

THERE'S NO PLACE LIKE HOME

How to overcome the failure of the Lower Hunter Regional Strategy



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Commissioned and published by:

Urban Taskforce Australia Ltd, GPO Box 5396, Sydney NSW 2001.

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FOREWORD



Last year the Urban Taskforce published *Going Nowhere*, a major report on the crisis in NSW and Sydney urban development.

This report takes the analysis one step further, by closely examining the impact of the existing Lower Hunter Regional Strategy on NSW's largest regional community. Frankly, the analysis is shocking.

The Lower Hunter Regional Strategy promised 4,600 dwellings, but this report shows that net additions to the Lower Hunter housing stock over the five years to 2009/10 have been at 2,000 per annum – **less than half of the Regional Strategy goal**.

The report shows that the strategy failed to anticipate the region's need for population growth – with strategy numbers (6,400 a year) falling short of actual numbers (6,800 a year).

This report compared the Lower Hunter region against other regional areas in the eastern states, to show that population growth has been greatly inferior to the Barwon region in Victoria, and to the Sunshine Coast, Townsville and Toowoomba regions in Queensland.

The Lower Hunter's lack of housing supply has placed important constraints on the region. In particular, we have seen that the weak supply of housing relative to overall population growth has stunted to the region's ability to accommodate "potential upgraders" (35 to 49 years). If this trend is allowed to continue the composition of the region's population base may become distorted, and be out-of-kilter with the rest of NSW. **No-one wants the Lower Hunter to become known as a region which families avoid, due to housing unaffordability.**

We have also seen increased dependence on rental housing. Nearly half the annual population increase the region saw over the 2005 to 2010 period was only possible because of the more intensive use of existing rental housing. To the extent that the Lower Hunter Strategy has forced a shift away from home ownership to renting, it also has led to increased social costs. These social costs will become more apparent as time progresses.

The more intensive use of existing housing has meant reduced living standards. Rooms set aside as studies or family living space, must be converted to bedrooms. Dilapidated premises that would otherwise have been regarded as unsuitable for rental (pending renovation) may instead be tenanted.

A rationed supply of housing will increasingly pit the region's existing residents seeking housing against those moving into the region. From 2000 to 2010, median rentals for a 3 bedroom house in the Lower Hunter have risen by between 82 per cent (Port Stephens) and 100 per cent (Newcastle). Rental growth has far outstripped Sydney, which suffered a 67 per cent rise over the same period. The proportion of rental households in stress is estimated to have risen to 56 per cent.

The break on housing supply induced by limits to net growth doesn't just mean less new people coming into the region. It inevitably means that many local people who have a preference to stay in the region will find themselves priced out of the local housing market.

This report finds that, without reform to the Lower Hunter's residential development process, population growth will be stunted to just 5,000 people a year (0.9 per cent a year). **That would see the Lower Hunter, the region that should be NSW's economic powerhouse, growing at roughly the same rate as Launceston, Burnie-Devonport and Lismore.** This will clearly have economic consequences, but the social consequences also should not be ignored. For example, if rental growth averages 8 per cent per annum across the Lower Hunter this report projects that in five years, 65 per cent of current rental households would be in a state of housing stress.

This report has projected that the Lower Hunter's annual population growth should at least increase to an average of 7,500 people over the next decade (1.4 per cent a year). However, any population projection, including the one favoured by this study, will be sensitive to its underlying assumptions. That's why this report considers a range of higher growth scenarios, as well as a "business-as-usual" no-reform scenario.

We recommend that the next Lower Hunter Regional Strategy contemplate population growth not only at 1.4 per cent a year, but also include scenarios that have the region growing in-line with growth consistent with the recent performance of other major regional communities such as Barwon (1.7 per cent) Toowoomba (1.9 per cent) and Townsville (3.2 per cent).

The existing 4,600 a year annual dwelling target, should be replaced with a more sophisticated target of 5,400 to 14,500 new homes a year for the region. Of course, the actual number built within this range will be for the market to determine. The important thing is that, within these boundaries, land use planning should not be the hand break on the community's clear housing needs.

Any new strategy must reduce the risk of undersupply of detached housing for the Hunter region's families, by providing for sufficient land release to generate competitive tension between landowners for developer capital. Rather than the existing single target of 2,760 greenfield dwellings a year, the new strategy should provide a target of 4,300 to 13,100 detached homes a year, with home buyers preference and market realities determining the actual number.

Similarly, rather than the single annual target of 1,840 medium and higher density dwellings, the new strategy should ensure capacity of between 1,100 and 5,800 medium and higher density homes a year.

This report demonstrates that, in part, the cost base of developing each new home does not allow the region's developers to produce new housing that is sufficiently competitive with existing housing stock. All the targets in the world will mean nothing if the private sector is expected to build the new housing, but it is not possible for a private enterprise to earn an income doing so.

State infrastructure contributions and local council development levies should be abolished, or if they are not to be abolished, lowered, made more certain and robust, and restructured so that they do not have a distortionary impact on housing supply.

We urge everyone who cares about the future of the Lower Hunter to study this document closely.

Aaron Gadiel
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Urban Taskforce Australia
September 2011

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EXECUTIVE SUMMARY

The failure of the Lower Hunter Regional Strategy

The Lower Hunter Regional Strategy goal implied that 4,600 dwellings per annum would be required as an average annual rate of supply:

Sufficient land and development capacity will be identified and rezoned to provide for an additional 69,000 dwellings in new release areas and 46,000 dwellings in existing urban areas and centres to meet forecasted demands for an additional 115,000 dwellings over the next 25 years.¹

Compared to this target, housing supply in the Lower Hunter region has been extremely low for the past five years. From 2005/06 to 2009/10, there was an annual average of 2,800 dwelling approvals per annum. The low was recorded in 2008/09, with just 2,180 approvals. That low followed five years of trend decline from 3,271 approvals in 2004/05. While there were 3,201 dwelling approvals in 2009/10, about 600 of those were for public housing. The level of private sales for new dwellings remains very low by historical standards.

While there was an average of 2,800 new dwelling approvals per annum over the five years to 2009/10, a significant proportion of these dwellings were holiday homes. We estimate that holiday homes accounted for about 400 new dwellings per annum on average in the Lower Hunter. These holiday homes don't provide housing for permanent residents, so they should be taken out of calculations of dwelling supply that enables population growth. In addition, there are demolitions required for knockdown-rebuilds or for infill housing projects. These adjustments mean that net additions to the Lower Hunter housing stock over the five years to 2009/10 are estimated at 2,000 per annum – less than half of the Regional Strategy goal.

The decrease in new dwelling sales has been most pronounced for new release areas. Lot production from new release areas plummeted from close to 1,400 in 2004 to less than 200 in 2008.

Trends in the rental market make it clear that the rate of housing supply has fallen well short of underlying demand. The rental vacancy rate in Newcastle is now comparable to Sydney at close to 1 per cent, and rental growth has been very strong, averaging 10 per cent per annum for the past five years.

There has been moderate population growth overall, with very weak growth for 'upgrader' age groups. But there is a cause and effect issue here – the high cost of rentals and new housing has discouraged upgraders, who have tended to migrate to Sydney. This has created a vicious circle, as soft population growth limits economic activity and constrains jobs growth.

Why the strategy hasn't delivered

The evidence shows that residential land prices in the Lower Hunter are very high relative to established house prices. In fact, this ratio has tended to be higher in most parts of the Lower Hunter than in Sydney. The deterioration in the relative price of land developed from 2003. As a result, the rate of sales for new houses has been extremely poor.

¹ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 27.

The explanation for the high price for land appears to vary by local government area. Local council development levies ("section 94 contributions") have been high relative to the price of established houses. In Maitland, Lake Macquarie and Newcastle, we estimate that section 94 contributions are in the range of \$12,000 to \$31,000 for a 3 bedroom house in new release areas. In addition, there are also state infrastructure charges applied to new release areas.

These charges represent a substantial proportion of the price of developed land. Compared to the median price for established houses, now ranging from \$310,000 (Maitland) to about \$340,000 (Lake Macquarie), it is difficult for residential lots priced at \$180,000 to \$220,000 to compete.

High development levies limit the supply of commercially developable land, but land supply is also constrained more overtly. In Newcastle, Cessnock and Port Stephens local government areas the number of zoned and serviced lots in greenfield release areas (as at 2008) amounted to just 3 to 4 years of healthy supply. While developer charges are more moderate in Cessnock and Port Stephens, the pipeline of land development appears very limited. This effect is most evident in the median price of land at Port Stephens, which was about \$230,000 over the past two years, compared to a median price of about \$340,000 for an established house.

The deterioration in land affordability has led to some diversion of supply towards smaller homes, in the form of new medium and high density dwellings. This trend is evident across the Lower Hunter. Notably, however, a substantial proportion of the region's apartment construction is pitched to holiday homes, given the coastal areas in the region, and these properties do not tend to enter the mainstream rental market.

Overall, it is evident that rates of construction over the past five years have fallen substantially below the Strategy goal for production of 4,600 dwellings per annum. Even with the improvement in the relative affordability of residential land over the past 18 months, approvals in 2010/11 remain weak by historical standards, at just 3,054 dwellings.

Hunter region to be the growth engine of NSW

The Hunter region promises to be the growth engine for the NSW economy for the next five years. There is a huge pipeline of engineering construction work being planned, which can deliver enormous benefits to employment growth and government revenues.

A key risk in this expansion path is the likely shortages of workers to actually implement the work program in place for the region. Unemployment is already down below 5 per cent in the Lower Hunter (and only 1 per cent in the Upper Hunter). Engineering projects in the Hunter will be competing with mining and energy projects in Western Australia and Queensland – in particular the highly profitable iron ore developments and liquid natural gas (LNG) projects being funded by long-term contracts.

Over the past five years, we have seen that many workers in the eastern states have resisted highly paid jobs located in remote areas. In part, this resistance was possible because of the high rates of activity in eastern Australia, led by commercial building and road construction. But over the past year, there has been a substantial decline in commercial building, and the number of major road construction projects is dwindling. As a result, the eastern capitals may not offer the same degree of job security to that observed in the recent past.

In this environment, the Hunter region could flourish, by attracting workers from the eastern state capitals who might balk at working in remote regional areas. In particular, many of the mining and civil works in the Hunter will be within commuting distance of established communities in the Lower Hunter.

The primary issue becomes the housing available to enable the region's pipeline of construction work over the next five years. Unfortunately, the Hunter is entering this potential expansion phase with dire housing shortages. Rental growth has been very strong for the past five years, and the vacancy rate is at close to record lows.

Potential for a future boom

The relative affordability of new dwellings will remain the primary determinant for overall population growth in the Lower Hunter region. Based on planned projects, there is a potential boom in construction work across the Hunter region over the coming decade.

The very substantial pipeline of potential construction work should lead to an increase in migration of construction workers to the Hunter region. However, the capacity to absorb this population gain will be defined by housing affordability.

If residential cost structures remain consistent with current levels, then there would need to be a substantial increase in overall property prices to improve development project feasibilities. However, this outcome would dampen population growth, because it involves deterioration in the affordability of established housing. This trend would be particularly adverse for potential first home buyers, who tend to enter the housing market through the purchase of older properties.

It is important to note that over the past five years a large proportion of population growth occurred through more intensive use of the existing rental stock. There is now limited scope for this method of sustaining population growth.

Further strong growth in residential rentals will be an enduring feature of the residential market. Some lower wage or fixed income households will need to move elsewhere in NSW, in order to access more affordable rental housing. These movements will restrain overall population growth in the Lower Hunter region.

If there is a substantial improvement in the financial feasibility of residential development, then the Lower Hunter region can sustain the much higher population growth that is made essential by the needs of the engineering construction project pipeline.

However, a material improvement in the feasibility of residential development will be required. The ratio of the median land price to median house price would be reduced from around 50 per cent to 45 per cent, and make this ratio more comparable to the levels observed in western Sydney.

The problem for the region's housing supply is that there is escalation in costs for both civil works and house building, due to rising wages for construction workers. Cost escalation places upward pressure on the price of new dwellings.

A greater imbalance in the housing market

This tightening of the housing market has occurred during a period when growth in population and employment across the region is moderate. To achieve the construction boom in the Hunter, workers will need to move to the region, boosting population growth and housing demand – particularly for rental properties. But at current rates of housing supply, there are fundamental constraints on the capacity for the region to sustain the migration inflows necessary to supplement the workforce.

This study estimates that there are currently about 1,000 vacant rental properties in the Lower Hunter. On the other hand, employment growth for construction alone could reach 7,500 persons over the next 4 to 5 years. In this event, the underlying demand for new dwellings would rise to 4,600 per annum over the 2011 to 2020 period, compared to an estimated 4,000 per annum over the 2005-2010 period. Projected underlying demand of 4,600 net supply per annum is based on population growth associated with planned construction projects in the Hunter region.

However, without a substantial rise in dwelling supply, there will be an even greater imbalance developing within the housing market. This imbalance is likely to have the following effects:

- Further strong growth in new rentals, averaging 8 per cent per annum, which is expected to outstrip growth in Sydney, and cause many local residents to move elsewhere – especially low income and elderly persons.
- Substantial increases in wages required for private sector jobs, to compensate for rental costs. Strong wages growth would reduce the profitability of coal mine construction, and cause least profitable projects to be deferred or cancelled. There would be direct effects on the potential government revenues in the form of mining royalties and payroll taxes. Other industries might also be impacted, including agriculture and tourism.
- By discouraging workers to move to the Hunter, strong rental growth would delay the completion of rail infrastructure and port expansion, reducing the export capacity of the region's mines.
- Through acceleration of wages growth, creating feedback effects on the cost of residential building and non-residential building, impacting on the feasibilities of housing and commercial development.

Further strong growth in rental costs would be expected to place upward pressure on worker demands for higher wages in the Hunter. As a consequence, it is likely that the least profitable mining construction projects (those with marginal feasibility) would be substantially affected, and some deferred or cancelled due to labour costs.

That outcome would reduce the potential mining royalties from coal production. We estimate that there is a pipeline of mining construction projects in the Hunter region which could produce an additional 76 million tonnes of coal per annum.

If a rise in labour costs meant that project returns were rendered inadequate for just 5 per cent of this capacity, then coal production would be reduced by 3.3 million tonnes. At today's average royalties per tonne of coal, that would reduce revenues by about \$30 million per annum.

Rental stress will continue to rise. We estimate that 56 per cent of rental households in the Lower Hunter currently

face housing stress, where rent payments account for more than 30 per cent of household income.

If rental growth average 8 per cent per annum across the Lower Hunter over the next five years, then even more households would be in a position of housing stress. We project that in five years, 65 per cent of current rental households would be in a state of housing stress.

How to avoid serious problems

The residential development process needs to be overhauled in a way that land affordability reaches levels that are comparable with other regional areas, such as the Barwon region in Victoria and Fitzroy region in Queensland, where strong population growth has been met by high rates of housing supply.

Development levies are inefficient, poorly administered, complex, non-transparent and set too high — they discourage investment in housing. For new dwelling prices to be steady for an extended period of time, there would need to be a sizeable drop in government levies. Abolishing the state infrastructure charge, and abolishing or substantially reducing section 94 contributions, will be necessary to deliver the necessary improvement in land affordability. Maintaining a rigid policy favouring development levies may cost the community far more in lost coal mining royalties.

If state infrastructure contributions and local council development levies are not abolished they will need to be lowered, made more certain and robust, and restructured so that they do not have a distortionary impact on housing supply.

In this event, this study projects that the population gain in the Lower Hunter can rise to 7,500 persons per annum over the course of this decade, as this region becomes a key growth engine for the New South Wales economy. Annual population growth in the Lower Hunter would be about 1.4 percent per annum, compared to a projected 1.1 percent per annum for New South Wales (according to the ABS Series B projections).

On the other hand, if the development environment is left to stagnate, then population growth will trend lower, due to dire shortages of vacant rental properties. If the rate of housing supply remains at the lows observed over the five years to 2010, then the Lower Hunter population growth will slow to an annual rate of 5,000 persons, or a growth rate of 0.9 per cent per annum.

New principles for a new Lower Hunter strategy

Under the Lower Hunter Regional Strategy 115,000 new dwellings are required in the 25 year period stretching from 2006 through to 2031, but it provides for just 69,000 dwellings in new release areas over 25 years, and is has identified “sufficient” land to supply this amount. The government is using its powers to delay some land owners from commencing work, on the basis that other land release sites have not yet been fully developed. This action reduces competition between landowners within the Lower Hunter region. The government has not accelerated the “sequencing” process in response to the lack of development activity clearly evidenced by the Metropolitan Development Program Report. This undersupply of potential development sites has reduced competition between landowners to sell their land to developers.

The evidence shows that a landowner in a non-competitive market may decline to invest, even though the project has a positive net present value, because the lack of competition offers the opportunity for a greater premium at

a later investment date. Increased competition reduces the prospect of investment being delayed. The erosion in value of the investment opportunity due to activities of one's competitors creates incentives to invest earlier. Any new regional strategy for the Lower Hunter should provide more land for urban development than might be considered strictly necessary. This helps create the necessary competitive tension.

The new strategy should actually include a requirement that there is a supply of undeveloped land equivalent to a number of years' worth of projected need. We favour a 20 year benchmark, although we recognise that planning authorities in other jurisdictions regard a 15 year benchmark as accountable. The current absence of any benchmark is inexcusable.

