22 December 2020

Christina Heather
City of Sydney Council

Sent via email: cheather@cityofsydney.nsw.gov.au

Dear Christina

Re: Sydney Affordable Housing Program - Review and Update to Southern Precinct Affordable Housing Rates

Atlas Urban Economics (Atlas) is engaged by the City of Sydney Council (the City) to undertake a review and update the Affordable Housing contribution rate proposed for the Southern Precinct in the City of Sydney Affordable Housing Program.

Background

The City of Sydney Affordable Housing Program (the Program) was adopted by the City in July 2020 and proposes to amend the Sydney LEP 2012 (clause 7.13) to expand the operation of affordable housing contribution schemes to all other land (not currently subject to an affordable housing contribution scheme) and where the City is the consent authority.

A contribution requirement would be required on 'residual land' and 'Central Sydney' to apply to 'new' floor area (i.e. additional to existing floor area) and/ or to the floor area that is changing in use.

The affordable housing contributions are to be phased-in over time to allow for market adjustment. It is expected that affordable housing contributions will be payable at 50% from when the Sydney LEP 2012 (Amendment No. 52) is made (originally intended at 1 June 2020). The full contributions (100%) are expected from 1 June 2022.

Table 1: Proposed Contribution Rates, Clause 7.13

Date of Determination of DA	Total Floor Area (non-residential)	Total Floor Area (residential)
To 31 May 2021	0%	0%
1 June 2021 to 31 May 2022	0.5%	1.5%
1 June 2022 onwards	1%	3%

Source: City of Sydney

The current equivalent monetary contribution rate is $11,341/sqm (indexed to 1 March 2020).

Planning Proposal Land

The Program proposes to amend the Sydney LEP 2012 to provide for a new framework to identify sites (as "Planning Proposal land") that will benefit from increased development capacity through a site-specific planning proposal process where a supplementary affordable housing contribution has been identified.

This would mean the affordable housing contribution requirement under clause 7.13 and a supplemental contribution would apply to land identified. The requirement may specify how the contribution requirement is to be satisfied, by either:

- An in-kind dedication of completed affordable rental housing dwellings in a development; or
- An equivalent monetary contribution payment.

Once land is identified, the contribution requirement is calculated at the DA stage and will be applied under s7.32 of the Environmental Planning and Assessment Act as a condition of consent.

The proposed contribution rates applicable to Planning Proposal land are shown in **Table 2**.

Table 2: Proposed Contribution Rates, Planning Proposal land

Precinct	Proportion of Additional Floor Area for Affordable Housing
West	12%
South	12%
East	24%

Source: City of Sydney

The above contribution rates are applicable only where the site-specific planning proposal is for FSR increase on land. Where other changes to planning controls are being made (e.g. rezoning or significant increase in height), site-specific analysis will be required to determine an appropriate contribution rate.

Contribution rates are to be reviewed bi-annually to ensure they continue to align with market realities.

Contribution Capacity Testing

Where a site is the beneficiary of planning uplift (e.g. increase in FSR) there is generally a commensurate increase in land value. It is through this value increase that a site will have the capacity to contribute to affordable housing while remaining viable for development.

This section investigates the capacity of land that is subject to a site-specific planning proposal (referred to as 'Planning Proposal land') to contribute to affordable housing (over and above the contribution requirement in clause 7.13).

For any (additional) contributions to be viable, development without the contribution needs to be viable in the first instance.

Approach and Methodology

The analysis presumes that land progressed under a site-specific planning proposal is viable even without an (additional) Affordable Housing contribution requirement for Planning Proposal land.

The contribution capacity testing is undertaken in three steps:

1. **Step 1 - Identification of sites and notional development scenarios for testing**

   Atlas worked with the City to identify typical sites in the Southern Precinct (including in the Waterloo Estate South) for contribution capacity testing. This step develops notional development yields based on planning uplift nominated by the City for testing in Step 2 and Step 3.

