the significant growth in residential values that has occurred over the last few years.
- In the case of the particular hypothetical development that was tested, a section 94 contribution would yield a higher income than a higher section 94A levy. However, the overall analysis of the CBD in section 3 suggests that total section 94A levies from all CBD development would be higher than section 94, if the levy was increased to 4.5%.

4.5 Commercial development

The above development feasibility analysis focussed on the impact of new contribution regimes on mixed use development that includes dwellings. This focus was applied given the significant development interest and preference that has been shown within the Parramatta CBD to deliver a higher amount of residential and mixed use development compared to straight commercial development.

Given Parramatta's role as the second CBD of Sydney, the impact of increased contributions on straight commercial development still needs to be considered.

The Parramatta City Centre Plan is a section 94A contributions plan that authorises a contribution of 3% of the cost of construction to fund the delivery of a works program in the order \$211 million. As shown below, this rate is typically the minimum standard for commercial office development in Sydney suburban centres.

With the exception of Burwood Town Centre, the contributions for commercial space in Parramatta CBD are generally consistent with other centres whether levied under a section 94 or section 94A plan, as shown in **Table 6**.

Table 6 Comparison of key centre contribution rates for commercial development

Major Centre	Contribution Regime	Contribution/ 100m ² commercial GFA
North Sydney	S94 levied per worker	\$13,164 ⁶
St Leonards	S94 levied per m ² of new GFA	\$14,200 ⁷
Chatswood Town Centre	S94A @ 3% cost of construction	\$13,335 ⁶
Macquarie Park	S94 levied per m ² of new GFA	\$13,002 ⁷
Burwood	S94A @ 4% cost of construction	\$17,780 ⁶
Parramatta	S94A @ 3% cost of construction	\$13,335⁸

The feasibility of commercial development in different centres is influenced by a number of factors including:

- Business operational benefits – Does the centre have any strategic advantages and service catchments, is it a speciality centre that supports the colocation of services
- Location attributes – Does the location provide a high level of amenity, access to services, transport, distance from the CBD, is it appealing/accessible for staff to access?.
- Quality and size of space – Is there variety in floorplates, what standard of finishes, how modern is the building?

⁶ Based on contribution per 100m² identified in the 2015/16 Fees and Charges update for S94 Costs, North Sydney 2015.

⁷ Based on contribution per 100m² identified in the 2015 update of the City of Ryde Section 94 Development Contribution Plan 2007, City of Ryde 2015.

⁸ Contribution value has been based on an assumption of cost for construction of new commercial GFA of \$3,300 per m² and cost of construction of new commercial office fitout of \$1,145/m² based on costs from Australian Construction Handbook, Rawlinsons 2015.

- Building costs and rental costs.

The Parramatta CBD has a number of strategic locational advantages and offers a range of commercial space types that makes it attractive in its own right compared to other centres.

The recent economic review prepared by Urbis⁹ illustrates that the Parramatta already provides a competitive rental offering compared to other centres as shown in **Table 7** below.

Table 7 Comparison of Centre market rents

Centre	A Grade Office Space Gross Face Rent (\$/m ²)
Sydney CBD	\$730 - \$1,020
North Sydney	\$670 - \$840
Macquarie Park	\$390 - \$445
Chatswood	\$520 - \$610
Parramatta CBD	A Grade \$450 - \$555 B Grade \$365 - \$460

Source: *Achieving A-Grade Office Space in the Parramatta CBD – Economic Review*, Urbis, August 2015 as amended by GLN

The report also notes that compared to other centres such as Macquarie Park, commercial development in Parramatta attracts 20 to 30% higher rents. However it incurs 40% higher development costs likely due to land values and the additional cost of a 'traditional' office tower construction compared to low-rise campus-style development prevalent in business parks such as Macquarie Park. This may have been an issue in attracting significant commercial development to the Parramatta CBD. As such, the imposition of a greater contributions on commercial development would increase the overall building costs. From a development feasibility perspective, this increased cost would have to be offset by either an increase in rents or reduction in overall building costs. Both of these situations would lead to a reduction in the competitiveness of the Parramatta CBD in being able to attract more commercial development compared to other centres.

4.6 Potential equity issues for contributions on non residential development

Section 4.5 highlighted the need for caution in implementing a higher section 94A levy on commercial development. If the Council decides to pursue a 'hybrid' contributions approach for non residential development similar to options 4 or 5 discussed in section 3.3, then it should also consider the equity impacts of this approach.

The hybrid approach is a section 94 contribution applying to employment floor space in a mixed use employment and residential development, and a section 94A levy applying to employment floor space where no residential use is also in the development. With the hybrid approach there is a concern that a developer of a mixed use development might bring an unreasonableness appeal against the Council by showing that the per worker section 94 contribution rate is

⁹ *Achieving A-Grade Office Space in the Parramatta CBD*, Urbis August 2015.

significantly more than the rate applying to a straight non residential development under a section 94A scheme.

To reduce this risk Council should, as part of formulating any hybrid contributions strategy, calculate the contribution amounts that would apply to mixed use and straight non residential developments, and adjust the contribution rates so that similar amounts of non residential floor space are subject to similar contributions regardless of whether the requirements is by way of a section 94 contribution or a section 94A levy.

4.7 Summary

As with the imposition of a new cost or significant change in market conditions, the application of a new contributions framework with higher contributions will erode the viability of projects.

In the instance of Parramatta CBD, after the increase of the section 94A levy to 4.5% or a new section 94 contributions plan, projects would move from being viable to being on the cusp of achieving the necessary development benchmarks to make it worthwhile to proceed or alternatively force developers to accept a lower margin for the same risk profile.

This would occur until the underlying land market adjusts (through ongoing land exchanges) to take the new contribution regime into account. In the meantime, if market conditions remain buoyant (particularly the residential market), it is likely that Council would continue to receive Planning Proposals to extend development rights above those proposed in the CBD Strategy to offset the contribution costs and allow developers to remain competitive in acquiring sites from land owners.

However, the imposition of an increase in contributions on solely commercial development would impact on development feasibility of those projects and could reduce the competitive advantages of the Parramatta CBD in attracting new commercial development compared to other established centres.

5. Value sharing and development viability impacts

5.1 Introduction

This part investigates alternative funding models for funding the infrastructure required to meet the demands of future Parramatta CBD development.

The discussion addresses 'value sharing' as the primary alternative funding mechanism. Value sharing relies on increases to value of properties brought about by planning or infrastructure decisions. Value sharing is therefore tied to property ownership and / or development.

There are of course other ways that governments can fund infrastructure. These relate to general fees, charges and taxation policy of governments and are beyond the scope of this study.

5.2 What is value sharing?

A value sharing levy or betterment levy scheme may be described as a tax imposed on a land owner on the unearned increment in land price growth that accrues due to a planning or infrastructure decision.

A value sharing scheme would obtain a portion of the value released through new zoning and other public improvements so the communities that create this value share in the wealth it generates.¹⁰

5.3 Types of value sharing schemes

Demonstrating nexus, or the relationship between a development and the imposition of any contributions regime, is an important pre-condition for the value sharing schemes that have been implemented in jurisdictions locally and across the world.