A new Lower Hunter Regional Strategy should also seek to provide certainty to the private sector by having clear rules, simple processes, swift processing times and low predictable costs. It should not be the role of the strategy to provide certainty to investors in one location, by giving them assurance that they will be protected from competition in other nearby locations.

The new strategy should be broadly framed. It should be highly flexible in its content, and contemplate a range of possible outcome in terms of dwelling mix, employment growth and population and job distribution. It should also actively contemplate that decisions will be made outside of the strategy, as needed, in order to ensure that the market demand for housing and business premises is able to be satisfied.

The substance of the reviewed Lower Hunter Regional Strategy should, once it is finalised, immediately be enacted in a state environmental planning policy (SEPP). The Minister, local councils and other consent and concurrence authorities (such as the joint regional planning panels, the Planning Assessment Commission and the Roads and Traffic Authority) should be required to approve proposals that are in-line with strategy, as embodied in the SEPP, in considering rezoning and determining development applications. This would necessarily be accompanied by an explicit duty for a consent authority to consider the financial constraints on the economic viability of a desirable planning development (when deciding conditions, etc) if the applicant has elected to provide information on the subject.

New numbers for the new strategy

The new strategy should contemplate population growth not only at 1.4 per cent a year, but also include scenarios that have the region growing in-line growth consistent with the recent performance of other major regional communities such as Barwon (1.7 per cent) Toowoomba (1.9 per cent) and Townsville (3.2 per cent).

The existing 'all the eggs in one basket' 4,600 a year annual dwelling target, should be replaced with a more sophisticated target of between 5,400 to 14,500 new homes a year for the region.

Assumptions that baby-boomers will migrate into infill housing should be treated with caution. Such an assumption should form the basis of just one of a strategy's scenarios (in order to ensure that development capacity for infill housing is there, if needed), but should not be the only basis of the plan (in the event that baby-boomers stay put, and a greater level of detached housing is therefore required).

Rather than the existing single target of 2,760 greenfield dwellings a year, the new strategy should provide a target of 4,300 to 13,100 detached homes a year, with home buyers preference and market realities determining the actual number. Rather than the single annual target of 1,840 medium and higher density dwellings, the new strategy should ensure capacity of between 1,100 and 5,800 medium and higher density homes a year.

1. LOWER HUNTER STRATEGY TARGETS

- The Strategy's projections for growth in population and employment fell short of the region's actual performance in the targets five years to 2010.
- Yet the net supply of new dwellings has been well below the Strategy's aspirations. The net supply of new dwellings is estimated to have been about 2,000 per annum over the five years to 2010, compared to the Strategy target for net supply of about 4,500 per annum.
- The rental market has absorbed close to half of the region's population gain, leading to a very tight rental market and very strong growth in rentals.
- The weakness in supply has been concentrated in detached houses. Lot production has dropped to parlous levels. Supply-side factors including government levies and zoning restrictions played a major role in the jump in land values.
- If the strategy is not sufficiently flexible to accommodate a wide variety of possible scenarios, there will be a serious risk of a gross and increasing undersupply of detached housing for the Hunter region's families, as baby-boomers continue to occupy their existing family homes and insufficient new dwellings are built.

1.1. OVERVIEW OF THE LOWER HUNTER STRATEGY

The Lower Hunter Strategy was released by the NSW Government in October 2006. It is intended to be an overall plan for the local government areas of Newcastle, Lake Macquarie, Maitland, Cessnock and Port Stephens. The plan explains the government's vision for the region's future development over a 25 year period from 2006 to 2031.

At the time of announcement, the government declared that the strategy would be reviewed every five years, and the Department of Planning has previously advised that a discussion paper will be released as part of this review during the course of 2011.

The key elements of the strategy are:

- Provision of sufficient new urban and employment lands to meet expected strong demands for growth. The Regional Strategy also refocuses development in the Lower Hunter towards the strengthening of centres that support the role of Newcastle City Centre as the Regional city.²
- The strategy works with the NSW Government's Regional Conservation Plan to ensure that the future growth of the Lower Hunter makes a positive contribution to the protection of sensitive environments and biodiversity.³

² Ibid inside cover.

³ Ibid.

- Maximising the economic, social and environmental outcomes of strong connections within the Lower Hunter and from the Lower Hunter to the broader Greater Metropolitan Region, Australia and internationally.⁴

The NSW Government's 25 year land use strategy for the region:

- Seeks to plan for 115,000 new homes to cater for a projected population growth of 160,000 people.⁵
- Assumes up to 66,000 new jobs with adequate supply of employment land.⁶
- Requires that the majority of new development within the region to be located in close proximity to major centres and employment lands.⁷
- Creates green corridors with high environmental value, which will be managed for conservation purposes. These corridors align with existing public reserves, some of which are to be expanded.⁸
- "Protects" the rural character and "viable" agricultural lands of the region, as well as the local mineral and coal resources.⁹

The regional strategy is intended to inform decisions on service and infrastructure delivery.

1.2. LOWER HUNTER REGION HAS UNDERPERFORMED

"If we compare the Lower Hunter region against other regional areas in the eastern states, we see that population growth has been greatly inferior to the Barwon region in Victoria, and to the Sunshine Coast, Townsville and Toowoomba regions in Queensland."

If we compare the Lower Hunter region against other regional areas in the eastern states, we see that population growth has been greatly inferior to the Barwon region in Victoria, and to the Sunshine Coast, Townsville and Toowoomba regions in Queensland.

In each of these regions, jobs growth has been substantially higher than population growth. The reason for this difference is that population growth has been concentrated in the workforce age cohorts, particularly in respect of persons aged between 25 and 50 years. These patterns reflect the importance of land affordability as a contribution to jobs growth, because the migration decisions by upgrader households are influenced by the cost of new dwellings.

⁴ Ibid 30.

⁵ Ibid 1.

⁶ Ibid.

⁷ Ibid.

⁸ Ibid 10.

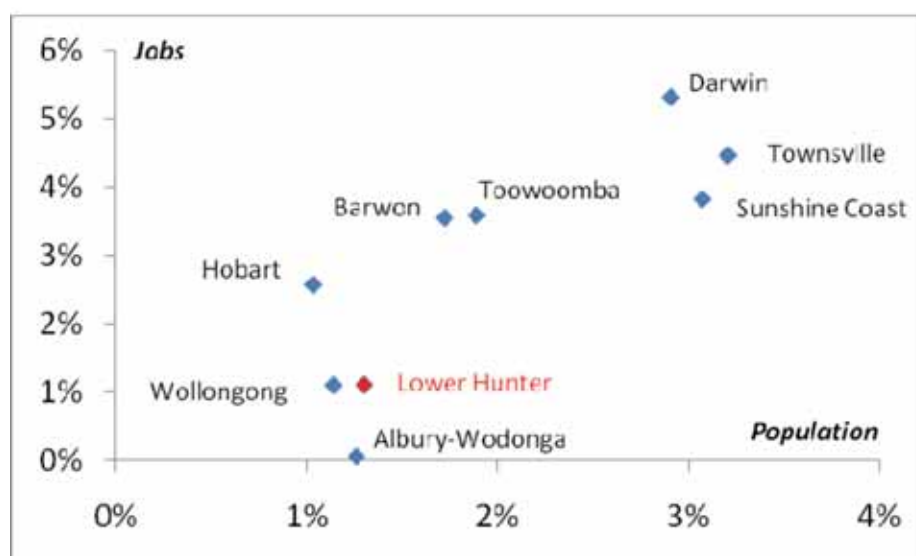
⁹ Ibid 8.

Figure 1. Population annual average growth rates, 2005 to 2010

	Population	Jobs
Lower Hunter	1.3%	1.1%
Albury-Wodonga, NSW	1.3%	0.1%
Wollongong, NSW	1.1%	1.1%
Barwon, Vic	1.7%	3.5%
Sunshine Coast, Qld	3.1%	3.8%
Toowoomba, Qld	1.9%	3.6%
Townsville, Qld	3.2%	4.5%
Hobart, Tas	1.0%	2.6%
Darwin, NT	2.9%	5.3%

Source: ABS, MacroPlan

Figure 2. Population annual average growth rates, 2005 to 2010



Source: ABS, MacroPlan

Our analysis indicates that to sustain the jobs growth potential on the horizon, the Lower Hunter should be sustaining substantially higher population growth than was provided for in the Lower Hunter Strategy.

1.3. THE LOWER HUNTER STRATEGY SOLD THE REGION SHORT

The Regional Strategy is based upon a population growth scenario which forecasts a regional population of 675,000 persons by 2031. This equates to an additional 160,000 persons over the period 2006–31.¹⁰

This assumed that the Lower Hunter's annual population growth would be just 6,400 persons per annum over 25 years (as we see from section 2.2 above, this is a low figure relative comparable regions elsewhere in Australia). Relatively modest population growth assumptions led to modest employment capacity targets. Provision was made for just 2,640 jobs per annum over the 25 year period (cumulative total of 66,000).

¹⁰ Ibid 4.

1.3.1. Population growth

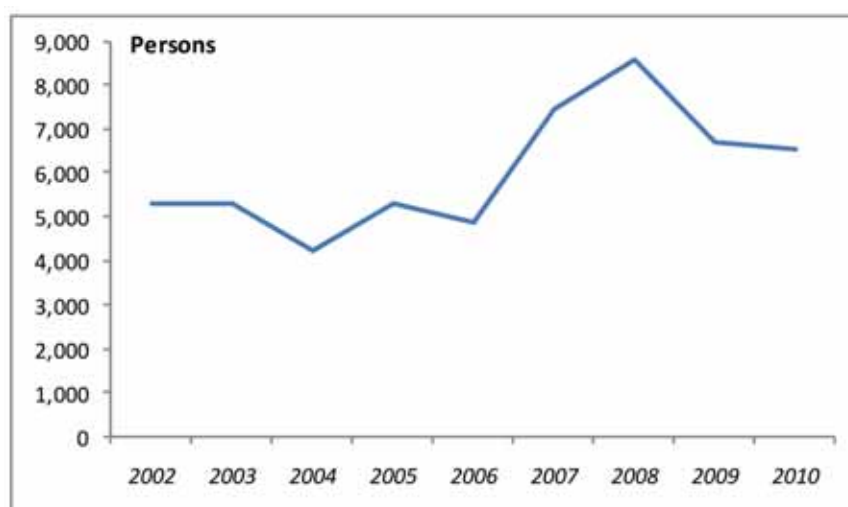
“It is now very clear that the strategy sold the Lower Hunter region short. Over the three years to June 2009, population and employment grew despite the strategy’s unambitious assumptions.”

It is now very clear that the strategy sold the Lower Hunter region short. Over the three years to June 2009, population and employment grew despite the strategy’s unambitious assumptions. The average population increase was about 6,800 persons per annum, compared to the strategy target of 6,400 persons per annum.

Population gains were driven by the temporary effects of a boom in overseas student numbers. Most of the rise in employment occurred during 2010, reflecting a strong upturn due to the beginning of an extended construction boom in the Hunter region.

From 2005 to 2009, the average annual population increase was about 6,800 persons per annum, higher than the levels observed over the first half of the decade. Population gains were particularly high from 2007 to 2009, even though employment growth in those years was fairly subdued.

Figure 3. Annual increase in Lower Hunter population (year ended June)



Source: ABS, MacroPlan

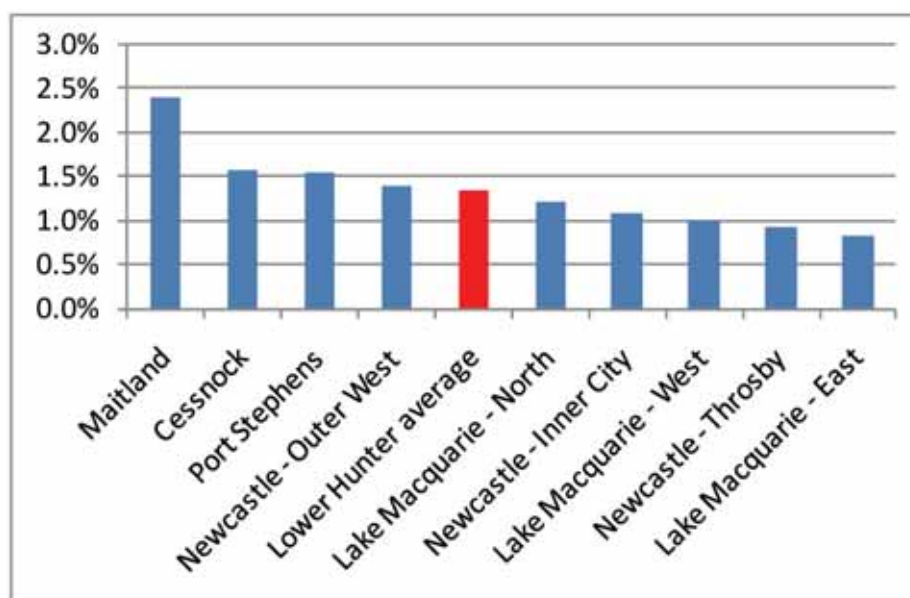
In this period, the national population gain was extremely high, led by a boom in net overseas migration, which peaked at just above 300,000 persons during 2009. The Hunter region enjoyed some benefit from rising net overseas migration, particularly through students at Newcastle University, as reflected in the high population growth for the inner city region of Newcastle.

The distribution of population growth across the Lower Hunter has been quite uneven.

- Population growth in the Lower Hunter averaged 1.3 per cent per annum from 2005 to 2010.

- The fastest population growth was in Maitland, Cessnock and Port Stephens.
- Population growth in Lake Macquarie and inner city Newcastle was very slow.

Figure 4. Average annual growth in population, 2005 to 2010



Source: ABS, MacroPlan

The Federal Government's independent public policy advisor, the Productivity Commission, recently handed down its report on the planning, zoning and development assessment systems operating across Australia.¹¹ One of the Commission's key findings was that:

With regard to just one of these challenges, in recent years the rate of population growth has been relatively high with rates varying considerably across cities and councils. ... [A] complexity comes from the uncertainty about how much each city's population will grow (immigration being just one of variables affecting this), so that city planning needs to allow for a wide range of alternative population growth rates (bold added).¹²

"It is important that any revised strategy considers the wide range of population growth scenarios that may arise in the future."

The Hunter Regional strategy failed to do this, and therefore did not adequately anticipate the Hunter's true housing and jobs requirements. It is important that any revised strategy considers the wide range of population growth scenarios that may arise in the future.

¹¹ Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments Volume 1* (2011).

¹² Ibid xxxiii.

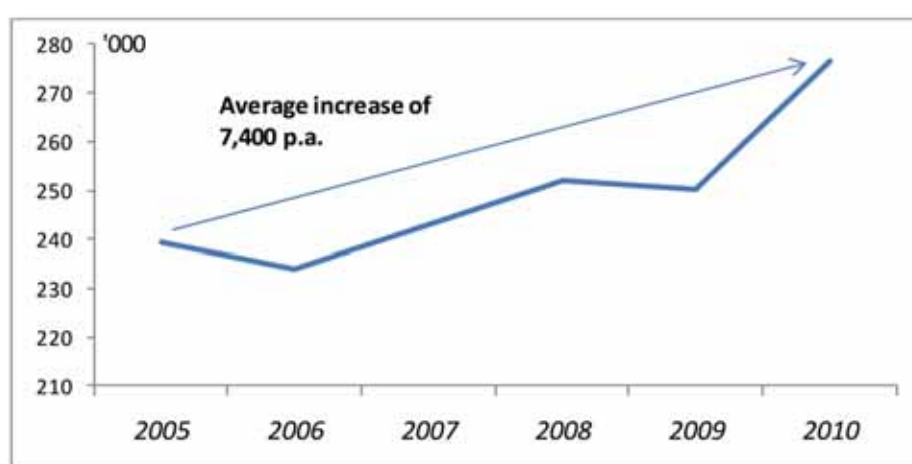
1.3.2. Jobs growth

“The Strategy only sought to provide employment capacity sufficient to support annual jobs growth of 2,640 jobs per annum, yet, from 2006 to 2010, average annual jobs growth was actually 7,400.”

The Strategy only sought to provide employment capacity sufficient to support annual jobs growth of 2,640 jobs per annum, yet, from 2006 to 2010, average annual jobs growth was actually 7,400. The Strategy’s capacity target was close to one third of the final outcome. Most of the gain occurred during 2010, led by work on major infrastructure projects.

Employment growth in the overall Hunter region was higher than the rate of overall population growth. From June 2004 to December 2010, jobs growth was 1.5 per cent per annum. The unemployment rate trended lower, averaging 4.7 per cent in the second half of 2010.

Figure 5. Total employment in the Lower Hunter region



Source: ABS, MacroPlan

1.3.3. Upgraders are being forced out of the Lower Hunter

“On the other hand, population growth amongst potential upgraders (35 to 49 years) has been very weak relative to the state average.”

Population growth in the Lower Hunter has been heavily skewed to older age cohorts. In particular, there is a substantial net inwards migration of persons in the 50 to 64 years cohort to the Lower Hunter. Population growth for the 25 to 34 years cohort was also quite strong, which largely reflects the contribution of more overseas students at the University of Newcastle.

On the other hand, population growth amongst potential upgraders (35 to 49 years) has been very weak relative to the state average.