2. **Step 2 - Baseline testing (with clause 7.13 Affordable Housing contribution)**

   Generic feasibility testing is carried out on sites selected in Step 1 based on notional development yields also developed in Step 1. The testing in Step 2 assumes all applicable statutory fees and charges including Affordable Housing contributions under clause 7.13.

3. **Step 3 - Iterative testing of *additional* Affordable Housing Contributions (for Planning Proposal land)**

   Step 3 involves the inclusion of additional Affordable Housing contributions to examine the capacity of the selected sites to contribute. A rate of 9% (over and above the clause 7.13 contributions) is initially tested before iteratively testing alternate rates should they be required.

   All things being equal, sites in receipt of greater planning uplift will have greater capacity to contribute to affordable housing (or other infrastructure or public benefit). The tolerance of development and capacity to pay is analysed in the context of the respective quantum of planning uplift assumed on the sites tested.

In assessing the tolerance of development to contributing to Affordable Housing, key performance indicators relied upon are residual land value[1] and hurdle rates (development margin[2] and project IRR[3]).

[1] Residual Land Value is the amount remaining once the gross development cost of a project is deducted from its gross development value and an appropriate return has been deducted.
[2] Development Margin is profit divided by total costs (including selling costs)
[3] Project IRR is the project return on investment, where the discount rate where the cash inflows and cash outflows are equal

The objective of feasibility testing is to assess if, after contribution to Affordable Housing, residual land values and performance indicators (hurdle rates) are within acceptable range.

The rationale of Affordable Housing contributions is that Planning Proposal land has the capacity to contribute from the receipt of planning uplift which then results in an increase in the value of the land resulting in 'surplus value[4]'. After contributing to Affordable Housing, the Surplus Value declines however should decline by no more than 50%.

Benchmark hurdle rates and their 'feasible' ranges for each development typology are indicated in **Table 3**.

Table 3: Benchmark Hurdle Rates

Performance Indicator	Feasible	Marginal to Feasible	Not Feasible
Development Margin	>20%	18%-20%	<18%
Project IRR	>18%	17%-18%	<17%

Source: Atlas

Assumptions and Limitations

Generic feasibility testing is based on notional development yields formulated for the purposes of contribution capacity testing. The development yields tested are notional only; they have not been urban design or engineering tested.

Generic feasibility testing is based on high-level revenue and cost assumptions and does not consider nuances of a site typically considered in detailed feasibility analysis.

A desktop appraisal of 'as is' or existing property values is carried out without the benefit of site inspections or property financial information (i.e. rental income and investment returns).

Despite the assumptions made and limitations of generic feasibility testing, the analysis is considered to be appropriate in examining the opportunity for, and impacts of affordable housing contribution rates in the Southern Precinct.

Sites Tested

Table 4 summarises the sites selected for capacity testing, their existing planning controls and the notional planning controls nominated for the purposes of the contribution capacity testing.

Two of the sites assume a mixed use development and one site assumes a residential development (residential flat building). The notional planning controls assume a modest increase in FSR (1.75:1 to 2.5:1) as well as a more significant increase from FSR 1.5:1 to FSR 3.0:1.

Table 4: Areas and Notional Developments Tested

Area	Suburb (Zone)	Notional Development
1	Waterloo (R1 General Residential)	• Residential flat building • Existing FSR 1.75:1 • Proposed FSR 2.5:1
2	Waterloo (B4 Mixed Use)	• Mixed use development • Existing FSR 1.5:1 • Proposed FSR 4.5:1
3	Alexandria (B4 Mixed Use)	• Mixed use development • Existing FSR 2:1 • Proposed FSR 3:1

Source: City of Sydney, Atlas

[4] Surplus Value is defined as the difference between the assumed cost of land and residual land value of development without Planning Proposal land Affordable Housing contributions

Feasibility Testing Outcomes

The tolerance of development to Planning Proposal land Affordable Housing contributions varies across the Southern Precinct. In this section, a series of graphs show the impact of the Planning Proposal land contributions on profit margin in four stages/ scenarios. These stages/ scenarios are described in **Table 5**.