Value sharing schemes are typically tied to a recent or proposed transport infrastructure project. Such infrastructure generates value uplift. The extent of uplift will vary depending on many factors including the level of improved accessibility provided to the land by the transport project and the distance of the land from the infrastructure. Value sharing programs linked to transport projects commonly hypothecate a portion of the land value increase to help pay for the infrastructure.¹¹

Australian examples of transport-linked value sharing schemes include the Gold Coast Light Rail and Melbourne CBD Underground Loop projects.

Value sharing schemes that are not linked to a transport infrastructure project can be linked to a planning decision. For instance where the planning authority makes a decision that provides development rights to land owners that generate an increase in the value of land. This could be rezoning of land that enables a more intense use of the land (for example, rezoning from rural to urban use), or that enables a more intense development of the land (such as an increase in the maximum height allowance). Bonus floor space schemes also fall into this category.

Local examples of value sharing schemes not explicitly linked to transport projects are discussed in the next section.

¹⁰ Langley J (2015), *Value Capture Roadmap*, p5

¹¹ *ibid.*, p7

5.3.1 Local examples

Value sharing as an infrastructure funding tool is not new, but examples of its successful implementation in Australia are few. There has not been much political appetite over the years for these types of schemes, with governments preferring instead to continue to rely on entrenched indirect taxation such as land tax and stamp duties on land transfers to fund capital works. Property and development groups typically resist further imposts on the development of land without some reform of the indirect taxes such as stamp duty.

There are no broad-based value sharing schemes operating in NSW that traverse local government boundaries, although a possible exception is the Special Infrastructure Contribution (or **SIC**). The SIC can be interpreted as a type of value sharing levy, as it is a tax flatly applied to residential or industrial zoned land at the time the land is first developed for those urban purposes.

The SIC currently applies to most greenfield development areas on Sydney's fringe. It does not apply to land that is used in accordance with its pre-urban zoned status (for example, for rural purposes), and only applies when development consent is granted for urban purposes. Different rates apply depending on whether the development is residential or industrial. The dollar rate is the same regardless of the underlying land value of the property – underlying land values between the South West and North West Growth Centres vary significantly. The value sharing aspect of the SIC is that some of the increase in value associated with the up-zoned land is captured through the developer paying a standard levy to the State Government, which is then applied to providing new road infrastructure and other purposes that are the responsibility of the State Government.¹²

There are some examples of value sharing schemes in NSW that have been connected with bonus floor space schemes in higher density housing and employment nodes in Sydney including Green Square (in City of Sydney LGA), Sydney Olympic Park (in Auburn LGA), Macquarie Park (in Ryde LGA), Waverley LGA, Randwick LGA and Rhodes (in Canada Bay LGA). These are locally based schemes in most cases implemented by the local council. The common elements of these schemes are that developers can secure extra development rights in exchange for part of the uplift in site value being shared by the local community via land, works or cash contributions for a range of public purposes.

The public purposes envisaged in these schemes include roads, stormwater drainage, public domain and open space, community and cultural facilities, and affordable housing/ affordable housing is a particular focus of the schemes operating in the City of Sydney and Waverley LGAs.

These contributions are usually additional to the usual development contributions that are compulsorily required as part of the development consent (i.e. section 94 or 94A contributions).

Some other councils have tried to pursue similar types of schemes over the years but have met resistance by the Department of Planning and Environment when trying to effect these schemes through inserting provisions in LEPs.

More detail on the local value sharing schemes currently operating in Sydney development areas, and their potential transferability to development sites in the Parramatta CBD, is provided in section 5.6 of this report.

¹² Current State Government policy is that SIC funds are applied to roads infrastructure, land for emergency and justice purposes and regional open space

5.3.2 Tax increment financing and growth area bonds

Tax increment financing (**TIF**) and growth area bonds (**GABs**) are types of value sharing schemes that have been promoted by developer and infrastructure lobby groups as a means of funding infrastructure for greenfield and renewal areas.

Both involve quarantining the revenue received from increased property taxes generated by rezoning and development in an area and applying the funds to service and pay out loans taken out to fund infrastructure provided to serve that development. This essentially involves determining a baseline land value for a precinct to determine the baseline revenue that would be generated by rates in the instance there were no changes to planning controls.

The increase in land value, and subsequent increase in the revenue stream from rates, is then determined for a specified period of time (say the anticipated length of development). Bonds, to raise money to forward fund the necessary infrastructure to support development generated by the change in planning controls, are then sold on the basis of guaranteeing a return at the maturity of the bonds, from the increase in rate / tax revenue as a result of the increase in land value. At the end of the bond period, the increased rate / tax revenue stream reverts back to rating / taxing authority.

TIF schemes have been successfully used in the United States where they are usually just one part of the funding mix.

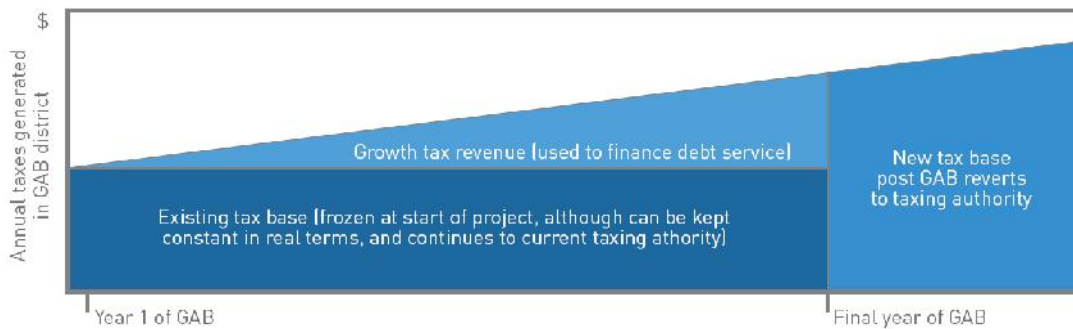
A typical scheme includes the following elements:

- Identify a suitable growth area bond precinct and establish a growth area bond authority
- Prepare a plan for the area that describes its infrastructure needs, and the costs of the infrastructure
- Calculate the property tax revenues currently derived from the area
- Issue bonds to fund the infrastructure works for the area
- Repay the bonds from the incremental increase in property taxes (above the revenue previously collected) generated by the new infrastructure and development in the area
- Once the bonds are repaid, all property tax revenue for the area returns to the Government.

Figure 3 over page illustrates the concept.

The main advantage of this type of scheme is that it ties the increased Government revenue attributable to development to paying back loans for infrastructure provided in the early stages of the development process. Governments fund infrastructure with a bond, then repay it with the growth in property taxes generated by that investment. The forward-funding of infrastructure creates a positive feedback loop where development happens sooner because of the early infrastructure provision, thus generating a greater rate of increases in property taxes. In this scenario, property taxes can be viewed as 'working harder'.

At a local council level, a TIF-like scheme could be implemented based on a change in planning controls assuming an increase in land values. Alternatively, it could be supported with the support of a special rate variation. However, such a scheme would require leadership by State Government and partnership with local councils.



Note: GAB = Growth Area Bond

Sources:

Growth Area Bonds: New Solutions for Funding Infrastructure, Property Council of Australia (NSW), 2010

Realising New Funding for Infrastructure and Urban Renewal: Capturing Value, Consult Australia and SKM (2013)

Figure 3 Growth area bonds

5.4 Opportunities for State government-led schemes

These schemes require State government leadership and implementation.

