HAS NSW DISCOVERED THE HOLY GRAIL OF TRANSPORT FUNDING?

Joe Langley, May 2021[1]

Figure 1 Faster rail

Journey time between Sydney and Canberra would drop from 4:07 hours using current services to 3:00 hours using Faster rail (pictured). Source: NSW Government

New South Wales Premier Gladys Berejiklian announced this week that the state will go it alone in building a modern, fast rail network across NSW instead of waiting for the Australian or other state governments to get on board[2]. In outlining her plan to reduce travel times between Sydney and regional NSW centres, the Premier has followed Winston Churchill's advice to never let a good crisis go to waste.

More than any other state or federal leader, Premier Berejiklian is using the COVID-19 pandemic and its economic consequences to take on long overdue economic and policy reforms that have foiled previous administrations. Infrastructure funding concepts previously rejected as politically unpalatable, such as hypothecation of tax revenue, betterment levies and value capture, are now

[1] This article dated 8 May 2021 contains minor editorial revisions to the original version published on 2 May 2021.

[2] (https://todayspaper.smedia.com.au/smh/shared/ShowArticle.aspx?doc=SMH%2F2021%2F04%2F30&entity=Ar00101&sk=6E3A06AD&mode=text)

back on the table. In doing so, the NSW Government has laid the foundation for what could arguably evolve into a global best practice funding model for major transport projects.

While this might seem like a brave call for a government not generally known for fiscal innovation, several related government initiatives could come together to produce the ideal transport funding model for NSW as well as other Australian states.

At a minimum, reforms recently announced by the NSW Government[3] represent a major change from the passive, low risk approach Australian governments have traditionally taken to fund big public transport projects. If fully developed, the reforms approved in March 2021 could become the best practice funding model for metropolitan and regional rail networks. They could even pave the way for funding high speed rail (HSR) connections between east coast capital cities.

Figure 2 Japanese Shinkansen High Speed Rail at Nagano Station

Journey time between Sydney and Canberra would drop from 4:07 hours using current services to 1:00 hour using High Speed Rail. Source: NSW Government

This article takes the unabashedly optimistic view that, by choice or necessity, the NSW Government is on a pathway that could lead to the holy grail of transport funding. That is, a recurring, self-sustaining funding model that leverages the unique city-shaping qualities of modern, high-capacity passenger rail while also balancing the playing field among key beneficiaries, particularly NSW taxpayers who have been saddled with the rising cost of building a major urban transport system that seems to deliver little apparent benefit to regional areas.

So what is so ground-breaking about the infrastructure funding reforms recently approved by the Berejiklian Government? A short background discussion of the NSW Government's recent work on tax and infrastructure funding reforms provides context for answering that question. This is followed by summary of key outcomes that the new transport contributions reforms could produce.

[3] NSW Department of Planning, Industry and Environment (March 2021), *NSW Government Response to NSW Productivity Commission's Review of Infrastructure Contributions*

Background

Beginning in early 2019, a series of NSW Government reviews and policy initiatives into productivity, tax policy and infrastructure funding were undertaken by state agencies, including NSW Treasury, the Productivity Commission, the Department of Planning, Industry and Environment (DPIE), and Transport for NSW (TfNSW). By far the most difficult initiative, replacing stamp duty and land tax with a single property tax, is being championed by NSW Treasurer Dominic Perrottet. This reform would inject around $11 billion into the NSW economy in its first four years and boost Gross State Product (GSP) by 0.3 per cent. Over the long term, property tax reform would lift GSP by 1.7 percent and increase employment by 1.4 percent, according to the NSW Government's Consultation Paper[4]. These increases would be driven by replacing the wildly unpopular and hugely inefficient tax on property transactions with a broader, more efficient annual land tax, thereby removing a major barrier to buying and selling houses and stimulating secondary rounds of economic stimulation in consumer spending, housing production and job creation.