Table 5: Capacity Testing Stages

Ref.	Stage	Statutory Fees and Charges	Cost of Land
1	Existing planning controls	• All applicable fees and charges • Clause 7.13 contributions	• Site value reflective of existing planning controls
2	Proposed planning controls	• All applicable fees and charges • Clause 7.13 contributions	• Site value reflective of existing planning controls + premium
3	Proposed planning controls	• All applicable fees and charges • Clause 7.13 contributions • Planning Proposal land contributions	• Site value reflective of existing planning controls + premium

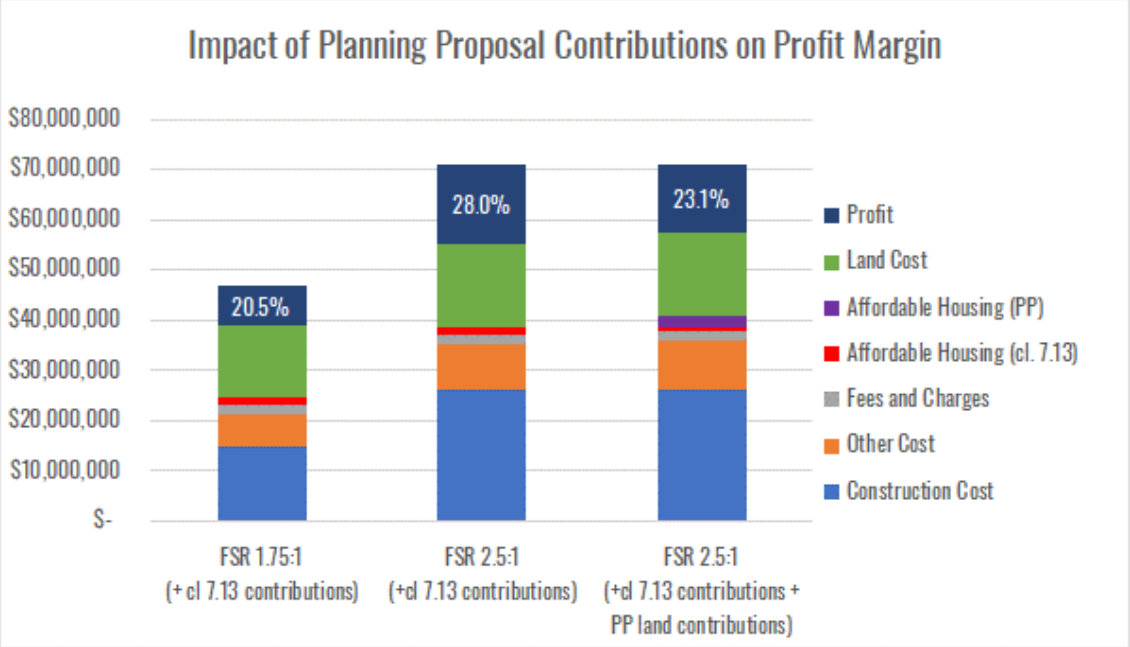
Source: Atlas

The cost of land is a critical variable to the feasibility of development. If the price paid for land exceeds its value as a development site (as permitted), its viability as a feasible development will be challenged. The consolidation of a development site from multiple owners change be a high-risk, high-resource activity for developers, particularly when site and ownership patterns are fragmented and when existing buildings are valuable.

The contribution impact testing that the price paid for land reflects the permitted development potential, and where there is a rezoning (including higher FSR sought), a reasonable premium is paid to the landowner.

Figure 1 shows impact of Planning Proposal land contributions on profit margin of a residential development in Waterloo.