Value sharing is recommended by Infrastructure NSW (**INSW**) as one of six strategies to help deliver infrastructure in the State Infrastructure Strategy.

INSW sees value sharing as a vehicle for taxpayers to recoup some of the value brought about by Government investment in major infrastructure. Some infrastructure projects, especially in transport, can increase the value of nearby landholdings and other assets over time. Where the taxpayer has made a financial contribution, it is desirable that a share of this value should be recovered by Government. INSW sees the challenges for value capture mechanisms as including identifying the beneficiaries, quantifying the gains and crystallising cashflows to Government. INSW however does not see value capture as a short term substitute for more conventional funding strategies.

The State Government has historically been hesitant in pursuing value sharing schemes in conjunction with major infrastructure projects. Some of the reasons for this are:

- Significant local land owner and developer resistance to what is seen as an additional tax on development and land transfer activity.
- Stamp duty already applies to the changing value of land on transfer. Increasing land values over time mean additional consolidated revenue for the State Government. State treasuries traditionally prefer to see these receipts accumulate in the pool of consolidated revenue rather than in a tied area-specific fund that would accompany a tax increment financing / growth area bond scheme for a particular area.

Because of this hesitancy there have been missed opportunities for implementation of State-led value sharing schemes. Value sharing is predicated on value uplift. Land value uplift generally commences when a firm decision is made to proceed with a transport infrastructure project. The formulation and implementation of a value capture scheme needs to occur well before the new infrastructure is operational, so as to not miss out on the value uplift. Some of the opportunity for value sharing income associated with the new rail links in north west and south west Sydney will

have already been lost because land sales along the routes have built in the value that will be derived from the yet-to-be-completed infrastructure.

There have however been some promising moves against this trend recently. There have been media reports that Commonwealth and State Governments are actively considering different potential value sharing mechanisms linked to major transport investment.

Speaking at a funding announcement on the Gold Coast light rail project the Prime Minister said in October 2015 that 'we have to look creatively at how we sharing the value that arises from the increase in property values and the improvement in the utility of adjacent land from the building of infrastructure like this'.¹³

The State Government is examining value capture levies as a key funding source for new light rail links connecting to the Parramatta CBD, particularly the route from Westmead to Sydney Olympic Park via Camellia. The mechanisms being considered include betterment levies, special infrastructure contributions and parking space levies.¹⁴

The Parramatta light rail project offers some promise of government action on a broad-based value capture scheme. Council should monitor these developments and, if a government-led scheme does materialise, the recommendations for a local scheme outlined in this report may need to be reviewed.

5.5 Why should Council extract some of the value uplift that results from planning decisions?

The value of land is directly related to the uses and densities permitted on that land.

Given the much higher value of residential floor space in highly accessible locations like Parramatta CBD, relative to industrial or business zoned land, rezoning sites to facilitate residential uses would result in a significant increase in the land value.

Similarly, decisions by planning authorities that enable development on land in high-demand locations to be carried out at a greater density can often also lead to a significant increase in land value.

There are philosophical public policy reasons why the landowner / developer should not receive all of this un-earned financial benefit - or 'windfall' gain – that has resulted from a government decision:

- These planning decisions will lead to developments that generate infrastructure impacts. The extra infrastructure required by development might not be able to be provided using conventional development contributions mechanisms. Sharing the value uplift from planning decisions between the developer and the community provides a valid funding source for the infrastructure needed by the extra development.
- Sharing value uplift can be justified on economic development grounds. The value uplift would not have occurred without the planning decision. It is reasonable for the prime beneficiary of this uplift (the land owner) to return some of the value to the community so that it can be reinvested in infrastructure that in turn adds value to other land in the area and allows more economic development of land and healthier local economy.

¹³ *Australian Financial Review*, 11 October 2015

¹⁴ *ibid*, 21 October 2015

Despite the State Government’s previous reluctance to investigate or implement comprehensive value sharing schemes, several Sydney councils have acted to implement local schemes. These schemes are described in the next section of this report.

5.6 Review of value sharing schemes

GLN Planning investigated local value sharing schemes operating, or in the implementation stage, in the Sydney metropolitan area.

This section summarises the results of that review. The full analysis is shown in **Appendix C**.

The schemes that were reviewed are listed in **Table 8** below:

Table 8 Local value sharing schemes

Scheme	Applies to
Southern Employment Lands Affordable Housing	Certain land in Alexandria and Rosebery that is zoned B7 under Sydney Local Environmental Plan 2012
Green Square Urban Renewal Area Community Infrastructure Scheme	Certain land in Alexandria, Zetland and Beaconsfield zoned R1, B2, B4, B6 and B7 under Sydney Local Environmental Plan 2012
Green Square Town Centre Infrastructure Strategy	Land surrounding Green Square railway station that is zoned 4a General Industrial under the City of Sydney Planning Scheme Ordinance 1971
Macquarie Park Corridor Access and Open Space Infrastructure	Land in Macquarie Park that is currently zoned B3 and B4 under Ryde Local Environmental Plan 2014
Waverley Variation Floor Space Infrastructure Scheme	<ul style="list-style-type: none"> Certain land zoned B3, B4 and R4 in Bondi Junction under Waverley Local Environmental Plan 2012 Certain land zoned B4, B1 and R3 in Bondi Beach under Waverley Local Environmental Plan 2012

5.6.1 How do the schemes work?

The schemes provide the opportunity for developers of land to voluntarily participate in an alternative land use control framework.

A person may seek approval for development under the zones, FSRs and height controls that currently apply to the land, or they may seek approval for a different development under an alternative set of controls. The presumption in all of the schemes is that the alternative set of controls allow different types or higher density of development that increase the value of the land.

If the developer wishes to utilise the alternative set of controls then that developer can do so if an offer is made to the council to make contributions of land, works and / or cash for provision of local infrastructure.

Local infrastructure includes new and widened roads, pedestrian and streetscape facilities, new parks, community facilities, stormwater management facilities. In some cases, the local infrastructure includes affordable housing managed by a community housing provider.

The offer of local infrastructure is secured through a VPA between the developer / land owner and the Council.

In some of the schemes the value uplift is triggered when the alternative planning controls are activated or 'switched on' after the statutory planning instrument (i.e. the LEP) is made. In other schemes (Green Square Urban Renewal Area and Waverley), the activation of value uplift is more aligned to the approval of the DA.

Table 9 summarises how value is captured in each of the schemes.