A second series of state and local infrastructure funding reforms are set out in the NSW Productivity Commission's Review of Infrastructure Contributions in New South Wales completed last November (the Review). NSW Productivity Commissioner Peter Achterstraat estimates that the 29 recommendations contained in the Review offer net benefits to the NSW economy of up to $12 billion over 20 years, realised through better services, lower house prices, and savings to business. Even if only partially achieved, the combined outcomes from these two major reforms would be mana from heaven for any state treasurer. They would also begin to turn around the decades-long downward slide in productivity across Australia while simultaneously dealing with the deep black hole in the state budget created by COVID-19 recovery spending.

Government Response

to the Productivity Commission Review

The first major policy outcome from these initiatives is the NSW Government Response to NSW Productivity Commission Review of Infrastructure Contributions (Government Response) prepared by the DPIE. With unusual speed and uncommon interagency congeniality, Treasurer Dominic Perrottet and Minister for Planning and Public Spaces Rob Stokes announced the Government's acceptance of all 29 recommendations made by the Productivity Commission. In a joint media release on 5th March, Minister Stokes may well have understated the significance of the reforms when he described his Department's Response as "the biggest shake-up of the (NSW infrastructure funding) system in three decades" with the potential to "deliver billions of dollars of benefits over the next 20 years through better services, savings for business and better public spaces".

[4] NSW Government (November 2020), *Buying in NSW, Building a Future*

The bulk of the Productivity Commission Review and Government Response deal with untangling persistent local government planning and funding issues, such as the lack of consistency in local infrastructure contribution systems, the vexed and still unsolved problem of affordable housing, protracted development approval processes and the misalignment of state and local infrastructure and land use planning. At the state level, the current mishmash of development contributions used to fund schools, hospitals, police, fire and emergency services would be replaced with a new system of fixed development contributions collected and spent within the Greater Sydney, Central Coast, Hunter and Illawarra-Shoalhaven regions. Metropolitan-level charges for water services will be reintroduced. Most significantly, the Government Response provides for the creation of a first ever, dedicated transport contribution for major projects. These measures would appeal to regional voters who justifiably feel that tax revenues collected state-wide are disproportionately spent in Sydney.

Following its approval by the NSW Government in March, DPIE has begun implementation of all 29 of the Productivity Commission's recommendations, with the reforms to be fully in place by the third quarter of 2022, illustrated in the diagram below.