Figure 6. Average annual population growth by age cohort, 2005 to 2009, Lower Hunter and NSW
(per cent per annum)

Age cohort	Lower Hunter	NSW
0-24	0.9	0.5
25-34	1.4	1.1
35-49	0.6	1.2
50-64	2.4	0.5
65+	2.1	2.3
Total	1.3	1.3

Source: ABS, MacroPlan

“Demographic data indicates that the upgrader age cohort (35 to 49 years) in the Lower Hunter showed very weak growth over the five years to 2009 - at an average of just 0.6 per cent, the rate of growth was just half the equivalent state-wide figure of 1.2 per cent.”

Demographic data indicates that the upgrader age cohort (35 to 49 years) in the Lower Hunter showed very weak growth over the five years to 2009 - at an average of just 0.6 per cent, the rate of growth was just half the equivalent state-wide figure of 1.2 per cent. In all other age groups the Hunter's growth exceeded the state average.

The very low growth in the upgrader age cohort is consistent with the relatively low supply of new detached houses in the Lower Hunter.

This outcome indicates that there was 'upgrader' migration out of the Lower Hunter, most likely into Sydney. We believe that this outcome was largely due to challenging housing affordability, particularly through the strong growth in residential rentals.

1.3.4. Increased dependence on rental housing

As outlined above, the strategy failed to anticipate the region's actual population growth in the 2005 to 2010 period. (The average population increase was about 6,800 persons per annum, compared to the strategy target of 6,400 persons per annum.)

As a result, a large proportion of the recent population growth has had to be sustained by occupation of the rental housing stock.

We estimate that new dwellings in the Lower Hunter region have only supported a population increase of about 3,600 persons per annum. This figure is based on an average of 1.8 persons for each new dwelling.

“Therefore, existing rental housing has been more intensively utilised to accommodate about 3,200 persons per annum, or almost half of the region’s population increase.”

The rest of the region’s population gain has been sustained by greater occupation of the existing rental stock. Therefore, existing rental housing has been more intensively utilised to accommodate about 3,200 persons per annum, or almost half of the region’s population increase.

Given that one-third of the Lower Hunter’s population growth has had to be supported by more intensive use of rental housing stock, it clearly follows that there has been a shift in the relative overall composition of the Lower Hunter community - away from home owners, to renters.

To date, NSW government planners have been, at best, agnostic about changes in housing tenure in the wider community.¹³ The Lower Hunter Regional Strategy identified fourteen “regional challenges” to which the strategy seeks to address.¹⁴ None of these challenges relates to boosting, or even maintaining, current levels of home ownership.

The strategy does not recognise the importance of promoting home ownership to the community as a whole. Other government bodies have taken this step. For example, the Council of Australian Governments’ Reform Council has observed that:

Home ownership is associated with many benefits for households These can include financial benefits such as lower real housing costs over a lifetime and wealth accumulation through a growth asset. Owning a home can also bring social and cultural benefits such as a sense of family and belonging, security, control and privacy, and is linked to improvements in health and educational attainment.¹⁵

While it is a private decision for an individual or family to buy a home and occupy it, significant benefits accrue to society as a result of such private transactions. These benefits are not taken into account by those parties themselves because they are distinct from the private benefits that the home owner will enjoy him or herself. In the absence of proactive government policy action, the price of a new home does not reflect these benefits, because they are not uniquely captured by home buyers, and therefore they are not able to value them appropriately (that is, individual homebuyers are not willing to pay extra money to realise benefits that will be largely enjoyed by others). Economists label these unpriced societal benefits as “positive externalities”.¹⁶

If government intervention does not ensure that the pricing of new homes reflects these benefits in some way, there is a risk that new housing will be under-consumed, as, for some people, modest private benefits of home acquisition will not be justified by the price of new housing, but in turn, denying the community the broader societal benefits of higher levels of home ownership.

¹³ Although, the *State Environmental Planning Policy (Affordable Rental Housing) 2009*, as originally published, set up more favourable bulk and scale controls for some rental housing, it did not make similar changes for owner occupied housing.

¹⁴ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 6-8.

¹⁵ Ibid 61.

¹⁶ Regulators are more familiar with the notion of “negative externalities” which occur when individuals maximise their own private benefits, at the expense of imposing negative costs on society generally. Where negative externalities occur (such as degradation of the public environment or over-use of public infrastructure) and there is no government intervention, housing may be over-consumed at a social cost that is disproportionate and unjustified relative to private benefits. However, regulators often overlook the existence of positive externalities flowing from private transaction made by individuals buying homes. Just as the existence of negative externalities may prompt regulatory intervention to increase prices, positive externalities should equally trigger consideration as to whether intervention to reduce prices should take place.

For example, well-known US research used an economic model to demonstrate that homeownership will increase investment in both social capital and local amenities and that this increase will improve economic efficiency.¹⁷ The study controlled for (i.e. removed biases in the data linked to) age, race, gender, marital status, children, income, education, residential structure type, detached home and city size. The study found that (in comparison with like-for-like renters) homeowners are:

- 6 per cent more likely to work to solve local problems;
- 12 per cent more likely to garden;
- 10 per cent more likely to know the name of their representative in the national legislature;
- 15 per cent more likely to vote in local elections;
- 9 per cent more likely to know the identity of their school board head;
- likely to be members of more non-professional organisations (on average, 0.25 more organisations); and
- likely to attend church more frequently.

The study concludes that there may be a causal link between homeownership and social capital. The empirical data suggests that homeownership positively influences the formation of social capital, and much of the influence of homeownership occurs because homeownership increases community tenure.

“Homeownership creates incentives for households to improve the quality of their communities since community quality is capitalised into the value of their homes.”

Homeownership creates incentives for households to improve the quality of their communities since community quality is capitalised into the value of their homes. In addition, because of the high transaction costs associated with homeownership, homeowners tend to be considerably more wedded to their local communities. Increased length of tenure in a community encourages investments in community, since homeowners will consume the benefits of community over a longer time period.

A separate empirical study by academics from the University of Wisconsin and the University of Michigan measures the impacts of home ownership on children and, in particular, tests whether for a given demographic group, children of homeowners behave in socially more desirable ways than children of renters.¹⁸ The study controlled for potentially biasing factors (such as income, etc). Having done so, it found that children of homeowners stay in school longer than children of renters and are less likely to have children themselves as teenagers. The study found that children of low-income homeowners had a 9 percentage point higher probability of staying in school than children of equivalent renters. The impact was more moderate, although still positive, for average income households: 4 percentage points. These results have been echoed by other research.¹⁹

¹⁷ D DiPasquale and E Glaeser (1999) “Incentives and Social Capital: Are Homeowners Better Citizens?” 45(2) *Journal of Urban Economics*, 354-384.

¹⁸ R Green and M White, “Measuring the benefits of homeownership: effects on children” (1997) 41 *Journal of Urban Economics*, 441-461.

¹⁹ T Boehm, A Schlottmann, “Does homeownership by parents have an economic impact on their children?” (1999) 8 *Journal of Housing Economics*, 217-232; D Haurin, T Parcel and R Haurin, “Does homeownership affect children’s outcomes?” (2002) 30 *Real Estate Economics*, 635-666; J Harkness, S Newman, “Differential effects of homeownership on children from higher- and lower-income families” (2003) 14 *Journal of Housing Research*, 1-20.

Bad behaviour by children (their own or their neighbours) may reduce the attractiveness of the neighbourhood and threaten the value of their homes. Thus homeowners have a stronger incentive than renters to monitor their own children and their neighbours' children and prevent them from engaging in behaviour which would threaten housing values. Furthermore, homeowners have higher moving costs and tend to remain in the same neighbourhoods longer than renters. This makes them better at monitoring and influencing the behaviour of children in the neighbourhood.

There are clearly positive externalities that arise from urban development, that are linked to the social benefits of high levels of home ownership.

"To the extent that the Lower Hunter Strategy has forced a shift away from home ownership to renting (by under-providing in terms of new housing supply), it also leads to increased social costs."

To the extent that the Lower Hunter Strategy has forced a shift away from home ownership to renting (by under-providing in terms of new housing supply), it also leads to increased social costs. These social costs will become more apparent as time progresses, particularly if these issues are not quickly addressed in a revised Lower Hunter Strategy.

1.3.5. A rationing of new housing supply

The substantial contribution from the existing rental stock was a temporary adjustment. The region's residential vacancy rate has decreased to be close to 1 per cent, so there is now little scope to support population growth through the rental market. New dwelling supply will now set the bar for future population growth in the region. In the event that new dwelling supply does not substantially increase over the next decade, then two consequences can be anticipated.

Firstly, any recent reduction in the standard of living through more intensive use of housing stock will be locked in, and further reductions may be anticipated as more people are compressed generally into existing housing stock.

"When existing housing stock is more intensively utilised it can mean a reduction in living standards."

When existing housing stock is more intensively utilised it can mean a reduction in living standards. For example, rental houses that would otherwise been regarded as unliveable, pending renovation or demolition, may be used as residences. It can mean more people occupying a single home, for example, couples sharing a home with others. It can also mean the use of a room as a regular bedroom rather than as a study, office, children's play room, guest bedroom or store room.²⁰ More young people may be forced to 'defer' their adulthood by staying on at home well into their twenties.

²⁰ Under the Canadian Occupancy Standard favoured by population planners a household is not "overcrowded" merely because such space is not available, yet Australians clearly have a preference for this additional living room. In 2007–08, 86 per cent of Australian lone-person households were living in dwellings with two or more potential bedrooms; 75 per cent of two-person households had three or more potential bedrooms; and 35 per cent of three-person households had four or more potential bedrooms: ABS (Australian Bureau of Statistics) (2010), *Year Book Australia, 2009-10*, Cat. No. 1301.0, Canberra: ABS. If housing in the Lower Hunter is progressively more intensely occupied, then the ability for additional rooms to be used for purposes other than a regular bedroom is lost. As result the quality of the housing enjoyed by the given household is lower.

Secondly, the potential population gain in the Lower Hunter will be heavily constrained. We estimate that the current housing supply will limit the Lower Hunter's net annual population growth to about 5,000 persons per annum.

"A rationed supply of housing will pit the region's existing residents seeking housing against those moving into the region. This will clearly disadvantage low and middle income earners in the region, and create a Diaspora of aggrieved Lower Hunter residents who have been forced out of the region."

It is important to understand that a limitation of the *net* growth in population does not merely mean a reduction in the number of new people coming to the area. It will inevitably mean that many local people who have a preference to stay in the region will find themselves priced out of the housing market (both in terms of rental and ownership). Those people will end up leaving the region, effectively being forced to make way for higher income earners whose skills are more in demand. In short, a rationed supply of housing will pit the region's existing residents seeking housing against those moving into the region. This will clearly disadvantage low and middle income earners in the region, and create a Diaspora of aggrieved Lower Hunter residents who have been forced out of the region.

However, a rationed housing supply will not entirely displace local people. Middle and higher income locals in particular, will be able to compete with potential aspiring Lower Hunter residents. As result, a constrained housing market will also see many aspiring new entrants to the region diverted elsewhere.

In addition, there is the issue of delivery of the pipeline of major construction projects planned for the Hunter region. These projects would create expansion in employment, but they would need to be sustained by inwards migration, due to the very low unemployment rate that currently prevails.

"If the region's economic potential is realised, then we project that population growth would need to increase to an average of 7,500 persons per annum over the next decade."

If the region's economic potential is realised, then we project that population growth would need to increase to an average of 7,500 persons per annum over the next decade. However, to achieve this potential, there would need to be considerable reform to the residential development process in the Lower Hunter, particularly relating to:

- the ease of securing rezoning and land release;
- the swiftness of development approval; and
- the impact of government charges on land affordability in new release areas.

We address these issues in detail in a following section.

Figure 7. Population growth in the Lower Hunter region

	Number	Percentage
Lower Hunter Strategy target per annum	6,400	1.3%
Actual 2005 – 2010 per annum	6,800	1.3%
<i>New dwellings</i>	<i>3,600</i>	
<i>Existing rental housing</i>	<i>3,200</i>	
Projected population growth: status quo for residential development process		
2010 - 2020	5,000	0.9%
Projected population growth: reform to residential development process		
2010 - 2020	7,500	1.4%

Source: ABS, MacroPlan

1.4. WIDER ECONOMIC IMPACTS OF LOW POPULATION GROWTH

“A consequence of low population growth in the Lower Hunter has been relatively weak jobs growth.”

Population growth creates demand for business and government services, and thereby stimulates job creation. A consequence of low population growth in the Lower Hunter has been relatively weak jobs growth. This positive effect has been evident in other regions with strong population growth.

For example, higher population growth creates more demand for commercial and industrial building space, and can thereby underpin the viability of new projects. We can see at the national level that there is a positive relationship between population growth and non-residential building activity. Higher non-residential building activity creates demand for construction materials and business services, which generate more jobs.

“If population growth had been sustained at a similar rate to the Barwon region, at 1.7 per cent per annum over the five years to 2009, then we estimate that the annual rate of jobs growth would have been about 2.0 per cent per annum.”

If new houses in the Lower Hunter had been more affordable, then the larger population growth would have led to higher jobs growth. If population growth had been sustained at a similar rate to the Barwon region, at 1.7 per cent per annum over the five years to 2009, then we estimate that the annual rate of jobs growth would have been about 2.0 per cent per annum.

We estimate that non-residential building would have been \$150 million greater per annum over the five years to 2010. In that event, rather than having a flat profile for non-residential building, activity would have been about 30 per cent higher on average over the five year period.

Stronger jobs growth would have supported a larger volume of non-residential building in the Hunter. We estimate that non-residential building would have been \$150 million greater per annum over the five years to 2010. In that event, rather than having a flat profile for non-residential building, activity would have been about 30 per cent higher on average over the five year period.

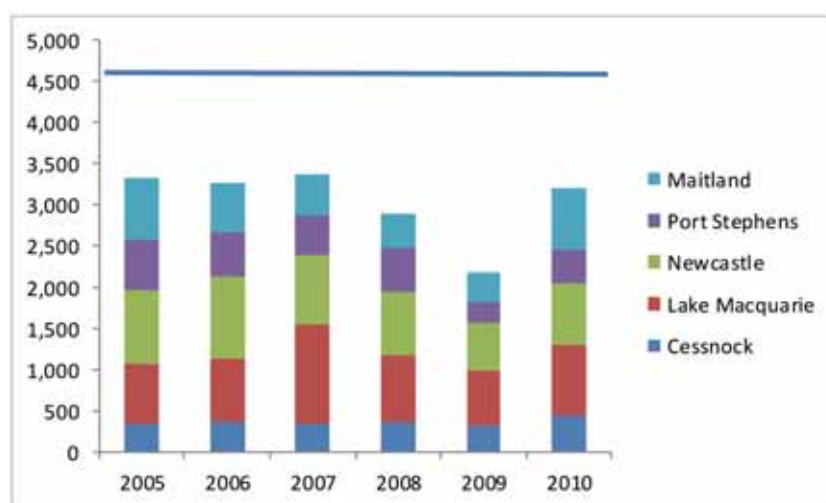
1.5. EXPECTED VERSUS ACTUAL DWELLING SUPPLY

The Regional Strategy goal implied that 4,600 dwellings per annum would be required as an average annual rate of supply, to meet the needs of an additional 6,400 persons per annum. According to the strategy, 60 per cent of the additional new dwellings are to be targeted for new release areas, with the other 40 per cent in existing urban areas and centres.²¹ The strategy says that

...sufficient land and development capacity will be identified and rezoned to provide for an additional 69,000 dwellings in new release areas and 46,000 dwellings in existing urban areas and centres to meet forecasted demands for an additional 115,000 dwellings over the next 25 years.²²

Compared to this target, housing supply in the Lower Hunter region has been very low for the past five years. The low was recorded in 2008/09, with just 2,180 approvals. That low followed five years of trend decline from 3,271 approvals in 2004/05. While there were 3,201 dwelling approvals in 2009/10, about 600 of those were for public housing. The level of private purchases of new housing remains very low by historical standards.

Figure 8. Dwelling approvals well below strategy target, Lower Hunter



Source: ABS, MacroPlan

²¹ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 24.

²² Ibid 27.