Table 9 Summary of how value is captured in the schemes

Scheme	How value is captured
Southern Employment Lands Affordable Housing	<p>A developer can have a Planning Proposal approved that allows:</p> <ul style="list-style-type: none"> residential development where it is not currently permitted, and / or permits a greater intensity of development through increased floor space or height controls. <p>The Planning Proposal proceeds only if the developer offers to share the 'planning gain' that accrues from the decision.</p> <p>The planning gain is calculated using a series of standard rates contained in a guidelines document. The rates, derived from an analysis by a land valuer, are a proxy for calculating the difference between value of the land before rezoning or before changes to height and FSR controls, and the value of the land following rezoning.</p> <p>The council requires 50% of the planning gain to be shared with the community by the developer providing works, land, or money up to that amount.</p> <p>The VPA that secures these arrangements is tied to the Planning Proposal. The amending LEP is not made until the VPA is entered into and is registered on the land title.</p>
Green Square Urban Renewal Area Community Infrastructure Scheme	<p>The LEP has a base and maximum FSR applying to all land in the renewal area. The maximum floor space can only be achieved in designated areas shown on the FSR maps and where the developer provides community infrastructure through direct provision and cash contributions. Additional floor space allowed is prescribed in clauses in the LEP.</p> <p>The value of the contribution is calculated based on standard rates published in a guidelines document and the amount of additional floor space above the base allowed in the LEP.</p> <p>The contribution may be provided in-kind or in cash. Regardless, the first \$100 per square metre of additional floor space must be made as a cash contribution towards Green Square Town Centre infrastructure.</p> <p>The VPA that secures these arrangements is tied to the DA.</p>
Green Square Town Centre Infrastructure Strategy	<p>The area is currently zoned Industrial under a 1971 planning ordinance. Two LEPs have been made that zones land for residential, retail, commercial and other non-industrial uses. The new B4 Mixed Use zone is 'deferred' and remains zoned Industrial until the developer offers to</p>

Scheme	How value is captured
	<p>enter into a VPA with the Council to deliver, or make an appropriate contribution toward, town centre infrastructure.</p> <p>The appropriate monetary contribution has been calculated for each site in the planning area; and has been based on the expected shortfall in funding available for the necessary upgrades. This amount is then broken up based on each site area's allowance of residential, retail and other non residential floor space, and standardised contribution rates that are included in the town centre infrastructure strategy.</p> <p>The VPA that secures these arrangements is tied to the Planning Proposal. The amending LEP is not made until the VPA is entered into and is registered on the land title.</p>
<p>Macquarie Park Corridor Access and Open Space Infrastructure</p>	<p>This scheme is predicated on the need to provide more open space and a more permeable and extensive local street network in the Macquarie Park employment area.</p> <p>The scheme operates in a similar way to the Green Square Town Centre model. Additional floor space allowed under the LEP is achieved through the consent authority being satisfied that there will be adequate provision for recreation areas and an access network.</p> <p>Adequate provision means the development making an equitable contribution (in cash, works or land) toward the provision of the recreation and access network described in the DCP.</p> <p>The types and amount of contribution would be confirmed in a VPA accompanying the DA.</p> <p>Monetary Contribution = total additional gross floor area x contribution rate. The contribution rate is \$250 per square metre of floor area, which is a proxy meant to reflect 50% of the increase in value assumed to result from the rezoning.</p> <p>The scheme also sets out the value of different works in kind and land dedications that may be offered by the applicant and offset against the total cash contribution.</p>
<p>Waverley Variation Floor Space Infrastructure Scheme</p>	<p>DAs in certain parts of Bondi Junction and Bondi Beach that propose up to 15% extra floor space above that permitted under the FSR controls in the LEP may be approved if:</p> <ul style="list-style-type: none"> • The development is acceptable on planning grounds, and • The developer enters into a VPA with the Council to provide public benefits (cash, works or land) in the surrounding area. <p>On this basis, the planning controls are varied in the instance that the requirements of Clause 4.6 are satisfied. The contribution to be negotiated in the VPA will be 50% of the increase in net value to the development arising from the increase in FSR beyond that allowed under the LEP.</p> <p>The formula for calculating the value uplift from the bonus floor space is:</p> $\begin{array}{r} \text{Marginal net sale proceeds} \\ \text{less} \\ \text{Marginal cost to construct} \end{array}$ <p>Council's VPA policy includes a step-by-step methodology that shows how the value uplift is calculated.</p>

5.7 Calculation of value sharing contribution

As shown in **Table 9**, there are various ways a value sharing contribution can be based upon and calculated. On balance, schemes like the *Green Square Urban Renewal Area Community Infrastructure Scheme* and the *Macquarie Park Corridor Access and Open Space Infrastructure Scheme* that utilise a standard \$/m² rate for additional GFA provides the simplest and cost effective methodology to implement. This is primarily due to there not being a need to individually calculate the value uplift as a result of individual planning decisions.

It is also considered that setting a consistent and standard rate, rather than a site-by-site value analysis, would establish a clear signal for the market and developers to respond to. This would allow for a level playing field that the same contribution amount should be factored into future feasibility investigations for sites in the Parramatta CBD.

From a Council perspective, a standard rate also improves transparency in the levying of a value sharing contribution rather than by site by site negotiation. It would also allow Council to better project potential funding that could be obtained from value sharing contributions in the Parramatta CBD.

On this basis, GLN Planning was requested to recommend a reasonable \$/m² of gross floor area (**GFA**) rate that could be used for a value sharing scheme in the Parramatta CBD.

The analysis initially drew on a sample of 10 sites zoned B4 Mixed Use with recently completed developments. Site areas ranged from 500m² to 6,000m² with apartment yields ranging from 19 dwellings to 591 dwellings. Land transaction date, including date of sale and sale amount was also provided. Land transactions had occurred for these sites between 2002 and 2015, some with development consent, some before development consent.

A \$/m² rate of approved GFA was determined for each site by dividing the land sales price by the approved GFA¹⁵. Based on this sample of sites and transaction data, which corresponded to a period of significant downturn during the GFC and a period of significant upswing around 2013/14, developers paid on average \$655/m² of GFA.

At the direction of the Council's Infrastructure Funding Review Committee, GLN Planning was asked to review more recent sales transactions to determine if there was any difference in the prices recently being paid for GFA entitlements identified in the CBD Strategy. On this basis, Council was able to provide sales transaction and development approval data for land identified as B4 Mixed Use in the CBD Strategy area for the 2 year period 2014 to 2015. This time period was chosen because it broadly corresponded to the time when information about the increased FSR limits in the CBD Strategy was publicly available.

The data was segmented into sites with the two main FSR ceilings permitted under the CBD Strategy (i.e. 6:1 and 10:1), as well as whether the sites had or did not have DA approvals for mixed use developments. Very small sites were excluded – a minimum lot size of 600m² was assumed to be representative of interest in consolidating sites to allow a reasonable size of development.

A total of 39 transactions comprised this data set.

The \$/m² rate paid for GFA under the existing controls or DA approvals in place was first reviewed. From this analysis, which showed values as high as \$2,850/m² of GFA, it was apparent that

¹⁵ Note the majority of these mixed use development only included token retail or commercial components to satisfy the requirement for 'mixed use development'. It is also assumed that the market for smaller retail and commercial space was not in high demand and as such, this GFA netted itself out in terms of cost to construct and revenue from the sale of this space.

development would be significantly constrained or unfeasible if only the GFA entitlement under the existing planning controls (or DAs approved under these controls) was constructed. As such, the \$/m² rate was adjusted to reflect the GFA entitlements that were identified under the CBD Strategy. The average, adjusted \$/m² rates are shown in **Table 10** below.