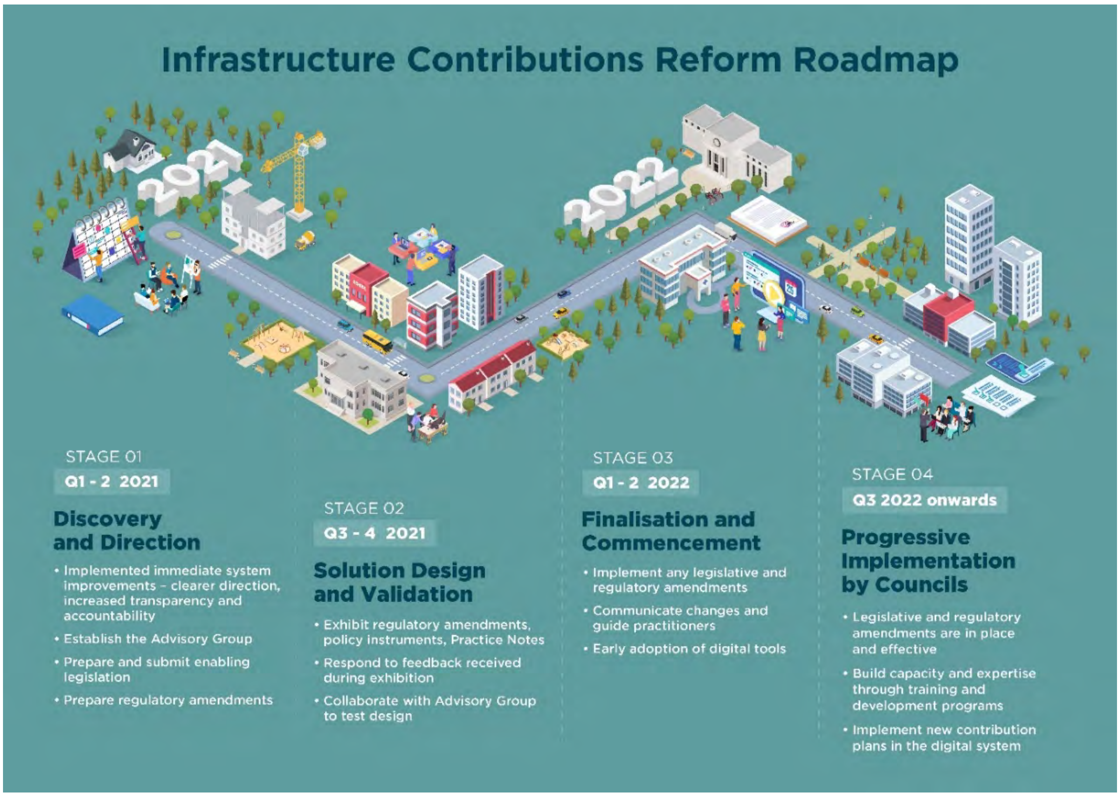

Figure 3 Infrastructure Contributions Reform Roadmap

Transport Contribution for Major Projects

Few tax reform-minded observers would dispute the view that the 29 recommendations in the Government Response, if fully implemented, will deliver short-term and long-term benefits to NSW residents and businesses through more efficient, consistent, fair and transparent infrastructure funding arrangements at the local, regional and state levels. As stated in the Productivity Commission's review, these changes are long overdue.

For those in search of the holy grail of transport funding, the path begins at Recommendation 5.3.- *Adopt transport contributions for major projects* in the Productivity Commission report, inconspicuously contained in just three lines of text in the Government Response as restated in the box below:

Recommendation 5.3 - Adopt transport contributions for major projects

Prepare and implement a transport contribution for major projects that:

- is additional to regional infrastructure contributions, where these apply
- applies to properties within a service catchment and is subject to additional development capacity created as a result of the investment.

Source: NSW Government Response to NSW Productivity Commission's Review of Infrastructure Contributions

While Recommendation 5.3 is not a clearly marked treasure map to a pot of gold for transport projects, a careful reading of the Review reveals a reform pathway built on an unflinching evaluation of the problems with the current infrastructure contribution systems, a logical assessment of what changes are needed, and sufficient guidance for policy makers and stakeholders to extract a better return on public infrastructure investments without diminishing private sector investment. The Productivity Commission deserves credit for shining a bright light onto the disfunctions of the present infrastructure funding arrangements and putting forward sensible alternatives.

The extent to which the NSW Government can deliver significant, sustainable improvements to future major transport funding falls on NSW Government advisory bodies established under the Infrastructure Contributions Reform Roadmap and led by DPIE:

- The Stakeholder Advisory Group, comprised of representatives from local government and industry and
- The Implementation Steering Committee, made up of senior representatives from key NSW agencies, including Treasury, DPIE and TfNSW.

Steppingstones along the reform pathway

To find the holy grail of transport funding, the NSW Government's advisory bodies must exploit five key opportunities.

1. Property tax replaces stamp duty and land tax

Although not part of the NSW Productivity Commission's Review of Infrastructure Contributions, the replacement of stamp duty on property transactions with a broad-based tax on unimproved land value has been recommended by Commonwealth and state government commissions, think tanks, industry bodies and other organisations for many years. This recommendation was repeated in a 2019 Productivity Commission report[5], adopted in the NSW Government's 2020 Consultation Paper, and finally embraced by Treasurer Perrottet. This reform provides the foundation for the Transport Contribution.

Key features

- Buyers have the choice of sticking with the current system of a single lump sum, upfront payment or a much lower annual tax payment based on a property's unimproved land value.
- It removes a barrier to homeownership, job mobility and housing costs.
- It broadens the tax base.
- It is simple to administer yet is difficult to avoid since it would use the government's existing land tax system.
- The new tax would be revenue neutral at the state level.
- $11 bn would be injected into NSW economy over 4 years.

Implications and opportunities for transport funding

- It stimulates new housing and commercial development by reducing the upfront development costs, which will be particularly beneficial in transport precincts.
- It provides a common, transparent revenue platform for future tax reforms and cost sharing arrangements between Commonwealth and state governments, as discussed below.