Figure 1: Site 1, Impact of Planning Proposal Contributions (9%)



Source: Atlas

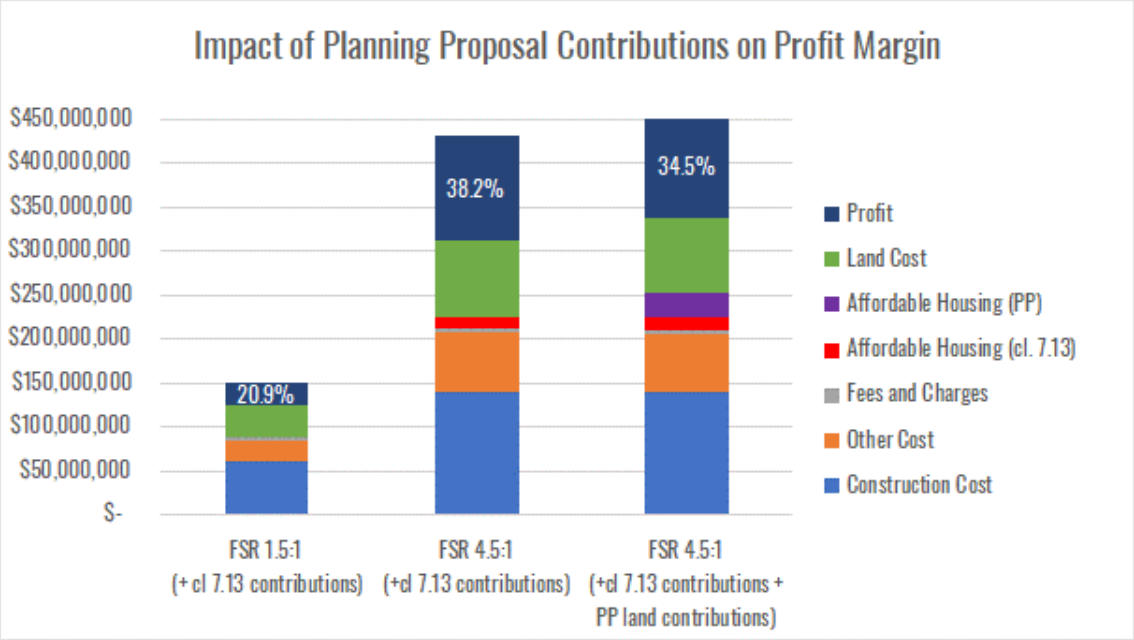
The following observations are relevant:

- A rezoning from FSR 1.75:1 to FSR 2.5:1 results in larger development with greater sales revenue potential.
- Assuming land cost that is reflective of existing planning controls (in this case FSR 1.75:1) and a reasonable premium to the landowner, the profit margin increases to 28.0%.
- If Planning Proposal land contributions were paid (at 9% of additional GFA), the profit margin falls to 23.1%.

As Site 1 is a feasible development proposition at FSR 1.75:1 (without Planning Proposal land contributions), the inclusion of additional Affordable Housing contributions (9%) in a rezoning scenario to FSR 2.5:1 is tolerated.

Figure 2 shows the impact of Planning Proposal land contributions on profit margin of a mixed use development in Waterloo.

Figure 2: Site 2, Impact of Planning Proposal Contributions (9%)