Table 10 Summary of \$/m² of GFA rates paid during 2014 and 2015

Site Circumstance	Average (\$/m ² GFA)	Highest (\$/m ² GFA)	Lowest (\$/m ² GFA)
Sites with DA approval	\$823	\$1,167	\$532
Sites with no DA	\$805	\$2,132	\$104

The data shows that average, adjusted site values reflective of recent market conditions and expectations were \$823/m² for DA approved sites and \$805/m² for sites with no DA.

It is considered that the 'no-DA' rate of \$805/m² of GFA rate would be the more appropriate rate to use for the purposes of modelling the impacts of various value sharing regimes on development viability.

5.8 Potential value sharing schemes

The draft CBD Planning Proposal being prepared by Council will significantly change the existing planning controls, including FSR. For instance, the FSR of certain sites will increase from 6:1 to 10:1 in the CBD core and from 2:1 to 6:1 on the periphery of the CBD area.

In addition to this increase in development right, Council's draft CBD Planning Proposal will also include 'incentive clause' provisions which will allow:

- (a) an additional 15% increase in FSR for 'Design Excellence'; and
- (b) an additional 0.5:1 FSR for 'High Performing Buildings' applicable to mixed use development on sites with a 10:1 FSR.

On top of this, the draft CBD Planning Proposal will also nominate a number of 'opportunity sites' that can benefit from an additional 3:1 FSR increase.

These changes will generate the potential for significant uplift in land values as a result of the increase in permitted development rights. In order to raise part of the funding required to deliver the Council's significant infrastructure program required to support development in the CBD, Council has identified a 2 phase approach for value sharing. In principle this approach is as follows:

- **Phase 1** value sharing is where the developer and the community share in the value uplift created by the extra floor space entitlements that will be permitted when the draft CBD Planning Proposal comes into effect;
- **Phase 2** value sharing is where the developer and the community share in the value uplift created by the extra floor space entitlements that will be permitted by the 'opportunity sites' provisions when the draft CBD Planning Proposal comes into effect.

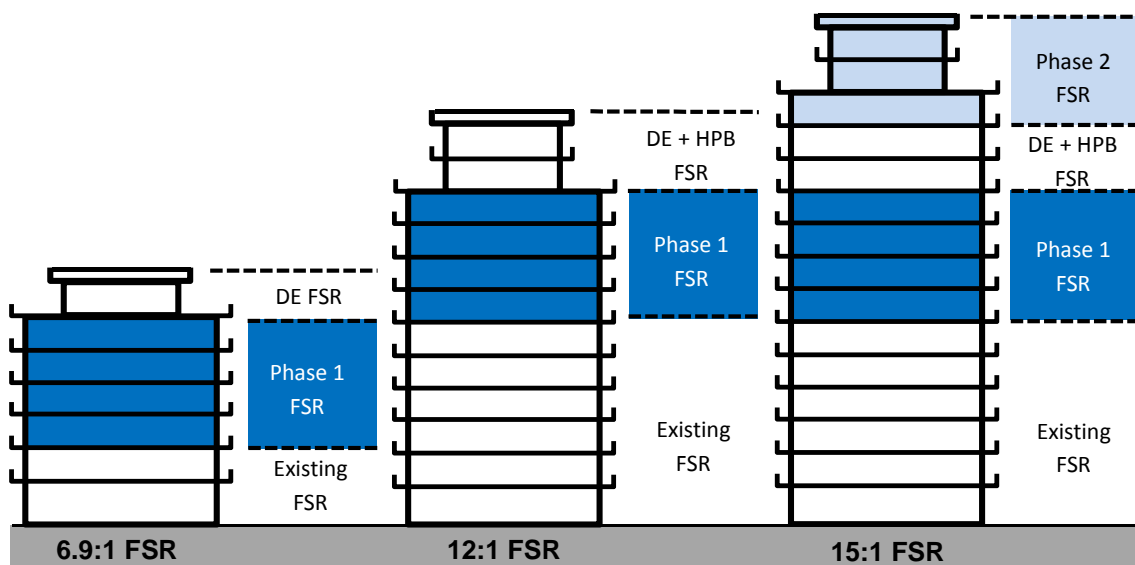
In effect, the draft CBD Planning Proposal will usher in three maximum FSR outcomes:

- **6.9:1 FSR sites** – Where the existing FSR control is increased to 6:1 plus an additional 0.9:1 (ie. 15%) from the 'design excellence' incentive. This outcome would only involve Phase 1

value sharing on the increase of GFA from the existing FSR to 6:1 FSR. Incentive FSR for 'High Performing Buildings' do not apply in this case.

- **12:1 FSR sites** – Where the existing FSR control is increased to 10:1 plus an additional 1.5:1 from the 'design excellence' incentive and an additional 0.5:1 from the 'High Performing Buildings' incentives. This outcome would only involve Phase 1 value sharing on the increase of GFA from the existing FSR to 10:1 FSR.
- **15:1 FSR sites** – Where the existing FSR control is increased to 10:1 plus an additional 1.5:1 from the 'Design Excellence' incentive, an additional 0.5:1 from the 'High Performing Buildings' incentive and an additional 3:1 from the 'Opportunity Sites' provisions.

These outcomes are diagrammatically shown below.



DE = Design Excellence Incentive FSR
HBP = High Performing Buildings Incentive FSR

Figure 4 Draft CBD Planning Proposal typical FSR outcomes

Based on these three typical FSR outcomes, following consideration of the contributions able to be generated by conventional means, Council identified three possible value sharing regimes mixed with a section 94A approach, as follows:

- Application of section 94A at 4.5% of the cost of construction over the full development delivered plus Phase 2 value sharing at 50% of the value on floor space delivered in excess of 12:1 FSR GFA.
- Application of section 94A at 3% of the cost of construction over the full development delivered plus Phase 1 value sharing at 10% of the value on floor space delivered between existing controls and the new controls (excluding incentive FSR) and Phase 2 value sharing at 50% of the value on floor space delivered in excess of 12:1 FSR GFA.
- Application of section 94A at 3% of the cost of construction over the full development delivered plus Phase 1 value sharing at 50% of the value on floor space delivered between existing controls and the new controls (excluding incentive FSR) and Phase 2 value sharing at 50% of the value on floor space delivered in excess of 12:1 FSR GFA.

5.9 Impact on development feasibility

5.9.1 Assumptions

The impact on development viability of the three different value sharing regimes was modelled for each of the typical maximum FSR GFA outcomes shown in Figure 4.

The potential revenue that would be generated under each regime was also calculated. Again, as per the previous modelling carried out for the conventional contribution approaches, a hypothetical development of a 3,000m² site was assumed for each FSR scenario.

This time, a standard value rate of \$805/m² of GFA was applied to the additional GFA above the existing controls as per the Phase 1 and Phase 2 approaches described earlier.

Additional allowances were made for the increase in the cost of construction that would likely result from the design excellence and building performance obligations. A full list of assumptions that underpin the hypothetical development model are included in **Appendix D**.

5.9.2 Results

A summary of the contributions and viability impacts is shown in **Table 11**.