Figure 9. Contribution of new dwellings to regional population growth (annual average for 2005 to 2010)

Dwelling approvals	2,700
Demolitions (knockdown-rebuilds or infill projects)	300
Holiday homes	400
<i>Net supply of new dwellings</i>	<i>2,000</i>
Estimated persons per new dwelling	1.8
Population increase supported by new dwellings	3,600

Source: ABS, MacroPlan

1.6. TRENDS IN HOUSING SUPPLY

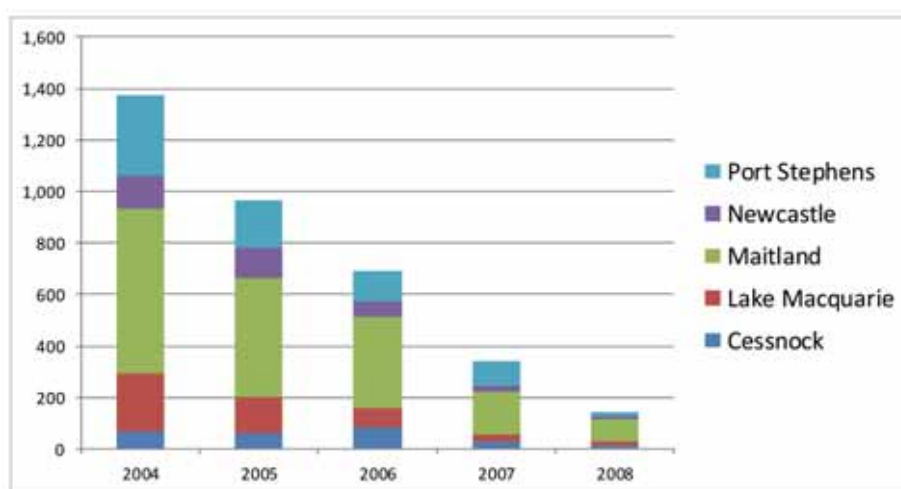
1.6.1 Detached houses

The Regional Strategy targeted 60 per cent of additional dwellings to be located in new release areas:

Existing trends are that 75 per cent of all new housing is being built in new release areas and just 25 per cent in the existing urban areas. The Strategy provides that 60 per cent of new dwellings will be provided in new release areas and 40 per cent will be provided in existing urban areas — that is, a 60:40 split in the provision of new dwellings.²³

At 60 per cent of 4,600 new dwellings, new release area would be supplying about 2,760 new dwellings per annum. However, lot production at new release areas has been well below that level. Department of Planning data shows that lot production at new release areas in the Lower Hunter trended down sharply from 2004 to 2008, dropping below 200 lots in 2008. We note that lot production does not necessarily equate to dwelling construction, as not all lots produced are used for construction in a particular year. Nevertheless, the rates of lot production do indicate the trends in the supply of new dwellings.

Figure 10. Lot production in new release areas



Source: New South Wales Department of Planning Review of Metropolitan Development Program, MacroPlan

²³ Ibid.

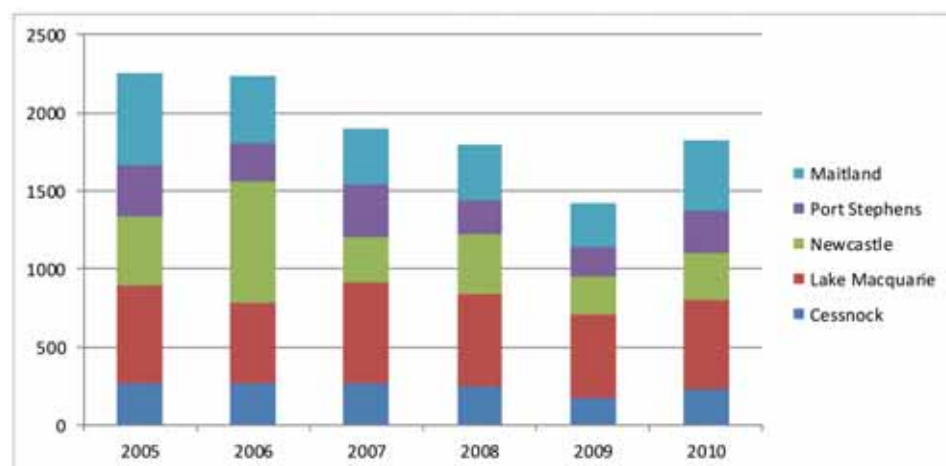
“The current Lower Hunter strategy has, so far, five years after it was introduced, contributed little to the region’s housing supply pipeline.”

Actual dwelling production figures have kept ahead of new lot production figures, only through development of lands largely released prior to the finalisation of the Lower Hunter Strategy. Simply put, dwelling numbers are very low, but would have been even lower, but for historical land releases carried out prior to the current Lower Hunter strategic framework. The current Lower Hunter strategy has, so far, five years after it was introduced, contributed little to the region’s housing supply pipeline.

Detached house approvals trended down from about 2,200 in 2004/05 to about 1,450 in 2008/09. This decline was concentrated in the Maitland and Port Stephens regions. Approvals were maintained at a fairly solid level in Lake Macquarie, where a large proportion of land released prior to the current is located. The rate of construction has remained very low in Cessnock.

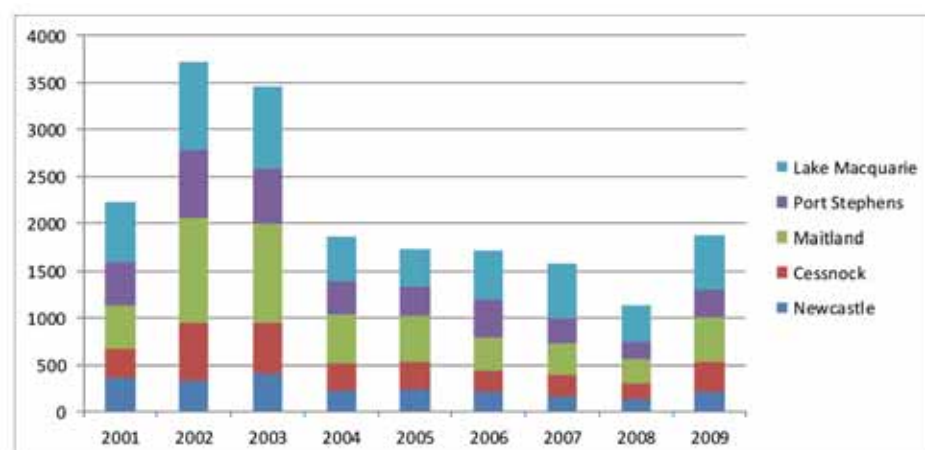
There was a rebound in 2009/10, due to the stimulus effect from the First Homeowners Boost Scheme and very low interest rates. Nevertheless, house approvals did not return to the levels observed in 2004/05.

Figure 11. Detached house approvals



Source: ABS, MacroPlan

Figure 12. Vacant urban land sales

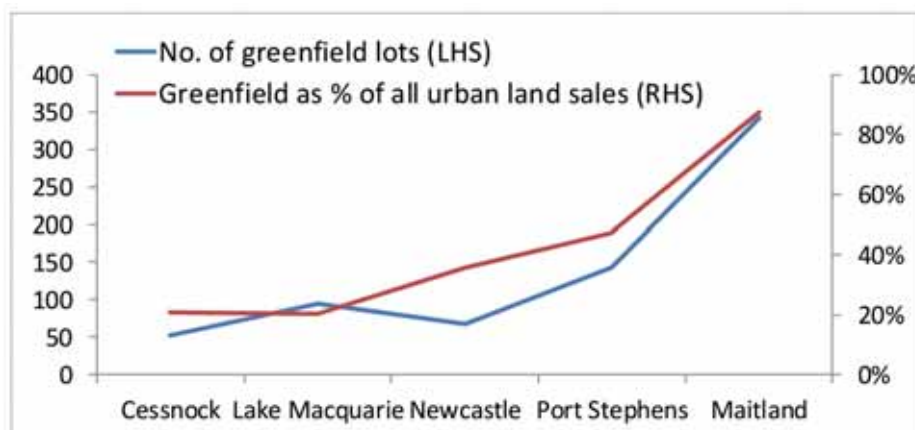


Source: RP Data, MacroPlan W

We can compare the level of greenfield lot production (new release areas) to the overall rate of vacant land sales. Greenfield developments accounted for very low proportions of total land sales in the Cessnock, Lake Macquarie and Newcastle regions, at about 20 per cent.

The proportions are much higher in Maitland, with about 85 per cent of all land sales occurring at new release sites.

Figure 13. New release area (greenfield) lots as share of all residential land sales, average 2005 to 2008

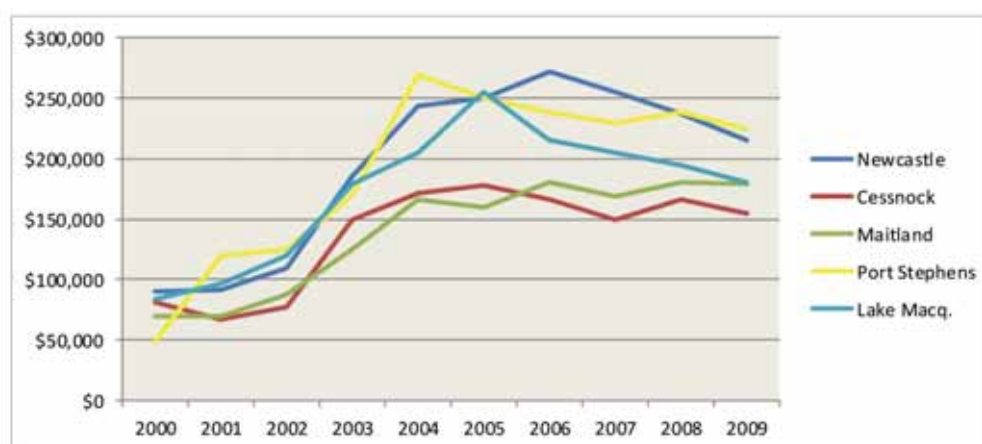


Source: ABS, MacroPlan

The relative strength of land sales in new release areas at Maitland is explained by the fact that median prices for land have tended to be more moderate there, when compared to Port Stephens, Newcastle and Lake Macquarie.

Land prices in the three coastal regions surged from 2002 to 2005, reaching \$250,000 for the median value. On the other hand, prices at Maitland and Cessnock levelled out at about \$160,000 and \$170,000.

Figure 14. Median prices for vacant residential land



Source: RP Data, MacroPlan

At any given point in time, transactions in the regional housing market are likely to be dominated by the turnover in the existing stock of housing. While the price of new homes will generally be higher than equivalent established homes (to reflect the premium associated with a new property), the overall price of new housing will still need to be competitive with the price of established housing in order to attract purchasers.

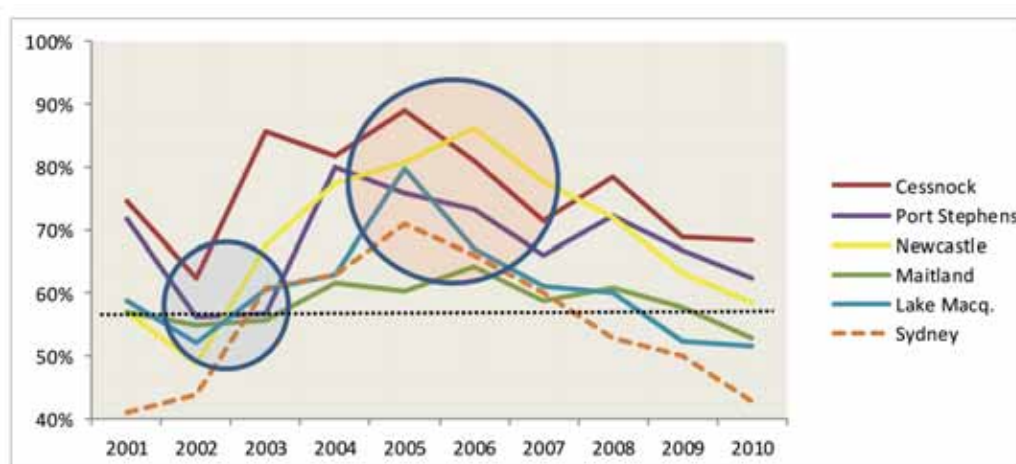
We can calculate the ratio of the median land price to the median house price as a measure of relative affordability for new houses. In Sydney, an extended decline in demand for new houses occurred once this ratio moved above 50 per cent, as observed from 2003 through to 2008.

In the Lower Hunter, this ratio was about 55 per cent for most regions as at 2002. However, by 2005, the surge in land prices meant that ratios ranged between 75 per cent and 90 per cent, with the exception of Maitland which moved no higher than about 60 per cent.

The jump in land prices relative to established house prices is a key factor as to why realised demand for new houses weakened from 2005 to 2009.

The surge in land prices was greater than the increase in established house prices. This evidence suggests that it was not simply demand factors, such as rental growth, interest rates or speculation about asset values that propelled land prices. Supply-side factors including government levies and zoning restrictions played a major role in the jump in land values. This interpretation is supported by an assessment of subdivision development cost structure (presented in a subsequent section), which shows that government levies are a large component of lot development costs.

Figure 15. Price of land relative to established houses



Source: RP Data, MacroPlan

Most recently, the relative price of land has improved across the Lower Hunter. However, the ratios in Cessnock, Port Stephens and Newcastle remain well above their respective 2002 rates.

Improvement has been most evident in Maitland and Lake Macquarie, which are now back to the ratios observed in 2002. However, most of the improvement in ratios has been due to the recovery in established house prices. In turn, the rising house prices are partly attributable to the strong growth in rentals, which have resulted from an extended and very substantial shortage of housing. Hence, it is evident that the market response to poor land affordability continues to evolve.

1.6.2 Medium and high density dwellings

The Strategy's implied goal implied of 4,600 dwellings per annum with a 40 per cent target for infill development, suggests that 1,840 medium and higher density dwellings would be built to supply the local housing market on an annual basis.²⁴

²⁴ Ibid.

“The rate of construction for medium and high density dwellings averaged 1,200 per annum from 2004/05 to 2007/08 – 35 per cent below target.”

The rate of construction for medium and high density dwellings averaged 1,200 per annum from 2004/05 to 2007/08 – 35 per cent below target. Most of this housing occurred in the inner city of Newcastle and the coastal suburbs of Lake Macquarie and Port Stephens.

On the surface, this might suggest that the targets for infill development have been more successful than the targets for greenfield development. After all, the strategy says:

The population and housing challenges are to:... achieve higher residential densities in-and-around major centres to maximise proximity to employment and services and the use of existing infrastructure, while maintaining amenity ...²⁵

However, a substantial proportion of the new medium and high density housing are holiday homes owned by residents of Sydney.

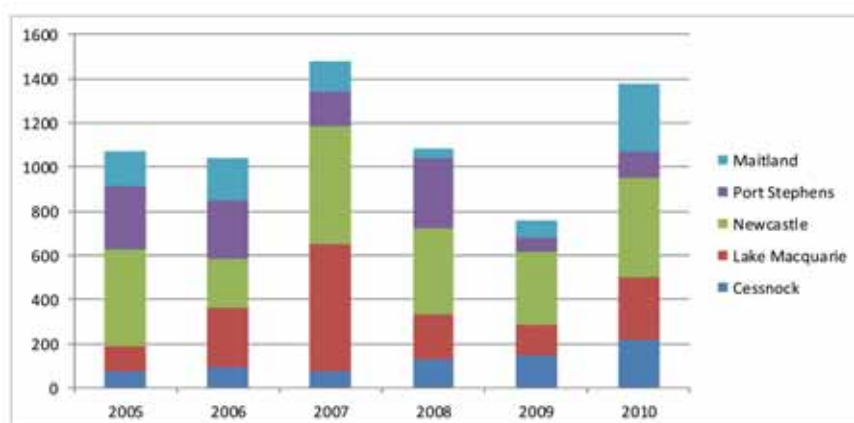
However, a substantial proportion of the new medium and high density housing are holiday homes owned by residents of Sydney. We estimate that about 400 such holiday homes per annum are built in the Lower Hunter.

This estimate is based on comparison of census data for the number of unoccupied dwellings. Most of the increase in unoccupied dwellings over time will tend to be additional holiday homes. By comparing the census figures for unoccupied dwellings as at 2001 and 2006, we find that there was an approximate 2,400 increase in the number of unoccupied dwellings in the Lower Hunter, or an average of 480 per annum. Most of this increase will be due to a rising number of holiday homes, and we have adopted a figure of 400 per annum.

Holiday homes do not add to the housing stock available for the local population. Consequently, the rate of dwelling construction needs to be adjusted to remove holiday homes from evaluation of housing supply to support population growth. In this context, when evaluating housing supply to enable population growth and respond to demographic change, the supply of infill housing appears to have been closer to 800 dwellings per annum.

²⁵ Ibid 6.

Figure 16. Medium and high density dwelling approvals



Source: ABS, MacroPlan

Challenges for infill housing are evident when we consider the dwellings targeted at retiree households. While there is a clear ageing demographic in the Lower Hunter, supply of new retirement housing or independent living units has been very limited. This pattern is very evident in Maitland and Cessnock, which have enjoyed substantial inward migration of retiree age people, yet there have been very low rates of medium and high density dwelling construction in both regions.

A recent study by the UNSW-UWS Research Centre, funded by the government-backed Australian Housing and Urban Research Institute, found that there was a strong preference for older Australians to remain in their own home for as long as possible.²⁶

The report questioned whether the demand for the provision of segregated and specialised aged-specific housing developments would rise as dramatically as previously predicted. The study observed that 'downsizing' may have appeal for some home owners, but the alternative housing they are seeking is not for very small dwellings as might be suggested by the predominance of single-and couple-households. According to this study, older residents may still require three-bedroom dwellings and multi-purpose rooms that can accommodate different uses, including hobbies, child care (grandchildren), fitness equipment, or private personal space.

The findings of the study, and the preference of older people revealed through market activity, suggests that strategic plans predicated on a mass movement of older people into smaller infill housing development may not be realised in the short-to-medium term. While this does not necessarily mean that demand for infill housing by older Australians will not increase at some point in the future if/when preference of baby boomers change, such a transformation cannot be treated as fait accompli.

This possibility raises significant questions as to the integrity of the Lower Hunter Regional Strategy, because it is heavily predicated on the demands of significant proportion of multi-person households being satisfied through the existing stock of detached houses (which the strategy assumes will be vacated by ageing baby boomers). Families with children have also a relatively strong preference for detached suburban dwelling.²⁷

²⁶ Bruce Judd, Diana Olsberg, Joanne Quinn, Lucy Groenhardt and Oya Demirbilek, *Dwelling, land and neighbourhood use by older home owners: AHURI Final Report No. 144* (2010).