Source: Atlas

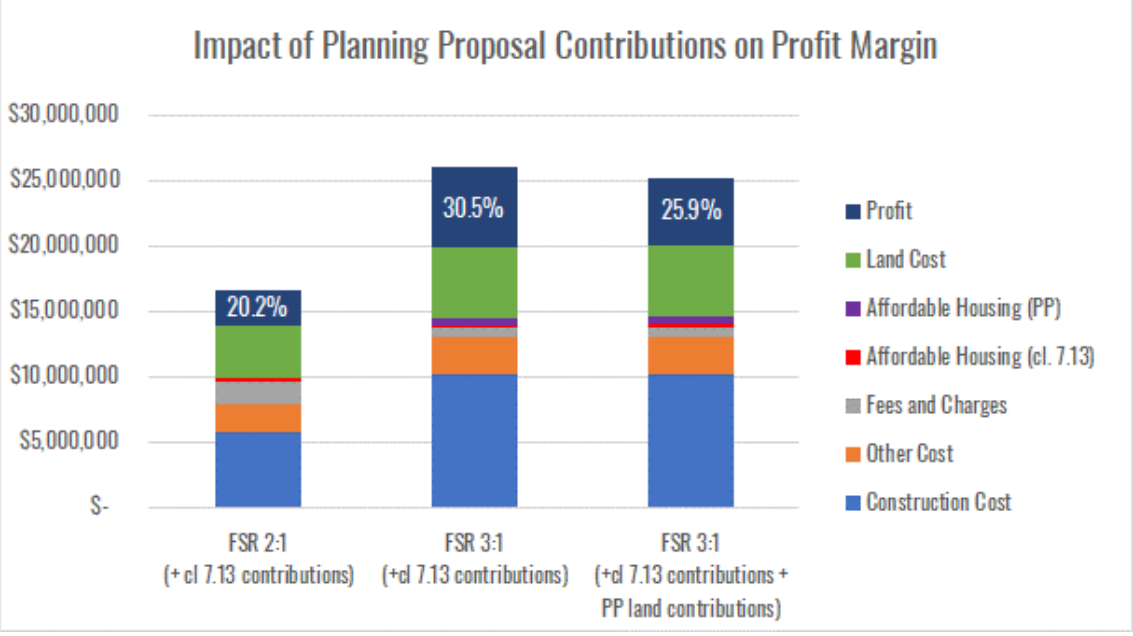
The following observations are made:

- A rezoning from FSR 1.5:1 to FSR 4.5:1 results in larger development with greater sales revenue potential.
- Assuming land cost that is reflective of existing planning controls (in this case FSR 1.5:1) and a reasonable premium to the landowner, the profit margin increases to 38.2%.
- If Planning Proposal land contributions were paid (at 9% of additional GFA), the profit margin falls to 34.5%.

There is much less impact on development at Site 2 from affordable housing contributions than on Site 1 due to the more significant increase in FSR (from 1.5:1 to 4.5:1).

Figure 3 shows impact of Planning Proposal land contributions on profit margin of a mixed use development in Alexandria.

Figure 3: Site 3, Impact of Planning Proposal Contributions (9%)



Source: Atlas

The following observations are made:

- A rezoning from FSR 2:1 to FSR 3:1 results in larger development with greater sales revenue potential.
- Assuming land cost that is reflective of existing planning controls (in this case FSR 2:1) and a reasonable premium to the landowner, the profit margin increases to 30.5%.
- If Planning Proposal land contributions were paid (at 9% of additional GFA), the profit margin falls to 25.9%.

As Site 4 is a feasible development proposition at FSR 2:1 (without the Planning Proposal land contributions), the inclusion of additional Affordable Housing contributions at 9% is tolerated.

Conclusion

Where a site is the beneficiary of planning uplift (e.g. increase in FSR) there is generally a commensurate increase in land value. It is through this value increase (or Surplus Value) that a site will have the capacity to contribute to affordable housing while remaining viable for development.

Surplus Value is the difference between the assumed cost of land and residual land value of development without Planning Proposal land Affordable Housing contributions. The 'assumed cost of land' reflects the highest and best use[5] of an asset which may not necessarily be as a development site. If a site is more valuable in its existing use (e.g. strata titled property with multiple strata units) than its potential as a development site under the Sydney LEP 2012, the site will not be feasible for redevelopment, regardless of contribution requirement.

If a development without the Planning Proposal land Affordable Housing contribution (but with clause 7.13 contributions) is in the first instance viable, there will be some capacity for Planning Proposal land to contribute in addition to clause 7.13.

The analysis demonstrates that a 9% Affordable Housing contributions rate is tolerated by the sites tested, with greater tolerance at Site 2. This is because the revenue levels for completed dwellings assumed at Site 2 (due to taller buildings affording views) are higher than those assumed at Site 1 and 3.

While the analysis indicates there is capacity for Site 2 to contribute at a rate higher than 9%, the analysis also acknowledges the need to 'strike' a rate that is generic and capable of being viable across the Southern Precinct.