Table 11 Summary of value sharing regimes at \$805/m² of additional GFA

Scenario		Contribution Generated	Developer Profit	IRR	Margin
Base Case – 6.9:1 FSR with S94A @ 3% and no VS		\$2.21M	\$18.20M	20.0%	17.3%
A	6.9:1 FSR with S94A @ 4.5% and no VS	\$3.31M	\$17.08M	19.2%	16.1%
B	6.9:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 10%	\$3.17M	\$17.21M	19.3%	16.4%
C	6.9:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 20%	\$4.14M	\$16.23M	18.6%	15.4%
D	6.9:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 50%	\$7.04M	\$13.29M	16.4%	12.6%
Base Case – 12:1 FSR with S94A @ 3% and no VS		\$3.84M	\$35.22M	20.0%	18.3%
E	12:1 FSR with S94A @ 4.5% and no VS	\$5.77M	\$33.34M	19.4%	17.1%
F	12:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 10%	\$4.81M	\$34.31M	19.7%	17.8%
G	12:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 20%	\$5.78M	\$33.33M	19.4%	17.3%
H	12:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 50%	\$8.62M	\$30.44M	18.3%	15.8%

	Scenario	Contribution Generated	Developer Profit	IRR	Margin
I	15:1 FSR with S94A @ 4.5% and Phase 2 VS on 3:1 FSR @ 50%	\$10.76M	\$53.93M	25.9%	23.6%
J	15:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 10% and Phase 2 VS on 3:1 FSR @ 50%	\$9.34M	\$55.34M	26.3%	24.5%
K	15:1 FSR with S94A @ 3% and Phase 1 VS on 4:1 FSR @ 50% and Phase 2 VS on 3:1 FSR @ 50%	\$13.21M	\$51.48M	25.0%	22.8%

The 2014-15 land transaction data demonstrated that the potential FSRs contained in the Architectus study (exhibited in late 2014) and adopted in the CBD Strategy have generally been factored into the price paid for land by developers and speculators, rather than the FSRs currently allowed under the existing LEP. As a result, any attempt by Council to extract a Phase 1 value sharing contribution on a development that did not exceed CBD Strategy FSR allowances will adversely affect viability.

This is shown in our base case where developments approved under the CBD Strategy FSR and paying only a 3% section 94A levy would achieve an IRR of 20%. This is a general minimum benchmark for lending authorities and represents the risk to reward appropriate for the development. If Council applied an additional 10% value sharing to Phase 1 floor space the IRR would reduce to 19.3% for the 6.9:1 FSR development scenario and to 19.8% for the 12:1 FSR development scenario. At this level, these developments would be considered to be on the cusp of being viable¹⁶.

Impacts on development viability with increased Phase 1 value sharing rates worsen to the point of being unviable as the development has to offset a greater contribution with the same revenue. These impacts will be most felt in the instance the residential property market flattens (i.e. static price growth) or declines for those that may have purchased sites.

In this instance, if the Council was to implement Phase 1 value sharing on developments that only achieve the CBD Strategy FSR, this:

- May render projects unviable and stall development unless a DA is already in place.
- Encourage developers to lodge Planning Proposals to exceed the CBD Strategy FSRs to offset the cost of the Phase 1 value sharing.
- Could stall future land transactions as developers would no longer be able to pay the current market rate and no longer provide the same incentives to landowners (unless they were under duress to sell). Although this would likely correct itself over time.

On the other hand, if the development site had been acquired and held for a lengthier period of time, say before the CBD Strategy was public knowledge, it is likely that the site had been acquired for less and as such, may be able to offset the imposition of a Phase 1 value sharing contribution.

¹⁶ This is ultimately dependent on the price a developer paid for land. If they had paid over the general average of \$805/m² of GFA, the impacts would be more severe. Conversely, if they paid under that rate, the impacts would be reduced and development more viable.

In the instance where the Parramatta residential market continues to experience growth, it is likely that the viability of all projects will improve and offset the imposition of a Phase 1 value sharing contribution.

Developments that achieve FSR outcomes above the CBD Strategy allowances – i.e. Phase 2 value sharing - are not nearly as sensitive to value sharing imposts. This is on the basis a developer acquired a site based on the 12:1 FSR outcome intimated in the CBD Strategy. These results suggest greater room for the application of Phase 2 value sharing but it is also reasonable to assume that there would be higher viability benchmarks for a larger, more risky development that would have greater exposure to changes in market conditions. We suggest adopting a 25% IRR and Profit Margin for projects exceeding the CBD Strategy FSR would be reasonable.

The results for developments exceeding CBD Strategy FSR mask a reality that any Phase 1 value sharing on such development reduces IRR, but any Phase 2 value sharing still allows the development to meet or beat viability benchmarks. Again, this will depend on the price developers have paid for land.

From the above it is evident that Council should use caution in designing its value sharing scheme.

Projects that seek to utilise GFA up to but not exceeding CBD Strategy entitlements will have their viability adversely affected, although value sharing at the 10-20% level could probably be tolerated in the current buoyant economic environment.

It must be stressed however that developments of sites bought in recent times, at or above average rates, that are only able to achieve an FSR of 6.9:1 (including incentives) are far more sensitive to the impacts of Phase 1 value sharing and as such, these projects could likely only tolerate sharing at the 10% level in the current market.

Conversely, a development exceeding CBD Strategy GFA allowances could tolerate Phase 2 value sharing at or above 50%. Although Phase 2 value sharing on a development at or above the 50% level is technically feasible, there is no precedent for value sharing at levels above 50% and would bring into question the notion of equity in the risk and reward taken by developers.

5.10 Recommended floor space value and value sharing rates

If the Council proceeds to implement its value sharing scheme then we recommend that it comprise the following features:

- *Adopt a floor space value in the range of \$700 to \$750 per square metre of GFA for the purpose of assessing value sharing*

Whilst analysis of land transfers since 2014 identified a higher average \$/m² GFA rate has been paid, it is considered that the recommended rate is reflective of the average rate paid through the full property cycle and is based on a significant sample size. The period since 2014 reflects a time of significant growth in apartment prices in the property cycle. It also represents a time where allowances under the CBD Strategy were public knowledge and this could have helped drive speculation in the market.

The previous analysis of 10 key sites identified by Council reflected a sample of land transactions between 2002 and 2014 and provided an average rate of \$655/m² of GFA. This rate is considered to be more reflective of full property cycle movements however is limited in sample size. A more recent, larger sample revealed an average rate of \$805/m² of GFA. As such, a mid point in the order of \$700 - \$750 / m² should be more a more reasonable 'through the cycle' rate for the purposes of a value sharing scheme.

- *Given the land transactions within the CBD over the last 2 years, a cautious approach should be taken to any Phase 1 value sharing rate – we recommend that the rate should be no more than 20% on larger projects, and 10% on smaller projects. Developments on sites that have been held for several years would more readily absorb a 20% or more Phase 1 value sharing rate, regardless of FSR.*

As demonstrated in the modelling results, any application of Phase 1 value sharing will have an impact on development viability for sites purchased in the last two years. If applied at a lower rate (say 10%) for recently purchased sites, it is evident that whilst there will be impacts on development viability, the resultant IRR would still likely be considered to be feasible. This would be dependent upon the price that was ultimately paid for the land and if any opportunities to reduce construction costs. As such, it is considered that caution should be applied when considering value sharing to Phase 1 for sites purchased in the last two years given that value sharing at 10% delivers borderline results (19.8% against the benchmarks used by developers and financiers). Developments on sites that have been held for several years would more readily absorb 20% or more Phase 1 value sharing, regardless of FSR.