2. A dedicated, recurring transport funding stream

The Review proposes that funds collected from the Transport Contribution would be applied to the underlying project, with repayments made for any forward funding provided by the State. This important provision, if fully adopted by the Government's advisory bodies, would provide a more predictable and sustained long-term funding source for major projects. It could also open opportunities for special purpose authorities and private organisations to participate in major projects by providing a source for underwriting a portion of project costs under certain conditions.

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[5] Productivity Commission 2019, *Kickstarting the productivity conversation*

Similar arrangements are widely used in the US under the Transport Transportation Infrastructure Finance and Innovation Act (TIFIA) program, which provides credit assistance for qualified projects of regional and national significance. "Many large-scale, surface transportation projects - highway, transit, railroad, intermodal freight, and port access - are eligible for assistance. Eligible applicants include state and local governments, transit agencies, railroad companies, special authorities, special districts, and private entities"[6]. For example, a $145 million TIFIA loan was used in the successful $550 million redevelopment of Denver Union Station in Colorado. The Denver Union Station Project Authority, a public-private partnership, repaid the loan from property tax increases, land value uplift from private property sales, and increased passenger revenue from an expanded light rail network. The City of Denver provided a loan guarantee to back up tax revenue commitments, but the guarantee was never called due to the success of the project.

Key features

- The Transport Contribution is separate from and additional to other government contributions, such as Commonwealth and state government grants and loans.
- Funds collected through value sharing mechanisms are applied to the underlying project, so surrounding property owners who benefit from land value uplift make a fair contribution to project costs.
- Projects with multiple elements and different values over time, such as new metro lines with multiple stations and network connections, would be able to spread revenues and costs over a much larger base.

Implications and opportunities for transport funding

- This feature removes an outdated state government policy that restricts infrastructure contributions for rail infrastructure.
- It secures a more predictable, long term income stream for major projects.
- It encourages innovative public and private sector financing options between the private sector and the three levels of government, such as those used in US TIFIA programs.

3. Precinct-based funding model

A considerable body of international research, practical experience and recent Sydney Metro business cases demonstrate that well-planned and located mass transit projects such as metro stations increase surrounding land values by supporting greater urban density. Land values drop off as walking distance increases from transit stations, with a 15-minute walking "service catchment" regarded as a practical limit for most routine pedestrian trips. This is also the likely extent of land value uplift around metro stations and a logical basis for applying value sharing mechanisms in the Australian context.

Recommendation 5.3 adopts the concept of service catchments by focusing the application of value sharing mechanisms within urban precincts surrounding a transport investment. It is within these

[6] https://www.transportation.gov/buildamerica/financing/tifia, downloaded 19/04/2021

catchments that demands by residents and businesses for floorspace are highest and their willingness to pay a premium for transport accessibility are greatest.

Key features

- Pre-investment land use and value (base case) are measured and compared against post-investment land use and value enabled by the transport investment (intervention case) to determine the equitable sharing of value uplift between landowners and transport investors.
- This approach encourages urban planners, designers and architects to allow for the optimum density of development within the service catchment.
- Supports the "beneficiary pays" principle between benefiting and non-benefitting areas by extracting a higher contribution from surrounding property owners.
- Revenue is typically captured over 25 – 30 years.

Implications and opportunities for transport funding

- Transport planners, urban designers, funding agencies and local stakeholders are incentivized to create long term value in surrounding catchments so that project funding can be secured.
- Steady, more predictable income stream.

4. Market-sensitive rate setting

While not specifically stated in Recommendation 5.3, the Productivity Commission Review makes it clear that commercial feasibility studies are required to provide evidence of development viability in setting contribution levels. DPIE's default position in recent precinct planning studies sets a 50/50 sharing of infrastructure investment generated from land value uplift, with half of the value subject to feasibility testing to determine how much of this amount should be allocated to government infrastructure and the remainder retained by the landowner. In effect, this practice leaves at least 50% of the land value uplift created by a public infrastructure investment in private hands. This is likely to be the starting point for contribution levels in the policies and guidelines developed by DPIE and its advisors.