²⁷ Y Tu and J Goldfinch, "A two-stage housing choice forecasting model" (1996) 33(3) *Urban Studies* 517–537; E Molin, H Oppewal and H Timmermans, "Analyzing heterogeneity in conjoint estimates of residential preference" (2000) 16, *Journal of Housing and the Built Environment* 267–284; C Bhat and J Guo, "A mixed spatially correlated logit model: formulation and application to residential choice modelling" (2004) 38(2) *Transportation Research* 147–168.

The propensity for older households to downsize from their family home is critical to the demand for new medium and high density dwellings. In Sydney, owner-occupiers account for about 50 percent of new medium and high density dwelling purchases in middle and outer ring suburbs. The other 50 percent is accounted for by investors. If this ratio applies to the Lower Hunter strategy target (approximately 1,800 annual net supply of dwellings from infill projects), then the annual owner-occupier demand for new medium and high density dwellings would need to be about 900, with investors accounting for the remainder. A large majority of the owner-occupier demand would be from older households, including both the 'empty nesters' and retiree population cohorts.

"The possibility of this shift of retired baby boomers from detached housing to medium and high density housing must be *allowed* for in a strategy, however, the prospect that this shift will not take place should also be accommodated."

The possibility of this shift of retired baby boomers from detached housing to medium and high density housing must be allowed for in a strategy, however, the prospect that this shift will not take place should also be accommodated. That is, the NSW Government should not place all of the Lower Hunter's eggs in one basket. This necessitates greater flexibility about the future dwelling mix (between, say, infill and greenfield) than is provided for in the existing Lower Hunter Strategy.

It is important to note that young households without children have generally exhibited the greatest willingness to trade off the benefits of a detached house for the benefits of medium and high density living with greater accessibility to high value amenities.²⁸ However, the current strategy does not relate its projected supply of medium and high density dwellings to either this demographic in particular, or to areas with high value amenities that are significantly more accessible from medium and high density development.

The Productivity Commission's recent inquiry into the state planning systems concluded that the uncertainty inherent in projections necessitates a wide range of alternative population growth rates.²⁹

"If the strategy is not sufficiently flexible to accommodate a wide variety of possible scenarios, there will be a serious risk of a gross and increasing undersupply of detached housing for the Hunter region's families."

If the strategy is not sufficiently flexible to accommodate a wide variety of possible scenarios, there will be a serious risk of a gross and increasing undersupply of detached housing for the Hunter region's families, as baby-boomers continue to occupy their existing family homes and insufficient new dwellings are built.

²⁸ P Rickwood, *The impact of physical planning policy on household energy use and greenhouse emissions* (2009) 153.

²⁹ Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments* (2011) xxii.

2. EVIDENCE OF A DEVELOPING HOUSING EMERGENCY

Housing supply in the Lower Hunter has fallen very substantially short of the regional strategy targets.

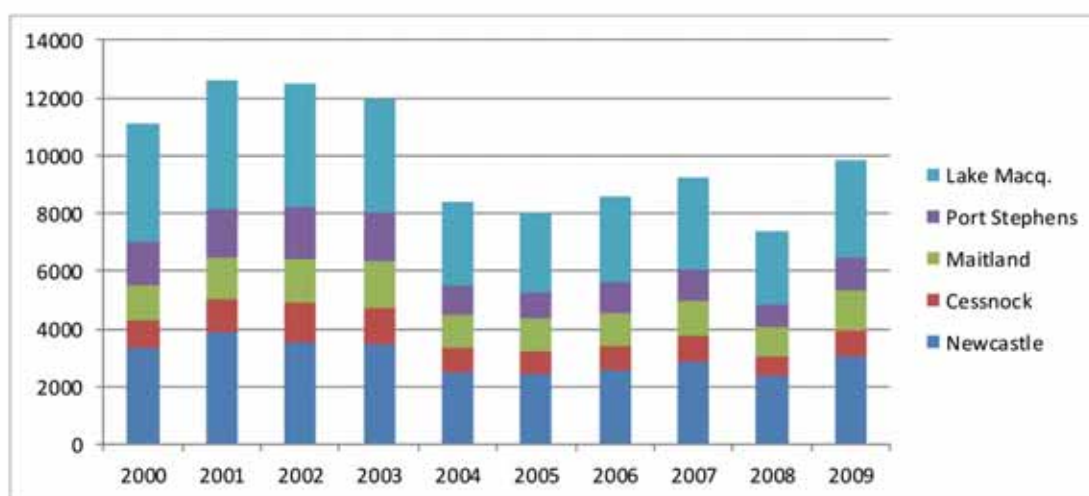
This section evaluates trends in residential property markets, to determine why the rate of construction has been maintained at a very low level. In summary, our analysis reaches the following conclusions:

- Evidence of a huge undersupply of housing, reflected in extremely strong and sustained growth in residential rentals over the past decade, which exceeded rental growth in Sydney and all other capital cities.
- Established residential property markets have exhibited strong turnover, with prices tending to show moderate growth from 2004 to 2008, in contrast to the weak conditions in Sydney.
- However, very high ratios of residential land prices to established house prices, which have discouraged the purchase of new houses. It has not been possible to produce the necessary levels of new housing stock at prices that are competitive with established houses.

2.1. TRENDS IN PROPERTY SALES AND PRICES

Turnover of established properties can be an important driver for upgrader demand for new dwellings. Historical data shows that turnover of established houses was fairly solid across the Lower Hunter from 2004 to 2007.

Figure 17. Sales of established houses (calendar years)



Source: RP Data, MacroPlan

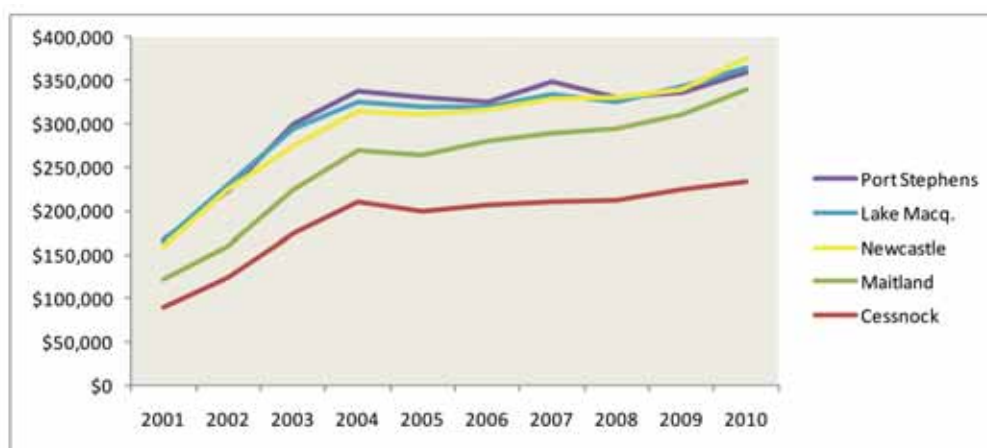
House prices showed marginal improvement from 2004 to 2008. There is little difference in median prices between the three coastal regions of Port Stephens, Newcastle and Lake Macquarie.

Prices in Maitland showed the best growth between 2004 and 2008, and are now only marginally lower than the prices in the three coastal regions. That trend reflects the strong population growth in Maitland, which has been favoured by lower income families seeking more affordable housing.

"The local economy in Cessnock has been hamstrung by very low rates of construction activity, particularly residential building, so young families have not been attracted to the area."

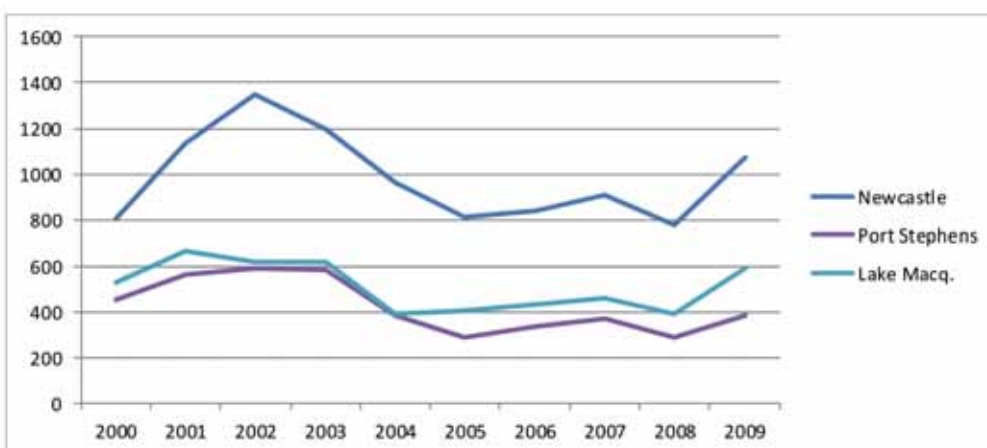
House prices in Cessnock have lagged well behind the rest of the Lower Hunter. This area has enjoyed better population growth than Lake Macquarie, yet house prices have shown little improvement for the past five years. The local economy in Cessnock has been hamstrung by very low rates of construction activity, particularly residential building, so young families have not been attracted to the area. In addition, the local population is ageing, and tending to stay in family homes, so turnover of housing is comparatively low.

Figure 18. Median house prices, 2000 to September quarter 2010



Source: RP Data, MacroPlan

Figure 19. Sales of units, annual number



Source: RP Data, MacroPlan

2.2. TRENDS IN RESIDENTIAL RENTALS

With the cost of vacant lots rising so strongly from 2002 to 2005, potential demand for new houses has been diverted to established houses. The lack of new construction has resulted in greater occupation of the vacant rental stock across the Lower Hunter.

Consequently, there has been an extended rise in residential rentals. We analysed Housing NSW data published in its quarterly Rental and Sales Report. This data collates figures on rental bonds lodged, which provide a guide to the evolving market conditions (rather than a measure of actual average rentals paid across all households at a point of time).

“From 2000 to 2010, median rentals for a 3 bedroom house in the Lower Hunter have risen by between 82 per cent (Port Stephens) and 100 per cent (Newcastle). Rental growth has far outstripped Sydney, which suffered a 67 per cent rise over the same period.”

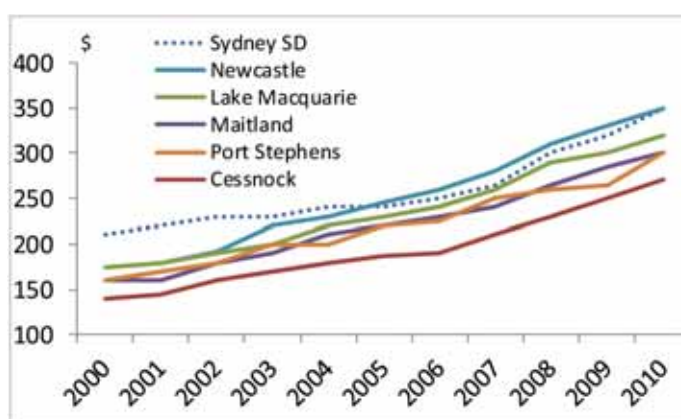
From 2000 to 2010, median rentals for a 3 bedroom house in the Lower Hunter have risen by between 82 per cent (Port Stephens) and 100 per cent (Newcastle). Rental growth has far outstripped Sydney, which suffered a 67 per cent rise over the same period.

“The continued strong growth in rentals during the subsequent 2005 to 2010 period is attributable to the decline in housing supply.”

It is important to note that the rate of increase across the Lower Hunter was substantial in the 2000 to 2005 period, which indicates that housing shortages were developing, even though supply appeared solid. The continued strong growth in rentals during the subsequent 2005 to 2010 period is attributable to the decline in housing supply.

The situation is particularly acute in Newcastle City local government area, as the median 3 bedroom house rental is now equal to that in Sydney.

Figure 20. Median rentals for 3 bedroom houses



Source: Department of Housing Rental and Sales Report, MacroPlan

Figure 21. Cumulative rise in rentals for 3 bedroom houses (per cent)

	Sydney SD	Cessnock	Lake Macquarie	Maitland	Newcastle	Port Stephens
1995-2005	19	4	13	9	13	10
2000-2005	14	36	37	35	33	36
2005-2010	47	47	35	45	46	33
2000-2010	67	100	86	96	94	82

Source: Department of Housing Rental and Sales Report, MacroPlan

2.3. RISE IN RENTAL STRESS ACROSS THE LOWER HUNTER

According to 2006 Census data, about 24 per cent of all households in the Lower Hunter live in rental properties. Most rental households were family households, although the propensity for rental was higher for lone person households.

Figure 22. Household tenure for Lower Hunter , 2006 Census data

	Owner-occupier	Per cent	Rental	Per cent	Total	Per cent
Lone person households	31,340	17	14,647	8	45,987	25
Family households	105,695	57	26,132	14	131,827	72
Group	2,742	1	3,486	2	6,228	3
Total	139,777	76	44,265	24	184,042	100

Source: ABS, MacroPlan

“Due to the very strong growth in rents since 2006, the proportion of rental households in stress is estimated to have risen to 56 per cent.”

The sharp rise in rentals has pushed an increasing number of households into rental stress. We estimate that the proportion of Lower Hunter rental households paying more than 30 per cent of gross household income on rent was 40 per cent in 2006. Due to the very strong growth in rents since 2006, the proportion of rental households in stress is estimated to have risen to 56 per cent.

Rentals in the Lower Hunter have tended to show far stronger growth than comparable regional areas. The table below shows growth in median rentals for a three bedroom house (based on rental bond data collated by state housing authorities). Using these measures for the 2006 to 2010 period, annual growth for rentals in Maitland and Newcastle exceeded growth in the Barwon region of Victoria by a full percentage point, even though population growth in Barwon has been well above the rate observed in the Lower Hunter. Rental growth was substantially higher than the average rates observed in the selected Queensland regions.

Figure 23. Residential rental for three bedroom house, annual average growth rates, 2006 to 2010

Region	Growth Rate
Maitland	8.9%
Newcastle	8.8%
Wollongong	8.5%
Barwon	7.8%
Sunshine Coast (Caloundra)	5.8%
Toowoomba	5.3%
Townsville	5.1%

Source: NSW Housing Rental and Sales Reports, Queensland Residential Tenancies Authority median rentals, Victoria Office of Housing Rental Report

3. DIAGNOSIS OF HOUSING SHORTAGES IN THE LOWER HUNTER

“Levels of supply in both new release areas and existing urban areas have fallen well short of the Regional Strategy targets.”

Housing supply in the Lower Hunter has fallen substantially short of the target of 4,600 new dwellings per annum. Levels of supply in both new release areas and existing urban areas have fallen well short of the Regional Strategy targets:

Sufficient land and development capacity will be identified and rezoned to provide for an additional 69,000 dwellings in new release areas and 46,000 dwellings in existing urban areas and centres to meet forecasted demands for an additional 115, 000 dwellings over the next 25 years.³⁰

Most recently, the gap has been most obvious in relation to the low rate of construction in new release areas, but the level of medium and high density housing at urban centres has also been very low, compared with the Strategy’s projections.

The problem has been observed by others in the region. For example, in the most recent Hunter Region Residential Market Outlook, the Hunter Valley Research Foundation observed that “the regional housing market has been under-supplied for an extensive period”.³¹

There are a number of root problems behind the failure to meet the Strategy goals for housing:

- depth and range of zoned and serviced land;
- challenging cost structures for residential subdivision development; and
- poor feasibility of medium and high density housing, particularly for retirement living.

The following section explores these issues.

3.1. DEPTH AND RANGE OF ZONED AND SERVICED LAND AT NEW RELEASE AREAS

In aggregate terms, there are a substantial number of lots in new release areas, which the government says are “zoned and serviced” for residential development.

³⁰ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 27.

³¹ Hunter Valley Research Foundation, *Hunter Region Residential Market Outlook* (2009) 1.

A review of the Metropolitan Development Strategy in 2009, undertaken by the Department of Planning, identified more than 13,000 lots that were both “zoned and serviced” in the Lower Hunter. Most recently, land at the King’s Hill area in Port Stephens has been rezoned to residential purposes, which has increased the magnitude of nominally developable land to an estimated 14,800 lots.

In theory, the scope for development is far greater than the recent levels of lot production at new release areas, which trended down from close to 1,000 in 2005 to less than 200 in 2008, according to Department of Planning information.

Figure 24. New release areas, lots zoned and serviced

	Zoned and Serviced	Zoned and Serviced - Next 5 years	Zoned and Serviced - beyond 5 years
Cessnock	730	11,920	8,150
Lake Macquarie	6,057	8,179	4,393
Maitland	3,198	3,100	14,444
Newcastle	1,437	-	4,750
Port Stephens*	3,378	2,362	5,250
Lower Hunter Total	14,800	25,561	36,987

* Adjusted to account for rezoning of King’s Hill

Source: MacroPlan, NSW Dept. Of Planning Review of MDP, 2009

Part of the explanation for this disconnect is the geographic distribution of land. Maitland and Port Stephens have had the highest levels of population growth in the Lower Hunter. On the basis of population growth, and given their smaller urban centres, we estimate that they should be producing at least 1,000 lots per annum from new release areas (to contribute to the overall 2,640 lots from new release areas, as targeted by the Regional Strategy).