- *A maximum 50% Phase 2 value sharing rate*

From the modelling of developments that achieve an FSR of 15:1 or greater, even after adopting a higher benchmark for development viability (i.e. IRR of 25%), development would still remain viable if a value sharing of 50% was adopted. It is possible there could be a greater tolerance however a value sharing greater than 50% would be hard to politically justify and may disincentivise developers.

5.11 Implementation issues

5.11.1 Risks of value uplift not materialising

The potential for value sharing as an alternative or additional funding source needs to be tempered with an understanding of the current and future economic circumstances.

A value sharing scheme is predicated on there being positive movement in the value of land in a planning area. Rapid price escalation and land speculation have been features of the Sydney residential land market in recent times. This scenario is likely to be a factor that has driven the lodgement of recent Planning Proposals seeking substantially higher floor space development rights on numerous sites in the CBD.

The application of extra development rights to land does not automatically lead to higher land values. Wider economic circumstances and cycles (e.g. interest rates, taxation policy, international money markets) and complex forces of supply and demand in metropolitan development sub-markets all impact both positively and negatively on land values over time.

It is possible that by the time Council was to commence its value sharing scheme that the project pipeline for major developments in the Parramatta CBD for the next 10-15 years will have been established. As the value sharing scheme proposed by Council would only apply to sites that will be developed further down the track, it could be many years before significant infrastructure dividends from the scheme is realised. If land values stagnate or decline for a period rather than increase like they have done recently then this timeframe would extend further.

In other words, if the recent price escalation and developer activity does not continue, this would be a risk to the success of the value sharing scheme. There is a risk that a scheme introduced at an inopportune time in the property cycle may fail.

5.11.2 Probity

Another important issue is the need for any value sharing scheme to be transparent, equitable and applied consistently.

Developers and the community should be made familiar with the purposes and operation of the scheme in order for Council to avoid perceptions of 'cash for floor space' deals. This perception will be difficult to quell anyway, so the responsibility is with Council to work with stakeholders to establish the need for the scheme and the benefits to the wider community that will be achieved by the scheme.

The principles that underpin the draft Macquarie Park scheme are a good example for the Council to follow, that is:

- **Nexus:** That some of the benefit afforded to sites is captured by the community to provide essential infrastructure required as a result of increased densities in the area.
- **Transparency:** There is a clear understanding of what infrastructure is to be funded and how contribution rates and community benefit are calculated and applied to individual sites.
- **Equity:** Both infrastructure and incentives for development are based on equity and fairness.
- **Practical:** The implementation of the mechanism must be practical and occur in a timely fashion to avoid delays and provide certainty for commercial dealings.
- **Feasibility:** The contributions must not create development opportunities which are not economically viable.

6. Conclusion and recommendations

6.1 Recommended scheme using conventional mechanisms

There are various contributions tools that are available under the current NSW planning system to facilitate the delivery of development-generated infrastructure by developers.

The optimum contributions strategy for the anticipated future development in the Parramatta CBD, **using only the current conventional development contributions mechanisms**, is outlined below:

- Continue the current practice of requiring developers to carry out works on and near their development sites where it is reasonable to do so.
- Continue the current practice of consent authorities imposing a section 94A levy on all eligible development, but seek the support of the Minister for Planning to allow consent authorities to impose a 4.5% levy instead of the current 3%. This approach has the advantage of it being the contributions mechanism currently imposed on development (albeit at a higher rate), and is thus familiar to developers.
- Continue to negotiate VPAs with developers to extract additional public benefits associated with new developments.

If on the other hand the Council was unsuccessful in obtaining the Minister's support for a 4.5% levy, and it still wanted to achieve a higher financial return than the current 3% levy, it could pursue a hybrid contributions strategy that allowed:

- Section 94 contributions to be imposed on mixed use development, which is expected to be the majority of the development.
- A section 94A levy on wholly non residential (i.e. commercial and retail) development.

However the disadvantage of this approach is that it is a more complex system to set up and manage. The relationship (nexus test) has to be determined for all the anticipated different development types to be subject to section 94 contributions and the Council is potentially exposed to legal challenge on the reasonableness of its contributions in individual development approvals. These risks however can be managed.

We therefore recommend that Council prepare a draft section 94A contributions plan that authorises a levy of up to 4.5% on future CBD development and seek the Minister for Planning's endorsement to amend the EP&A Regulation to allow the higher levy to be imposed on developments.

This approach, if successful, will provide a robust mechanism for an increase in development contributions revenue with minimal risk of legal challenge. It would also be necessary for Council to consider its position on encouraging solely commercial development in the CBD and whether a levy of less than 4.5% on these developments is needed to achieve this goal.

If Council is unsuccessful in gaining the Minister's approval for an increased levy, we recommend that Council pursue a mixed or hybrid contribution strategy of:

- (a) Section 94 contributions applying to all residential and mixed use development
- (b) A 3% section 94A levy applying to all development that does not include a residential component.

It is recommended that Council take the following action to ensure a robust section 94 contributions plan is prepared that minimises risk of legal challenge:

- (a) Prepare a comprehensive infrastructure schedule and costs that is linked to a well – researched demand analysis to justify the schedule.
- (b) Carry out a thorough demand assessment of worker and visitor use of facilities in the infrastructure schedule to provide a robust argument for costs apportionment.
- (c) Analysis of the contribution rates that would generally be attributable to the worker population under both the section 94 and section 94A plans to ensure it is generally aligned and equitable.

6.2 Potential for value sharing schemes as an alternative or additional infrastructure funding source

Council officers advised that the estimated costs for the infrastructure that will be required for the future Parramatta CBD development exceeds \$800 million.

They have also advised us that continuing with the business-as-usual approach of imposing a 3% section 94A levy on CBD development will only yield a small fraction of the funds needed to meet this cost. A change to a 4.5% levy will improve the result, but a substantial funds shortfall will still remain. Council therefore wants to explore alternative or additional mechanisms to bridge the funding gap. Value sharing is one such mechanism.

Although value sharing has become a topical urban issue in recent times, there has historically been little appetite for State or Commonwealth Governments for pursuing a revenue model that extracts some of the uplift in value from planning or infrastructure decisions. Governments have so far been reluctant to act because of the difficulty in defining beneficiaries of planning and infrastructure decisions, likely community resistance, and treasuries being reluctant to tie revenue to particular areas and projects.

The proposed Parramatta light rail network offers potential as a catalyst infrastructure project that could underpin a value capture scheme. Such a scheme is currently under active consideration by the State Government. Council should monitor developments in this space in terms of potential effects on any local value capture scheme it may wish to implement.

Some Sydney local councils are implementing their own value sharing schemes. Whereas international examples of value sharing schemes are usually linked to major transport infrastructure projects, the local schemes are linked to the value uplift on sites that emanates from decisions that allow more valuable development types or increased intensity of development.

We reviewed 5 local schemes. In all but the Waverley scheme the extra floor space opportunities are secured when the statutory plan that allows those opportunities is activated or 'switched on'. This is important in sending a clear signal to the market that the full site value can only be achieved once the property is rezoned or the developer takes up the opportunity for bonus floor space through a formal VPA. If this is not done then it is highly likely that sites will be bought and sold on the basis that 100% of the extra value is secured by the land owner, and not shared with the community.