Sites in Waterloo (owing to their 'more desirable' market status and consequent higher sale prices) have the capacity to contribute to a higher Affordable Housing rate. It would be prudent for the City to consider where the majority of Planning Proposal land is likely to be located, in selecting the 'strike rate' in the Southern Precinct.

The foregoing analysis demonstrates the close alignment indexation to FACS median prices has had to real market price movement in the Southern Precinct. The Program expressed an Affordable Housing contribution rate of 12% (which included clause 7.13 affordable housing contribution rates) in 2017. Three years later, development capacity to pay is still aligned to the overall rates of 12% (which can also be expressed as 9% Planning Proposal land rate and 3% clause 7.13 rate).

Impact of COVID-19

Over the short-term, the COVID-19-induced recession is expected to dampen residential price growth in some markets. Market response will depend on a multitude of factors which influence residential property values. Some of these include:

- Any future reversions to severe lockdown measures as a result of a 'second wave' of major COVID-19 outbreaks.
- The depth and severity of the COVID-19 health crisis both nationally and globally and its implications for domestic and international travel.
- The potential for reintroduction of international students to Australia's main universities in the short-term.
- The effective end date of current Federal Government stimulus packages (such as JobKeeper and JobSeeker).

Australia has arguably largely been in control of infection outbreaks, with business sentiment overall reported to be cautious but optimistic in Q4 2020. The rebounding of market activity is challenging to predict. Notwithstanding, the markets of Waterloo and the Southern Precinct are generally desirable locations for investment and are well placed to be resilient in the wake of COVID-19. On balance, we expect the foregoing affordable housing contribution rates will be tolerated when they are eventually made.

[5] The use of the property that results in the highest value of the asset. It must be physically possible, financially feasible and legal

Please contact the undersigned should you have any questions.

Yours sincerely

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SCHEDULE 1

Analysis of Development Site Sales Activity

Table 6: Sales of Development Sites, Southern Precinct

Address	Sale Price (Sale Date)	Site Area ($/sqm)	Zoning (FSR)	GFA ($/sqm)
88-92 Dalmeny Avenue Rosebery	**$10,050,000 (01/2020)**	**2,313sqm ($4,345)**	**B4 (1.5:1)**	**3,470 ($2,897)**
Site located in the Green Square Urban Renewal precinct. Existing improvements comprise commercial building. There was no DA submitted at the time of sale.				
219-231 Botany Road Waterloo	**$39,500,000 (12/2019)**	**4,908sqm ($8,048)**	**B4 (2.2:1)**	**10,937 ($3,612)**
DA submitted and refused for 3 buildings of part 6 storey/ part 7 storey mixed use development. The development was subsequently approved on appeal to Land and Environment Court.				
102-106 Dunning Avenue Rosebery	**$31,800,000 (07/2019)**	**4,949 ($6,426)**	**B4 (2.2:1)**	**10,886 ($2,921)**
Site located in the Green Square Urban Renewal precinct. Existing improvements comprise commercial building. There was no DA submitted at the time of sale.				
552-554 Botany Road Alexandria	**$5,500,000 (03/2019)**	**835 ($6,587)**	**B7 (2.0:1)**	**1,624 ($3,387)**
Site sold with a subsequent DA for mixed use development for 21 residential units and ground floor retail floorspace in a 4-6 storey development.				
6-8 John Street Mascot	**$14,000,000 (05/2019)**	**1,125 ($12,444)**	**B4 (FSR 3.9:1)**	**4,388 ($3,191)**
Site sold with DA consent for a residential flat building (10-11 storeys) with 52 residential units and basement parking.				

Source: RP Data, Atlas

SCHEDULE 2

Generic Feasibility Testing Assumptions

Project Timing

The tested sites are assumed to be appropriate zoned and progressed immediately upon settlement and span 6 months. Thereafter a development application is assumed to occur with pre-sales occurring shortly thereafter.