However, this rate of lot production is high relative to available land for development. The number of lots zoned and serviced at new release areas in Maitland and Port Stephens is currently close to 5,600, which represents only 5.6 years of supply. That constitutes a relatively limited scope for development.

Planning authorities normally consider that there should be a supply of undeveloped land sufficient to meet 15 years of projected demand necessary to avoid speculative pressure and aid efficient production of land.³² Adelaide and Perth go further than this, with their targets requiring 25 years supply of land for future development and 15 years supply of land zoned for urban uses.³³ For Sydney, the NSW Government seeks to achieve “stocks of land zoned and serviced with trunk infrastructure” equivalent to 55,000 dwellings, which is equivalent to 7 years supply (based on the implicit greenfield development target of 7,690 homes a year).³⁴ Under the Lower Hunter Strategy there is no expressed target for any number of years of land supply to be made available.

In its recent report on the planning systems across Australia, the Productivity Commission noted that local planning authorities can claim that there is more than sufficient land available while the private sector argues for the release of more land.³⁵ There can be, notionally, “no shortage” of land for development, but the land available for development may not be in the areas in which it was commercially viable to develop.

³² Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments* (2011) 124.

³³ Ibid xxiv.

³⁴ NSW Government, *State Plan 2010* (2010) 11; NSW Department of Planning, *Metropolitan Plan for Sydney 2036* (2010) 115.

³⁵ Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments* (2011) 106.

For example, consider the issue of fractured land holdings. Where the ownership of land is fractured into a number of small parcels it may be very difficult and expensive to undertake the complex negotiations and resources required to assemble the land into a site large enough to support a major development.

“This potential for disconnect between the land identified in planning strategies for development, and the commercial reality of development, suggests that planning authorities should err on the side of making more land available for development rather than less.”

This potential for disconnect between the land identified in planning strategies for development, and the commercial reality of development, suggests that planning authorities should err on the side of making more land available for development rather than less. A supply of undeveloped land equivalent to 20 years worth of projected need will be more likely to achieve this outcome than Sydney's 7 year goal, or the more commonly cited 15 year target. The fact that the Hunter Strategy contains no such target at all is clearly a deficiency.

Figure 25. New release areas, lots zoned and serviced

	Zoned and Serviced	Zoned and Serviced - Next 5 years
Maitland	3,198	3,100
Port Stephens	2,378	2,362
Combined	5,576	5,462
Years supply at combined 1,000 per annum	5.6	5.5

Source: MacroPlan, NSW Dept. Of Planning Review of MDP, 2009

On the other hand, the volume of land “zoned and serviced” at new release areas in Lake Macquarie is largely relative to population growth. There are just over 6,000 lots identified at Lake Macquarie, compared to an estimated take-up rate of about 400 per annum according to the Regional Strategy.

This potential supply from new release areas appears to be placing some restriction on pricing of existing urban land in Lake Macquarie. Over the past three years, the ratio between land prices and established house prices has improved substantially in that region.

Figure 26. New release areas, lots zoned and serviced

	Zoned and Serviced	Zoned and Serviced - Next 5 years
Lake Macquarie	6,057	8,179
Years supply at 400 per annum	15.1	20.4
Newcastle	1,437	-
Cessnock	730	11,920

Source: MacroPlan, NSW Dept. Of Planning Review of MDP, 2009

3.2. COST STRUCTURES FOR RESIDENTIAL SUBDIVISION DEVELOPMENT

3.2.1. Zoned land in new release areas

The volume of land zoned and serviced is not the only factor that determines pricing for residential lots. Beyond land acquisition, there are a range of costs that play a key role in setting the feasibility of developments.

In the above section, we observed that the ratio of the median land price to the median house price as a measure of relative affordability for new houses has tended to be very high since 2003. We have also noted that the level of housing supply necessary to support Hunter population growth and demographic change has fallen short of requirements. How can this disconnect be explained?

“The short answer is that, in part, the cost base of developing each new home does not allow developers to produce new housing that is sufficiently competitive with existing housing stock.”

The short answer is that, in part, the cost base of developing each new home does not allow developers to produce new housing that is sufficiently competitive with existing housing stock. The main elements of this cost base are land acquisition, construction costs and government levies. If the Lower Hunter is to get the housing supply it needs, policy-makers will need to consider what action the government and local councils can take to lower the costs of development.

To evaluate the operating environment for residential developers in the Lower Hunter, we have used an indicative cost structure for subdivision development. This structure is used to analyse the Maitland and Lake Macquarie regions, which have the largest number of lots in new release areas.

We find that subdivision development for zoned land in new release areas is only marginally profitable in these regions. Current margins are not compelling, with a level of 20 per cent considered necessary to attract developers. The estimates for Lake Macquarie indicate that subdivision development at new release areas is not profitable.

These findings indicate that the sharp decline in lot production at new release areas has been due to the inability of developers to derive adequate margins from subdivision development. In turn, if the rate of residential supply from these sources is to substantially improve, there would need to be some significant adjustment to either land prices or development costs.

The estimated “section 94” contributions imposed by local governments vary, ranging from \$11,400 to \$31,000 at Thornton North. These charges clearly have a substantial impact on developer profit margins. In addition, there is a state infrastructure charge, which we have assigned a value of \$8,000 (based on the recently exhibited draft levy). At the current time, this amount may vary according to the characteristics of different land holdings (which we discuss further below).

The bottom line is that government charges (principally the section 94 contributions and state infrastructure charges) have placed an excessive hurdle for residential development in new release areas of the Lower Hunter. Consequently, the combined section 94 contributions and state infrastructure contribution revenues being generated from residential development in new release areas will currently be very small. Using an average value of \$20,000 to \$30,000 in charges per lot, and assuming a total of 300 lots developed per annum, the aggregate annual revenues would be in the order of \$6 million to \$9 million.

These amounts are extremely low when compared to the potential impact of restraining population growth in the Lower Hunter. There are linkages between new dwelling supply, population growth, workforce growth, and expansion of coal mining production in the Hunter region. Low population growth will limit the capacity to sustain the Hunter's workforce growth, at a time when the region has a burgeoning pipeline of projects to boost coal mining production.

"Aggregate government development levy revenue for new release areas amount to less than 1 per cent of the state's coal mining production royalties."

As we will discuss in more detail later in this report, the total value of NSW government royalties from coal mining production in 2010 was \$1 billion. By comparison, aggregate government development levy revenue for new release areas amount to less than 1 per cent of the state's coal mining production royalties.

Clearly, if residential development charges create only a marginal constraint on the expansion of coal mining, then the loss of mining royalties is likely to be orders of magnitude greater than the aggregated developer charges.

This equation is a real subject now facing authorities in NSW. Our analysis indicates that there is a considerable workforce increase required to enable expansion of coal mining production in the Hunter region. This workforce increase far exceeds the capacity of existing rental properties, due to years of parlous dwelling supply.

Our view is that if dwelling supply is not raised substantially over the next three years, then the workforce expansion will not be sustained, and the mining construction phase will be truncated. If this occurs, the revenue impacts in terms of lower mining royalties will be long-lasting, extending out for the life of coal mines which tend to be twenty to thirty years. Hence, it is the cumulative effect of lower mining royalties that need to be assessed.

"When compared to the minor revenues currently derived from charges on development of Lower Hunter new release areas, it is clear that enabling growth of mining royalties should be the priority for the New South Wales government."

When compared to the minor revenues currently derived from charges on development of Lower Hunter new release areas, it is clear that enabling growth of mining royalties should be the priority for the New South Wales government.

We can consider the prospective impact of abolishing the section 94 contributions and the state infrastructure charge, in terms of developer margins or land prices. If the lower government charges are fully retained by developers, then the margins would be substantially improved – but only rising to reach the benchmark levels that are generally required from subdivision development across the nation.

Why should the community care whether or not developers' margins are improved? In answering this question it is important to re-cap on two key issues identified earlier in this report.

Firstly, the region's fundamentals are strong: annual job growth has average 7,400 – nearly three times the strategy's projection of 2,640 jobs a year.

Secondly, housing has been unable to keep up with employment growth:

- new dwellings in the Lower Hunter region have only supported a population increase of about 5,000 persons per annum while the actual population increase was 6,800 dwellings per annum;
- growth in the Lower Hunter's upgrader age cohort (35 to 49 years) grew by just 0.6 per cent in the five years to 2009 - half the equivalent state-wide figure of 1.2 per cent; and
- the Lower Hunter's overall population growth averaged at 1.3 per cent between 2005 and 2010 while Barwon in Victoria grew at 1.7 per cent, Toowoomba in Queensland grew at 1.9 per cent and Townsville grew at 3.2 per cent.

This strongly suggests that there is latent (unmet) demand for housing in the Lower Hunter. Unmet demand arises when there is little incentive or ability for a developer to produce more residential land. That is, the cost base of producing new land is too high relative to the price that potential home buyers are willing to pay. When this occurs there may be either insufficient (or no) return on the capital a developer must invest to make a project succeed. It is impossible to justify allocating scarce capital to new home development in the Lower Hunter when returns are not competitive with other investments of a similar risk profile elsewhere.

In a market where supply is constrained because developers are unable to make a sufficient margin to justify investment, public policy moves that support margins are also very likely to boost supply. The justification for public policy action becomes stronger, when the necessary boost is not delivered by a cash subsidy by government, but by the removal of an inefficient tax that is clearly distorting market activity.

In short, home buyers would benefit substantially from reductions in government levies because many more home lots would be made available to the market without any need for further price increases.

Developers face escalation of construction costs, both in terms of land development (especially civil works) and house building. There tends to be escalation for civil works and house building costs, as rising wages feed into both elements. We estimate that construction cost increases will lead to increases in final dwelling prices at about 2 per cent per annum. Of course, established properties do not face comparable upward pressure from construction costs on market prices.

Consequently, there is upward pressure on the cost structure for new dwellings, which will require price increases

if developer margins are to be maintained. This situation is likely in the Lower Hunter, as our analysis indicates that developer margins are already very low.

If there are substantial decreases in government levies, then this would work to offset cost escalation and thereby reduce upward pressure on new dwelling prices. We estimate that the abolition of development levies would offset several years of cost escalation, and thereby improve the affordability of new houses. In turn, improved affordability would stimulate demand and allow for a higher rate of new dwelling supply over the long-term.

Importantly, the abolition of such levies would remove the distortionary impact that development levies create by permanently making new housing less price competitive with existing housing stock. Our view is that this magnitude of improvement in land affordability in new release areas would lead to a material improvement in the rate of new dwelling purchases.

Figure 27. Indicative cost structure for subdivision development (per lot for zoned land in new release areas) and final price for new house release area

Component	Notes	Maitland (Thornton Nth)	Cessnock (Heddon Greta)	Lake Macquarie
Land Acquisition	excludes GST	40,000	35,000	70,000
Stamp Duty		2,000	1,750	3,500
Council rates		600	525	1,050
Land Tax		453	397	793
Statutory fees - Council		375	295	300
Statutory fees - Hunter Water	Recycled water DSP	3,800	3,800	3,800
Consultant fees		3,000	2,360	2,400
Section 94 contributions		31,000	11,400	15,736
State Infrastructure Charges		8,000	8,000	8,000
Environmental offsets		2,000	4,000	2,000
Civil works - on site		75,000	59,000	60,000
Civil works - lead in		0	5,000	0
Marketing		2,500	2,500	2,500
Selling Costs	3.50%	7,400	5,900	6,700
Interest	9.00%	6,484	5,098	7,403
TOTAL COSTS		182,612	145,024	184,183
MEDIAN LAND PRICE	includes GST	210,000	169,000	190,000
Less: GST on sale price		-19,091	-15,364	-17,273
Less: Total Costs		-182,612	-145,024	-184,183
DEVELOPER PROFIT	excludes GST	8,297	8,612	-11,455
MARGIN ON COSTS (per cent)		4.5	5.9	-6.2
New house building cost		\$240,000	\$240,000	\$240,000
Final price for new house		\$450,000	\$409,000	\$430,000
Price escalation of 2% p.a.		\$9,000	\$8,180	\$8,600
Impacts of abolishing SIC and s94 Contributions				
Cost reduction		\$39,000	\$19,400	\$19,400
Years of static new house prices		4.3	2.4	2.4

Source: MacroPlan

3.2.2. Evaluation of the state infrastructure charge

Developers face additional state infrastructure charges for land that is rezoned for residential development. In the past, and at present, these charges have been determined by the State Government through complex and lengthy negotiations with developers on a project-by-project basis. This approach creates uncertainty about the value of financial contributions, and diminishes the likelihood that residential development will proceed in the Lower Hunter.

Developers may be interested in purchasing land to achieve a rezoning for residential development. However, land owners and developers may have different expectations about the magnitude of future infrastructure charges, as these charges are determined during the rezoning process.

This uncertainty makes it less likely that there will be agreement about land value, which reduces the probability that land sales and subsequent development, takes place.

This issue was discussed in the Henry Tax Review:

... where infrastructure charges are poorly administered — particularly where they are complex, non-transparent or set too high — they can discourage investment in housing, which can lower the overall supply of housing and raise its price.³⁶

When development approval is contingent on development charges of uncertain size, this can also add risk to projects and affect their viability. ... Where developer charges are set in an ad hoc fashion or are subject to unexpected changes, they can create uncertainty around new developments.³⁷

"In January 2011, the Department of Planning released the public consultation documents for a proposed levy on new homes in the Lower Hunter (said to be \$8,800 per lot). The Department is also proposing a \$42,100 levy on each hectare of new Lower Hunter industrial land."

In January 2011, the Department of Planning released the public consultation documents for a proposed levy on new homes in the Lower Hunter (said to be \$8,800 per lot). The Department is also proposing a \$42,100 levy on each hectare of new Lower Hunter industrial land.³⁸

However, the Urban Taskforce notes that the Department of Planning's "per lot" calculation assumes a yield of 12 lots per "net developable hectare". The Taskforce believes that the Department of Planning have erred in assuming that 12 lots can be generally realised per net developable hectare in the Lower Hunter. It is impossible to say with any accuracy what the correct yield is, because of the serious uncertainty in the definition of "net developable hectare". For instance, the inclusion of flood prone land suggests that the label "net developable hectare" is a misnomer, and in fact should be reference to "gross developable hectare". The figures are fictional,

³⁶ Commonwealth of Australia, *Australia's future tax system: Report to the Treasurer: December 2009*. Part Two: Detailed analysis (2010) 428.

³⁷ Ibid 426-427.

³⁸ The levy on "industrial land" will also be extended to many developments with non-industrial uses, such as premises for service related firms (e.g. lawyers, accountants, architects), motels, function centres, office premises, fast food outlets and retail premises, because the levies apply to the "Business Development" and "Business Park" zones and their equivalents.

because the definition of “net developable hectare” is, in truth, a definition of gross developable hectare.³⁹ It will end up including land that is not developable for reasons such as the presence of:

- acid sulphate soils (usually occurring in low-lying parts of coastal floodplains, rivers and creeks);
- bushfire hazard;
- steep slopes;
- soil subject to a high degree of erodibility and instability (for example, fine-grained sediment may be a problem on steep slopes near creek lines);
- wetlands;
- flood risk;
- archaeological sites;
- areas of scenic value;
- riparian corridors (a watercourse - which may only flow infrequently - and its vegetated buffer zone); and
- particular flora or fauna.

“To give one example: if actual yields in the Lower Hunter are six lots per “net developable hectare” the levy jumps from just under \$8,800 per lot to \$17,600 per lot.”

To give one example: if actual yields in the Lower Hunter are six lots per “net developable hectare” the levy jumps from just under \$8,800 per lot to \$17,600 per lot. This would make it more or less equal to the Western Sydney levy, but make up a much higher percentage of the final sale price (due to the lower land values in the region). In some instances, for example in the “large lot residential” zone, it is clear that the levy may easily range from \$5,000 to \$52,000 per lot.

The uncertain and arbitrary nature of the actual charge is compounded by the vagueness of the uses the charge is to be put to.

There is a broad-brush 25 year horizon for the Lower Hunter. No scope of works is presented or defined for named projects. Some descriptions are very generic, so it will be difficult to hold the government to account.

³⁹ According to the document, “net developable area” includes flood prone land located at or below the one in 100 average recurrence interval. Such flood prone land will only be excluded from a levy if the land is unsuitable for the relevant development by virtue of it being at or below that level. In planning law, the term “development” is a technical term with a very broad meaning. It covers a very wide range of activity and land uses that a layperson would not regard as “development”. Most flood prone land, in an urban development area, will be subject to some form of development when surrounding land is converted to urban uses. Additionally, the “subdivision of land” is in itself a form of development, irrespective of what the ultimate purpose of the subdivision is. So by definition, if flood prone land is included in a subdivision application, and the consent authority intends to approve the application, it can be safely said that it is not unsuitable for relevant development (i.e. the subdivision).

The government has disclosed how much of each infrastructure project it thinks should be recovered through levies, but it has not disclosed the full cost of many of these items. This means, in most cases, it's not possible to tell how the cost of the project has been apportioned between existing residents and new residents.

Financing costs have been built into the figures - apparently to take into account the fact that some infrastructure will be delivered prior to the receipt of levies. However no information has been presented as to which infrastructure has what financing component. Nothing is said about how much is to be borrowed, the applicable interest rate and the expected pay-back period, or anticipated take-up rates.