It is necessary for any local value sharing scheme to be supported by legislation provisions or a statutory plan such as an LEP that invokes a general power to allow additional development floor space to be approved in exchange for the provision of infrastructure or payment of infrastructure contributions.

A statutory scheme that shows all the candidate sites for bonus floor space has maximum transparency. This is the approach followed in the City of Sydney (in the Green Square Urban Renewal Area and the Green Square Town Centre) and in the City of Ryde (in the Macquarie Park Corridor). These bonus floor space schemes provide a good model for Council in structuring a similar scheme for the Parramatta CBD.

6.3 Development viability testing of Council's value sharing proposals

Council officers provided us with a 2-phase concept for a value sharing scheme that could apply to Parramatta CBD development sites in the future. GLN Planning tested the impacts of different value sharing regimes in terms of the contributions generated and the viability of hypothetical developments on sites with the typical FSR outcomes anticipated by Council. The typical FSR outcomes include:

- (a) 6.9:1 FSR with only Phase 1 value sharing applied to FSR in excess of the current controls;
- (b) 12:1 FSR with only Phase 1 value sharing applied to FSR in excess of the current controls; and
- (c) 15:1 FSR with Phase 1 value sharing applied to FSR in excess of the current controls and Phase 2 value sharing applied to additional FSR allowed for 'opportunity sites'.

This analysis was also compared to the contributions generated and viability outcomes that would result from the Council imposing a traditional section 94A levy scheme on the same hypothetical developments instead of, or in combination with, Phase 1 and 2 value sharing.

Table 11 showed a summary of the contributions and development viability outcomes of the various tested scenarios with the adoption of a 'value sharing' rate of \$805/m² of GFA. In light of the impacts of the different value sharing regimes on the hypothetical development at this rate, a revised rate of \$750/m² has been recommended to be a more reasonable 'through the cycle' rate for the purposes of a value sharing scheme.

The following is a summary of the results of our testing with the adoption of \$750/m² of GFA as for the different value sharing regimes (detailed results are shown in **Appendix D**):

For the 6.9:1 FSR development:

- The total development contribution ranged between \$2.2 million and \$6.7 million.
- The highest contribution would be in the instance of the developer sharing 50% of the value uplift created by the draft CBD Planning Proposal (i.e. a Phase 1 value share). However, that development would not likely be seen as viable by lending authorities because of the low profit margin and diminished IRR well below industry benchmarks.
- Negative impacts on viability are reduced in instances where the contribution is either a section 94A levy at 4.5%, or where it is a combination of Phase 1 value sharing at the 10% level. These hypothetical developments would likely to be seen as viable in the current market, with the total contribution being \$3.3 million, \$3.1 million and \$4 million, respectively.

For the 12:1 FSR development:

- The total development contribution ranged between \$3.9 million and \$8.3 million.
- The highest contribution would be in the instance of the developer sharing 50% of the value uplift created by the draft CBD Planning Proposal (i.e. a Phase 1 value share). However,

being a larger and more risky development than the 6.9:1 FSR development, its viability would likely be seen as marginal.

- Negative impacts on viability are reduced for the other scenarios, with a similar viability benchmarks and contributions amounts being achieved where the contributions imposed were a 4.5% levy or a combination 3% levy / 20% Phase 1 value share. These hypothetical developments would likely to be seen as viable in the current market, with the total contribution being \$5.8 million and \$5.6 million, respectively.

For the 15:1 FSR development:

- The total development contribution ranged between \$9 million and \$12.6 million.
- While this hypothetical development is the largest and riskiest of the three, viability benchmarks are likely to be easily achieved where any contributions scheme involved both Phase 1 and 2 value sharing.
- The favourable viability results are due to the assumption that the site purchase price was based on development yield that would be achieved under the draft CBD Planning Proposal

In considering the parameters of a value sharing scheme, it will be necessary for Council to balance the feasibility impacts on development against the significant shortfall in funding that will be available to deliver necessary infrastructure support the significant population growth that is expected.

This will have to be assessed on CBD wide basis, not just on individual hypothetical development sites. In this regard, when the proportion of sites that will deliver a 6.9:1 FSR outcome versus a 12:1 FSR and above outcome is considered, the standard application of a section 94A contribution at 4.5% with only Phase 2 value sharing may deliver a lower contribution pool than the application of a section 94A contribution at 3% accompanied by a Phase 1 and Phase 2 value sharing regime.

It is our understanding that in progressing a potential value sharing scheme, Council will be considering the impacts on feasibility including impacts on the limited number of sites which have been recently purchased in the last two years, and on the larger number of sites that have been held for longer periods. Council will also be considering the overall cost of infrastructure required to be funded to support development in the CBD and potential pool of contributions to fund these works.

6.4 Way forward for Council to pursue a local value sharing scheme

Council is considering implementing a 2-phase value sharing scheme on developments in the Parramatta CBD area in order to help fund the significant CBD infrastructure upgrades.

If Council was to proceed with its value sharing scheme, based on our investigations of similar schemes and our assessment of viability impacts, we recommend that Council incorporate the following elements in the scheme:

- (a) Retain the 3% section 94A levy in preference to seeking the Minister's approval for a higher (4.5%) levy.
- (b) Develop in consultation with the Department of Planning and Environment a town planning scheme that provides a choice for the developer between pursuing an 'as-of-right' development under current general planning controls and infrastructure contributions; or pursuing a development under different planning controls that also have value sharing contributions attached to them.

- (c) Prepare a comprehensive infrastructure plan containing details of the different facilities and amenities that will be delivered using the proceeds from value sharing.
- (d) Prepare guidelines that contain details of the value sharing scheme and that show how developers can participate in the scheme.
- (e) Adopt a floor space value in the range of \$700 to \$750 per square metre of GFA for the purpose of assessing value to be shared.
- (f) Consider carefully the rate of Phase 1 value sharing that is implemented. Our investigations of hypothetical developments based on recent average sales data show that larger developments could absorb up to a 20% Phase 1 value share with the community and probably meet viability benchmarks. Smaller developments on sites purchased in the last two years could absorb a 10% Phase 1 value share. Developments on sites that have been held for several years would readily absorb 20% or more Phase 1 value share, regardless of FSR.
- (g) The Phase 2 value sharing rate be set at no more than 50%.
- (h) The arrangement for the developer to provide public benefits is achieved through the negotiation of a VPA between the developer and the Council.
- (i) Value sharing contributions that are paid by developers be held in a dedicated account that has accountability and reporting protocols that at least reflect the accounting requirements for section 94 and section 94A monies.

Glossary of terms and abbreviations

CBD	Central business district
DA	Development application
DPE	Department of Planning and Environment
EP&A Act	Environmental Planning and Assessment Act 1979
EP&A Regulation	Environmental Planning and Assessment Regulation 2000
FSR	Floor space ratio
GFA	Gross floor area
GAB	Growth area bonds
INSW	Infrastructure New South Wales
IPART	Independent Pricing and Regulatory Tribunal
IRR	Internal rate of return
LEP	Local Environmental Plan
LGA	Local Government Area
SIC	Special Infrastructure Contribution
TIF	Tax increment financing
VPA	Voluntary Planning Agreement
VS	Value sharing

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