Demolition and construction are assumed from Month 12-18 spanning 12-18 months depending on scale of the development. Development is assumed to be completed in 2-4 years depending on scale after a 12-18 month lead-in period.

Development Yields

Retail/ Commercial Yield

Non-residential development yields in mixed use development are assumed at 5%-10%.

Residential Yield

Unit mix and average internal areas:

- Studio units (10%) - 50sqm.
- 1 bedroom units (20%) - 60sqm.
- 2 bedroom units (50%) - 80sqm.
- 3 bedroom units (20%) - 110sqm.

Parking Requirements

Maximum parking ratios assumed at (sourced from Sydney LEP 2012):

- Retail and commercial floorspace - 1 space per 60sqm GFA.
- Residential floorspace:
    - Studio units - 0.2 space per unit.
    - 1 bedroom units - 0.4 space per unit.
    - 2 bedroom units - 0.8 spaces per unit
    - 3 bedroom units - 1.1 spaces per unit.
    - Visitor parking - 0.167 spaces per unit (<30 units), 0.1 spaces per unit (30-70 units), 0.05 spaces per unit (>70 units).

Revenue Assumptions

Average end sale values are adopted based on market research and analysis.

- Non-residential - $12,500/sqm lettable area

Residential revenue assumptions are based on NSA (net saleable area) and detailed in **Table 7**.

Table 7: Residential Revenue Assumptions

Dwelling Type	Avg. NSA	Site 2		Site 3		Site 4	
Studio units	50	$14,500/sqm	$725,000	$14,000/sqm	$700,000	$14,500/sqm	$725,000
1 bedroom units	60	$14,000/sqm	$840,000	$13,500/sqm	$810,000	$14,000/sqm	$840,000
2 bedroom units	80	$13,500/sqm	$1,080,000	$13,000/sqm	$1,040,000	$13,500/sqm	$1,080,000
3 bedroom units	110	$13,500/sqm	$1,485,000	$13,000/sqm	$1,430,000	$13,500/sqm	$1,485,000

It is assumed that 75% of the apartments would be pre-sold prior to completion of construction and the balance would be sold post completion at an average rate of 6-12 units per month.

Other revenue assumptions:

- GST is excluding on non-residential sales and included on the residential sales.
- Sales commission at 2.5% (residential) and 1.5% (non-residential) gross sales.
- Marketing costs of 1.0% on gross sales.
- Legal cost on sales included at 0.25% on gross sales.

Cost Assumptions

- Assumed cost of land based on desktop research.
- Legal costs, valuation and due diligence assumed at 0.5% of land price and stamp duty at NSW statutory rates.
- Construction costs are estimated with reference to past experience and Rawlinsons Construction Handbook 2020:
    - Retail and commercial construction (warm shell) assumed at $2,500/sqm of building area
    - Residential construction assumed at $2,750/sqm to $3,000 of building area, balconies at $1,000/sqm.
    - Basement car parking at $50,000 per car space.
- Construction contingency at 5%.
- Provisional allowance for lead-in and services infrastructure at 2% of construction costs.
- Professional fees and application fees at 10% of construction costs.
- Statutory fees:
    - DA fees of 1% of construction costs.
    - CC fees of 0.5% of construction costs.
    - Long service levy of 0.35% of construction costs.
    - s7.12 contributions of 1% (Sydney Development Contributions Plan 2015).
- Affordable Housing contributions (clause 7.13) at $11,341/sqm total floor area above existing floor area.
- Finance costs:
    - Land value assumed as equity contribution with balance funded at interested capitalised monthly at 6% per annum.
    - Establishment fee at 0.35% of peak debt.

Hurdle Rates and Performance Indictors

Target hurdle rates are dependent on the perceived risk associated with a project (planning, market, financial and construction risk). The more risk associated with a project, the higher the hurdle rate.

Key hurdle rates assumed for the feasibility modelling are 18% discount rate (effective) and 20% development margin.

If the resulting profit from this feasibility analysis is sufficient to meet the target hurdles (target development margin and discount rate), the project is considered financially viable for development.