While methodologically lazy, this approach achieves the practical result of eliminating much of the objections by the property industry to transport infrastructure charges. Market sounding studies and stakeholder engagement sessions with property owners, developers, financiers and other stakeholders conducted for the most recently approved metro projects have consistently shown strong support for infrastructure contributions as long as they provide certainty in delivering the promised infrastructure and do not inhibit commercially viable property development.

Key features

- As with the value sharing formula, pre-investment land use and value (base case) is compared against new land use and value enabled by the investment (intervention case) in setting contributions rates.

- Private sector contributions are set at levels determined through market-based commercial feasibility studies.
- The Review recommends a modest minimum contribution level ($5,000 per dwelling) while allowing upper limits in areas with higher delivery costs and greater user benefits to be determined by commercial feasibility studies on a case-by-case basis.
- Sharing land value uplift based on commercial feasibility supports the beneficiary pays principle while encouraging complementary private sector investment.

Implications and opportunities for transport funding

- This provision encourages both government and private sector planners to strive for the highest and best use within transport catchments.
- Contributions towards project funding will be determined by market conditions within transport precincts, avoiding a regressive one-fits-all approach that favours higher end developments and diminishes housing affordability.

5. Resets strategic planning sequencing

The Productivity Commission Review highlights the worst kept secret in NSW that out-of-sequence rezonings and ad hoc development have created windfall gains to property owners at the expense of taxpayers. NSW Planning Minister Rob Stokes acknowledged that this failing of government process has gone on for decades and has cost taxpayers billions of dollars in lost infrastructure funding[7]. Former Prime Minister Malcolm Turnbull and Federal MP John Alexander have championed policies at the federal and state level to correct this flaw, resulting in the first ever agreement between federal and state governments in Australia to share value uplift from their joint investment in the development of the Western Sydney Aerotropolis in the Western Sydney City Deal.

While admittedly “very, very difficult” politically, the Review and the Implementation Roadmap lay out relatively simple and intuitive policy changes to mandate a transparent sequence which addresses this problem:

- Infrastructure charges should be announced prior to land rezonings as part of market signals to property developers and investors, thereby allowing development costs to be fully factored into land values and resulting development feasibility studies.
- Funds collected should be applied to the underlying project.
- Repayments can be made for any forward funding provided by the State, such as through traditional grants and budget allocations.

Key features

- Reinforces the importance of setting funding arrangements before projects are announced and rezoning takes place.

[7] ‘Holy grail’ of taxing landowners who profit from ‘stroke of a pen’ proves elusive, Sydney Morning Herald (2 February 2021)

- Promotes transparency between land buyers and land sellers.
- Deters speculative land value escalation and value escape.
- Reduces windfall profits earned by unintended project beneficiaries.

Implications and opportunities for transport funding

- Reduced government land acquisition cost for transport corridors and stations.
- Accelerates take-up of development by reducing private sector land development costs.
- Promotes development feasibility and housing affordability.

Conclusions and next steps

At the 2021 Critical Infrastructure Summit held in Sydney on the last day of April, Premier Gladys Berejiklian promised a ‘‘golden age of infrastructure delivery’’ starting with a plan for regional rail lines. The Premier can back up that promise with the tax and infrastructure initiatives now working their way through government. Rather seeing COVID-19 as crisis to be managed, her government has used the pandemic as a springboard to take on tax and economic reforms and to invest in productivity-enhancing infrastructure that will reinvigorate the NSW economy for decades into the future.

It turns out that funding for faster passenger rail services within and between Australia’s regional centres and capital cities is not so elusive after all. Evidence from overseas projects indicates that between 20% and 30% of major transport projects can be funded by the reforms under consideration by the NSW Government. A deep dive into the Productivity Commission Review of Infrastructure Contributions reveals that the true capacity of major transport funding has simply been obscured by contradictory policies, glued together by commercial rather that public interests, constrained by lack of innovation and private sector participation and papered over from public scrutiny by protracted government processes. The five opportunities described in this article suggest important outcomes made possible by the Implementation Roadmap and property tax reform. It is now up to the NSW Government’s advisory bodies, hopefully following the Implementation Roadmap and guided by these opportunities, to reach transport’s holy grail.

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