According to the Federal Treasury, infrastructure efficient infrastructure charges should satisfy the following tests:

- Demonstrate need and nexus. That is, only the infrastructure that a development 'needs' should be financed through developer charges and there should be a clear link between the need and the infrastructure that is provided; and
- Be accurate so that where infrastructure is needed, the charge equals its cost. Such a charge would not only accurately cover its real cost, but also be apportioned to ensure that the development is charged only for that portion of infrastructure that it demands (or is likely to use).⁴⁰

It seems unlikely that the infrastructure charge proposed for the Lower Hunter can satisfy these two basic principles, given the paucity of information that has been released to justify them. The Urban Taskforce made a freedom of information request to obtain more detail on the infrastructure to be funded, but this material was withheld on the ground of "cabinet-in-confidence".

In particular, given that there is no certainty that any infrastructure to be funded by a levy will be delivered in any particular timeframe, if at all, it is hard to see how it can be argued that the infrastructure funded through the levy is "needed" by the development.

Indeed the former NSW Government was proposing to fund \$81 million of its \$200 million contribution to the Hunter Expressway through these new levies. Yet this expressway has not led the government to increase the projected level of urban development in the region at all. That is, no additional urban development capacity has been possible by the expressway. (In any event the former state government announced and repeated its commitment to the Hunter Expressway on numerous occasions, but never previously revealed that new home buyers would actually be picking up the tab.)

If the infrastructure is truly needed, then the lack of certainty about delivery ensures that the proposed infrastructure charging regime fails the principle (articulated by the Commonwealth Treasury) that such charges should be set to provide certainty.⁴¹

⁴⁰ Address to the Council of Capital City Lord Mayors' Towards a National Urban Policy Summit 27 May 2010 by Dr Steven Kennedy, General Manager, Infrastructure, Competition and Consumer Division, Australian Treasury, <http://www.treasury.gov.au/documents/1818/HTML/docshell.asp?URL=Housing_Affordability.htm> at 18 March 2011. ³⁷ Ibid 426-427.

⁴¹ Ibid.

3.3. FEASIBILITY OF MEDIUM AND HIGH DENSITY HOUSING DEVELOPMENT

The regional strategy aims to raise the level of infill housing in the Lower Hunter. There is an expressed goal to

achieve higher residential densities in-and-around major centres to maximise proximity to employment and services and the use of existing infrastructure, while maintaining amenity ...⁴²

"Our analysis indicates that it is difficult to achieve feasible medium and high density housing projects in most parts of the Lower Hunter, due to the comparatively low prices that new apartments currently attain."

Our analysis indicates that it is difficult to achieve feasible medium and high density housing projects in most parts of the Lower Hunter, due to the comparatively low prices that new apartments currently attain.

In Newcastle, new two-bedroom apartments currently sell for about \$500,000 and three-bedroom apartments for \$650,000. Those prices equate to selling values of \$4,300 to \$4,500 per square metre. Taking out agent selling fees, the revenue expected is \$4,000 to \$4,200 per square metre.

Our analysis indicates that overall costs of delivery (including site acquisition, building costs, government charges and financing) are in the order of \$3,900 per square metre.

Given these estimates, developers would normally be unable to earn a sufficient return on their capital to justify their investment, and there would be significant risks of outright losses. Unless the selling prices for new units increase substantially, it is unlikely that there will be a substantial increase in the rate of medium and high density dwelling construction across the Lower Hunter.

There will be some premium developments, located near to beaches or with water views, which do not fit the basic feasibility assessment framework. These dwellings are more likely to be holiday homes that are not purchased as rental properties, and can achieve price premiums to standard infill projects as households pay for amenity value. However, they do not add to the supply of housing to accommodate population growth in the Lower Hunter.

"A meaningful strategy for the Lower Hunter would recognise the need for and allow holiday homes, but acknowledge that these dwellings do not contribute to additional housing to enable population growth."

A meaningful strategy for the Lower Hunter would recognise the need for and allow holiday homes, but acknowledge that these dwellings do not contribute to additional housing to enable population growth.

⁴² NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 6.

4. COMPARISON WITH FITZROY AND BARWON REGIONS

We can compare the recent housing supply track record in the Lower Hunter with those observed in the Fitzroy region in Queensland, and the Barwon region in Victoria.

We see that both of the Fitzroy and Barwon regions achieved a strong housing supply increase in response to high population growth over the past five years.

It is evident that the rate of population growth that has been sustained in the Fitzroy and Barwon regions was much higher than the Lower Hunter (over the five years to 2010). The flexible response from the residential development sector meant that housing supply improved, and this limited the upward pressure on residential rentals.

Reasonable affordability of residential lots has meant that housing supply responded quickly to rising demand. The ratio of land price to established house prices in both the Fitzroy and Barwon regions ranged between 50 per cent and 55 per cent over the five years to 2010.

In contrast, this ratio was above 60 per cent for most regions in the Lower Hunter during the same period. Poor affordability of residential lots has limited population growth in the Lower Hunter region, and created a considerable undersupply of housing as reflected in the enduring strength of rental growth.

4.1. TRENDS IN THE FITZROY REGION

“Over the five years to 2009, population growth in the Fitzroy region averaged 2.2 per cent per annum, which was far greater than growth in the Lower Hunter region.”

Over the five years to 2009, population growth in the Fitzroy region averaged 2.2 per cent per annum, which was far greater than growth in the Lower Hunter region.

Figure 28. Fitzroy statistical division population growth by age bracket, 2004 to 2009

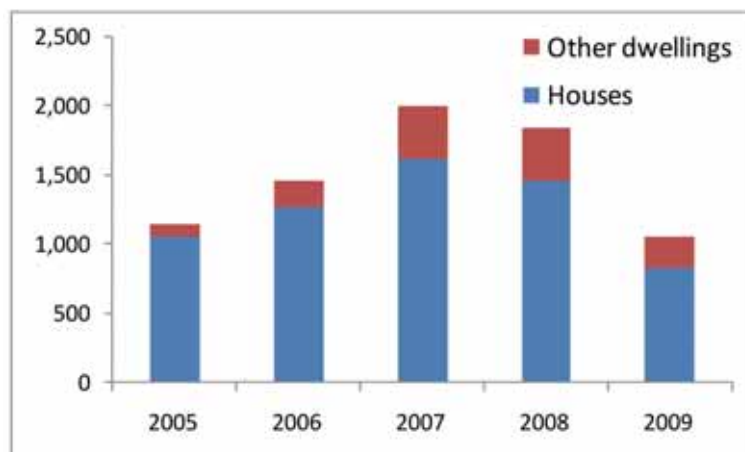
Age cohort	June 2004	June 2009	Annual growth per cent
Less than 20 years	61,509	67,069	1.7
20 to 34 years	40,733	45,549	2.3
35 to 49 years	44,914	49,206	1.8
50 to 64 years	32,498	38,090	3.2
65 years and more	20,604	23,780	2.9
Total	200,258	223,694	2.2

Source: MacroPlan, ABS

Strong population growth translated into high rates of demand for new dwellings. Approvals were very strong from 2005/06 to 2007/08. The number of approvals in 2006/07 was almost twice the level in 2004/05.

There was a substantial downturn in dwelling approvals during 2008/09, following the global financial crisis, and cautious sentiment regarding the prospects for the mining sector.

Figure 29. Dwelling approvals in the Fitzroy region

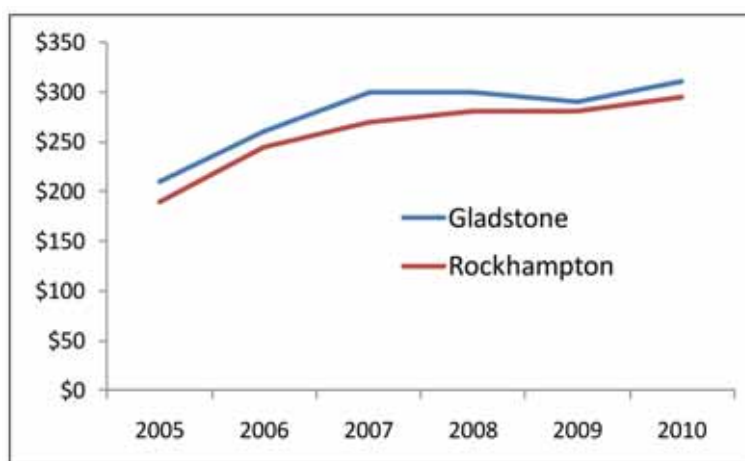


Source: MacroPlan, ABS

High rates of construction during this period helped to alleviate considerable pressure on the rental market, which had emerged in 2006 and 2007. By the end of 2007, rentals for three-bedroom houses were 40 per cent higher than they were just two years earlier.

However, the boom in residential construction enabled a rising supply of rental properties, and the upward pressure on rentals eased. Rentals have been close to steady for the past three years.

Figure 30. Median rentals for three-bedroom houses

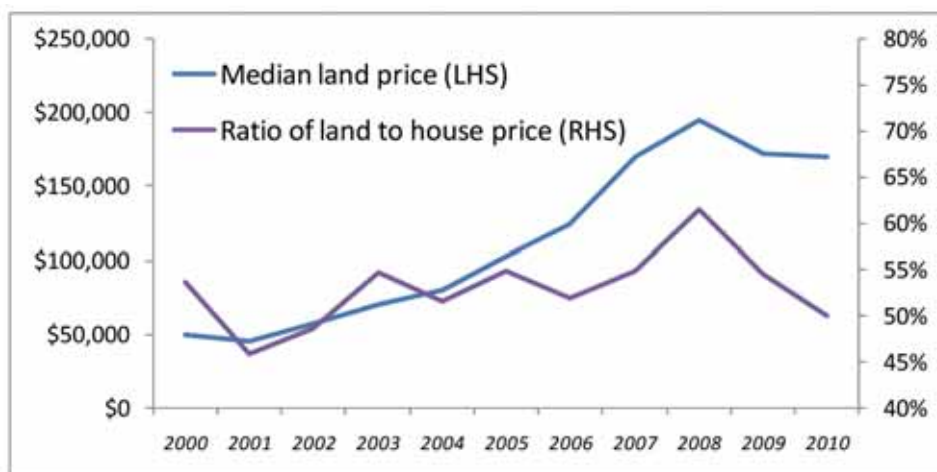


Source: Queensland Residential Tenancies Authority

The data indicates that there was a healthy supply response to high population growth in the Fitzroy region. Demand for new dwellings was very strong because the relativity between prices of established houses and new houses did not shift greatly over the period.

The chart below shows that the median price for residential lots has been about \$175,000 over the past four years, with the exception of 2008 when the median peaked at close to \$200,000. The ratio of land to established house price has ranged between 50 per cent and 55 per cent for most of the past decade, temporarily reaching 60 per cent in 2008.

Figure 31. Median land price for combined Rockhampton and Gladstone regions, and land to house price ratio



Source: RP Data, MacroPlan

4.2. COMPARISON WITH BARWON REGION IN VICTORIA

Comparing the housing supply in the Lower Hunter with that observed in the Barwon region (in Victoria's south west), we notice that the Barwon region achieved a positive housing supply response to population growth. The Barwon region includes Geelong - Victoria's second largest city.

Employment in the Barwon region has traditionally been supported by manufacturing-based industry. However, employment growth in Barwon has recently stemmed from the service-based sector.

The main draw card for the Barwon region is cheaper land relative to Melbourne. In addition, accessibility to Melbourne from Barwon is reasonable, which provides an additional source of demand. These advantages have facilitated strong population growth into the region. Given that they are anticipated to persist, solid population growth is expected over the immediate future.

"Over the five years to 2009, population growth in the Barwon region exceeded that registered in the Lower Hunter region, averaging 1.7 per cent per annum."

Over the five years to 2009, population growth in the Barwon region exceeded that registered in the Lower Hunter region, averaging 1.7 per cent per annum.

Figure 32. Barwon statistical division population growth by age bracket, 2004 to 2009

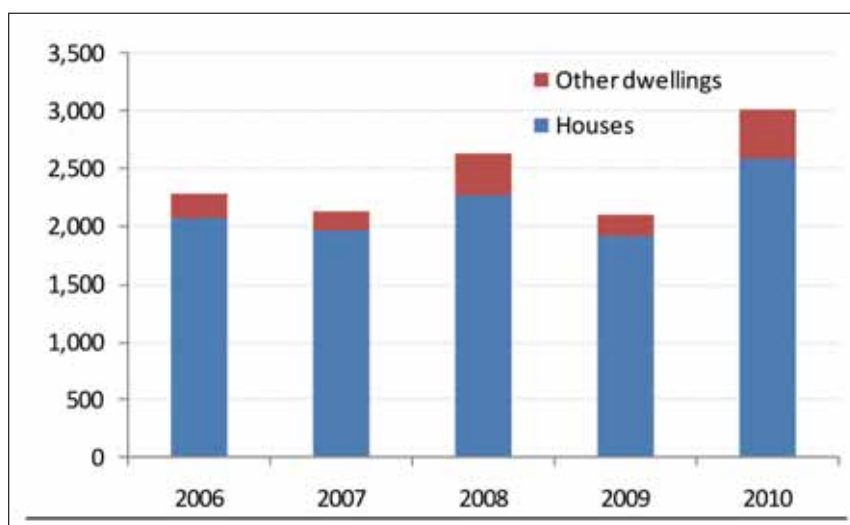
Age cohort	June 2005	June 2009	Annual growth per cent
Less than 20 years	70,869	73,776	1.0
20 to 34 years	49,637	53,140	1.7
35 to 49 years	56,970	59,318	1.0
50 to 64 years	47,837	53,996	3.1
65 years and more	40,960	44,866	2.3
Total	266,273	285,096	1.7

Source: MacroPlan, ABS

A combination of strong population growth and housing affordability in Barwon supported high underlying demand for new dwellings. Residential construction activity responded, with the number of residential approvals averaging 2,383 per annum over the five years to 2008/09.

Consistent with that observed in Fitzroy and the Lower Hunter, there was a correction in dwelling approvals during 2008/09. Although not exposed to the mining sector, the global financial crisis weakened household sentiment, which resulted in reduced residential building activity.

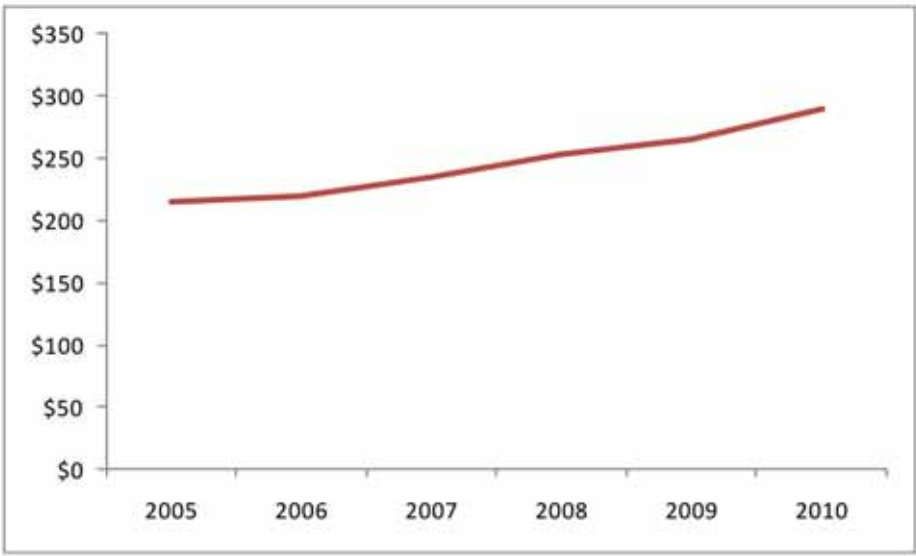
Figure 33. Dwelling approvals in the Barwon region



Source: MacroPlan, ABS

In keeping with a higher rate of population growth, strong residential supply has facilitated growth in the rental stock. This has managed to limit rent growth within the region. Median rentals for the region are shown in the chart below.

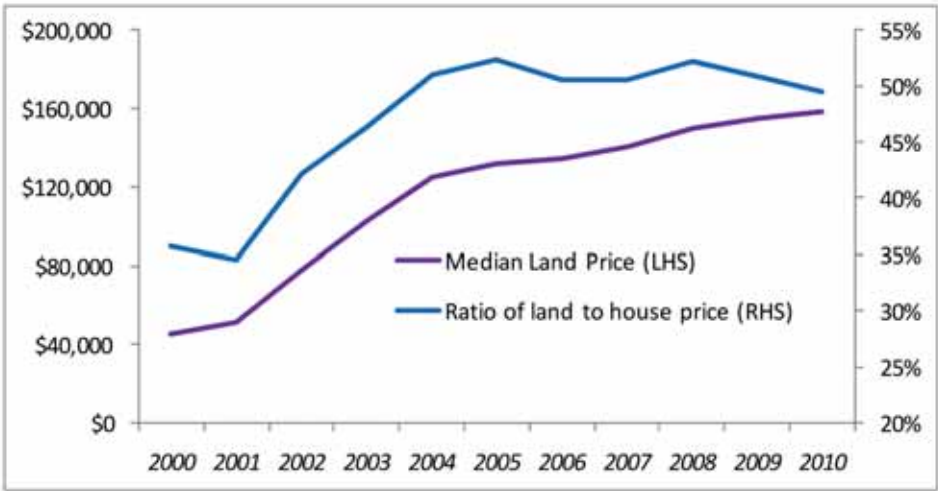
Figure 34. Median rentals for three-bedroom houses



Source: Victoria Office of Housing

The chart below shows that the median price for residential lots has ranged between \$140,000 and \$158,000 over the past four years, which is significantly less than registered in both the Lower Hunter and Fitzroy region (Gladstone and Rockhampton). The ratio of land to established house price has increased to about 50 per cent, but still remains at a price level that is supportive of housing demand and population growth.

Figure 35. Median land price for Greater Geelong City, and land to house price ratio



Source: Valuer-General Victoria, MacroPlan

5. HUNTER IS THE POTENTIAL ENGINE FOR THE NSW ECONOMY

Based on projects underway, and those in the planning process, there is a substantial expansion in potential engineering construction work in the Hunter. By 2014, the Hunter is expected to account for about 30 per cent of total engineering construction work in NSW, up from about 18 per cent in 2010.

Much of the prospective construction work is directly or indirectly targeted towards expansion of coal production. We project that the potential increase in coal production would increase state government royalties by almost \$600 million per annum (over the productive life of the projects). Hence, there is very considerable revenue at stake.

“The planned boom in engineering construction will only be achievable if the required workforce becomes available – and that will require a substantial migration of workers and families to the Lower Hunter region.”

The planned boom in engineering construction will only be achievable if the required workforce becomes available – and that will require a substantial migration of workers and families to the Lower Hunter region. Our analysis indicates that the engineering construction workforce would need to be increased by 1,500 persons per annum from 2011 to 2015, in order to enable the planned project pipeline. In turn, there will need to be a sharp increase in the demand for new dwellings in order to sustain higher population growth.

The following section explores these issues.

5.1. HUNTER REGION'S INDUSTRY PROFILE

Major employment industries in the Hunter Region include coal mining, wine, energy, agribusiness, equine and tourism.⁴³ The region has enjoyed strong employment growth. Monthly employment figures from the ABS show that in December quarter 2010, there were 332,000 persons employed in the Hunter Region, of which 84 per cent resided in the Lower Hunter. The unemployment rate across the Hunter region was 4.5 per cent in December quarter 2010 compared to 4.9 per cent in New South Wales and 5.0 per cent in the national economy.

As at December quarter 2010, the Hunter Region employment accounts for 9.2 per cent of the total employment of New South Wales and 2.9 per cent of Australia's employment.

The region also has a significant small to medium business concentration. In 2006, there were over 43,000 businesses in the Hunter statistical division with 55 per cent non-employing businesses, 27 per cent of businesses with 1-4 employees and 18 per cent with 5 or more employees.

⁴³ James Naylor, *Lower Hunter Transport Needs Study* (2009) 17-18.

Other key economic features of the Hunter are:

- The Hunter has the world's largest coal exporting port and produced 32 per cent of New South Wales' exports valued at \$10.3 b in 2007/08.
- The Hunter has a wealth of natural and man-made attributes, a diverse economy and a regional centre at Newcastle.
- The Hunter Region provides 33 per cent of Australia's aluminium production, generates 65 per cent of New South Wales electricity, is blessed with world famous vineyards and has an equine industry of international standing.
- The Hunter is Australia's oldest wine growing area, and amongst the largest; this attracts a significant influx of tourists, assisted by its close proximity to Sydney as an international destination.
- The Lower Hunter is strategically positioned for logistics management, being at the confluence of north, south, north-west and central-west road and rail corridors. Combined with nearby sea port facilities, the Lower Hunter offers significant potential to serve a major freight management function for the State of NSW and more broadly the eastern sea board of Australia.⁴⁴

5.2. PROSPECTS FOR JOB GROWTH

"As the second most populous region in NSW and Australia's biggest regional market, the Hunter offers significant economic advantages for industry."

As the second most populous region in NSW and Australia's biggest regional market, the Hunter offers significant economic advantages for industry. Its proximity to Sydney gives it an ease of access to the leading consumer and jobs market within Australia. The region's rail, air and sea transport network is relatively uncongested and there are significant landholdings that can be made available for employment uses.

The region is already home to the world's largest coal export port, sophisticated telecommunications services, a leading University, and high quality TAFE and education facilities.⁴⁵

All of the local government areas of Newcastle have been identified by the Federal government as one of 20 national "priority employment regions".⁴⁶

NSW Government planning documents paint a positive future for job growth and industry development in the Hunter. Sectors identified for likely employment growth include:

- port-related industry on landside Port of Newcastle

⁴⁴ Ibid.

⁴⁵ <<http://www.business.nsw.gov.au/invest-in-nsw/regional-nsw/nsw-regions/hunter>> at 31 January 2011.

⁴⁶ Australian Government, *Our Cities: The Challenge of Change: Background and Research Paper 2010* (2010) 105.

- airport-related industry;
- transport and logistics;
- alternative energy;
- defence;
- coal industry (expansion in the Upper Hunter and the Gunnedah Basin);
- green industries, such as clean coal technologies;
- research;
- tourism (growth in the cruise and resort sectors); and
- coal seam gas development.⁴⁷

The NSW Government's 2003 Ports Growth Plan stipulates that the former BHP steelworks site at Newcastle Port, known as the "Intertrade Development", will be the State's next major container facility when Port Botany reaches capacity. At current growth rates this capacity will be reached by 2020 to 2025 (noting that Sydney Ports Corporation revised this estimate in its 2006/07 Annual Report and if current growth rates are maintained, the three million twenty-foot equivalent unit threshold could be reached in 2017).⁴⁸

The implications of the State's Port Growth Plan were considered in the Freight Hub Hunter study.⁴⁹ This study concluded that container trade at Newcastle would need to commence well in advance of the time when Port Botany reaches its notional capacity of three million "twenty-foot equivalent" (TEU) per annum to ensure that the State's container trade capacity is positioned to deal with ongoing growth.⁵⁰

It is anticipated that the Intertrade site will cater for start-up container trade, but once its capacity is reached, there will be a need to move containers to any potential freight hub for processing, storage and trans-shipment.

The Freight Hub Hunter study stated that by 2021 it is possible that 230,000 TEU could move through Newcastle. This number is forecast to grow to around 750,000 TEU by 2031 by which time Newcastle will be taking up all the growth in the NSW container market, Port Botany having reached capacity.

The scope of mining and civil infrastructure projects being planned for the Hunter region is enormous. This expansion promises to lead to strong employment growth in the Lower Hunter, and it would make a very large contribution to state government royalties on coal production.

⁴⁷ NSW Government, *State plan: Supporting Business and Jobs Hunter region – Regional Business Growth Plan* (2010) 2.

⁴⁸ James Naylor, *Lower Hunter Transport Needs Study* (2009) 34-35.

⁴⁹ The Freight Hub Hunter Report was initiated as a result of the Lower Hunter Regional Strategy. The Report was prepared for Department of Premier and Cabinet Hunter, Hunter Economic Development Corporation, Dept of Planning, Department of State and Regional Development and Newcastle Port Corporation to investigate the demand for a freight hub over the next 25 years and the infrastructure required to support the Hub. <http://www.dpc.nsw.gov.au/publications/news/stories/?a=34380> at 1 February 2011.

⁵⁰ TEU is a widely used measure of container capacity.

However, achieving these potential gains will require a huge rebound in the supply of new dwellings, because the rental markets are already very tight. Rising rentals will increase housing stress, and it may also diminish migration movements by workers to the Lower Hunter, which would damage the feasibility of new coal mine projects and thereby reduce mining royalties.

5.3. MAJOR CONSTRUCTION PROJECTS UNDERWAY

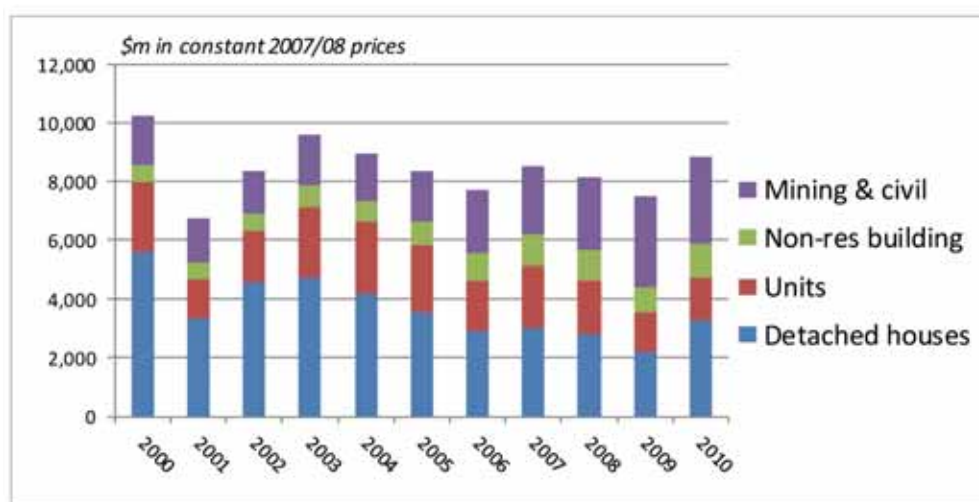
Over the past decade, there has been no expansion in construction activity in the Hunter region. A downturn in residential building developed from 2004 to 2009. However, there has been a clear offset from growth in engineering construction (mining and civil work projects).

Across NSW, there is already a strong upturn underway in mining construction. The figure below shows a surge in mining capital expenditure over the past year.

“Based on planned projects, the pipeline of mining construction in the Hunter is set to expand substantially over the next five years.”

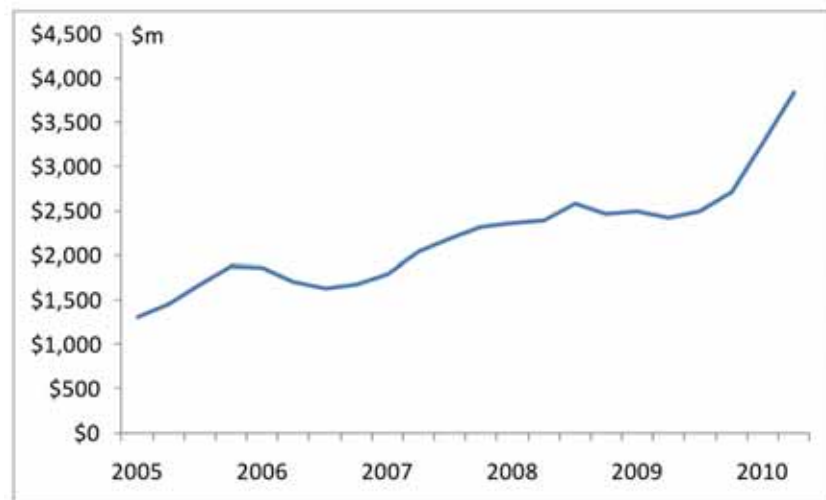
Most of the NSW coal mining projects currently underway are located outside the Hunter region. Based on planned projects, the pipeline of mining construction in the Hunter is set to expand substantially over the next five years.

Figure 36. Construction activity by sector, Hunter region



Source: ABS, MacroPlan

Figure 37. Mining capital expenditure, NSW

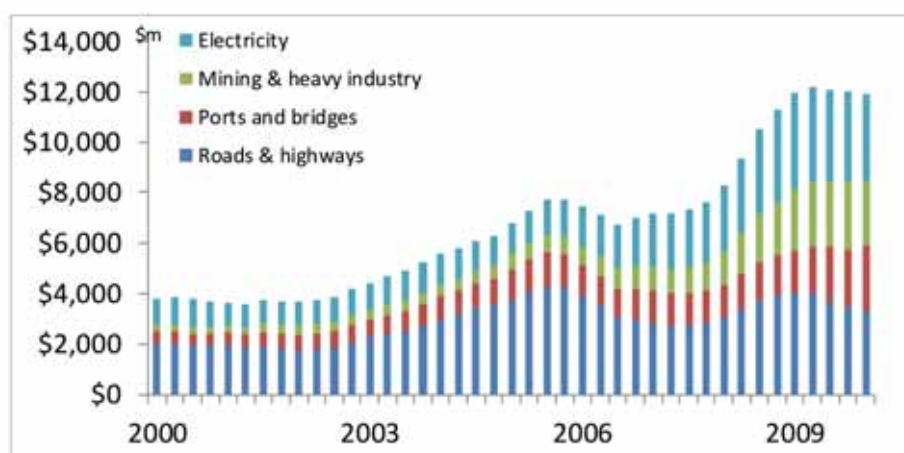


Source: ABS, MacroPlan

"The state's largest road project is the Hunter Expressway,
which is located in the Lower Hunter."

While mining construction is expanding, there is a downturn underway in other engineering construction sectors in NSW. In particular, road construction is now declining, as there are no major motorway or toll road projects underway in Sydney. The state's largest road project is the Hunter Expressway, which is located in the Lower Hunter.

Figure 38. Engineering construction capital expenditure, NSW, moving annual total value



Source: ABS, MacroPlan

5.4. PROJECTS BEING EVALUATED AND PLANNED

“By 2014, the Hunter is expected to account for about 30 per cent of total engineering construction work in NSW, up from about 18 per cent in 2010.”

Based on projects underway, and those in the planning process, there is a substantial expansion in potential engineering construction work in the Hunter. By 2014, the Hunter is expected to account for about 30 per cent of total engineering construction work in NSW, up from about 18 per cent in 2010.

Major investments are almost certain to occur in the form of Port Waratah expansion (\$880 million) and the Newcastle Coal Infrastructure Group plans to extend its new terminal (further \$1 billion).

Mine development projects will also proceed. The largest project over the next few years will be the Anvill Hill open cut mine at Mangoola (\$825 million) being undertaken by Xstrata.

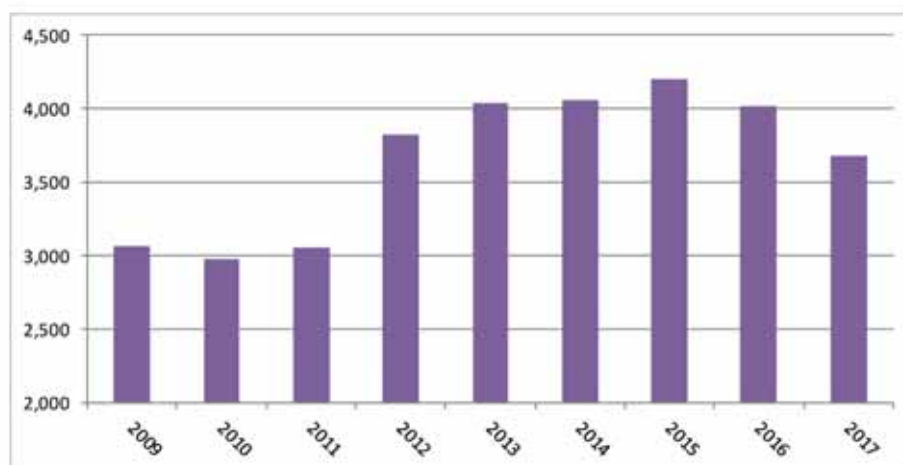
These four projects represent a total of about \$3.5 billion in engineering construction work, with a large majority to be completed over the next five years.

In addition, there are the following major projects underway or planned.

- Ausgrid (formerly Energy Australia): huge pipeline of project works to be undertake over the next five years;
- Hunter Expressway, highway project from Seahampton to Branxton;
- Department of Defence: barracks projects at Singleton and new RAAF Joint Strike Force facilities at Williamstown; and
- Port of Newcastle: potential intermodal terminal supporting Intertrade port redevelopment now underway.

Taking these major projects together, we project that the potential value of engineering construction in the Hunter region will rise by \$1 billion by 2013, and stabilise at that level until 2016. That volume of activity would require a substantial expansion of the construction workforce in the Hunter in order to achieve the private sector and public sector plans.

Figure 39. Projected potential engineering construction in the Hunter region (\$m in constant 2007/08 prices)



Source: ABS, Cordells, MacroPlan

5.5. POTENTIAL INCREASE IN STATE GOVERNMENT MINING ROYALTIES

Coal mining has become a major source of revenue for the New South Wales government.

"In 2009/10, the state government earned about \$1 billion in royalties from coal mining."

In 2009/10, the state government earned about \$1 billion in royalties from coal mining. Royalties in NSW are now calculated on a volume and value of production basis (prior to 2008, royalties were only levied on the volume of production). Revenues equated to about \$8 per tonne of saleable coal production.

Figure 40. NSW State Government royalties from coal mining

NSW	\$M	\$ per tonnes (saleable)
2008/09	1,200	8.8
2009/10	1,000	7.4

Source: New South Wales Treasury, MacroPlan

Figure 41. Saleable black coal production by state (million tonnes)

	2007-08	2008-09
NSW	135	136
Qld	181	186
S.A.	4	4
W.A.	6	7
Tas	1	1
Australia	327	334

Source: New South Wales Treasury, MacroPlan

Coal mine construction projects currently planned in the Hunter promise to raise coal production by about 76 million tonnes per annum in 5 to 7 years time.

Figure 42. New coal mining projects in the Hunter

Major projects	Million tonnes per annum
Approved	8
Yet to be approved	68

Source: ABARE, MacroPlan

Setting aside potential increases in coal prices, that volume of production would increase state government royalties by almost \$600 million per annum (over the productive life of the projects). This potential royalty revenue is far greater than the likely revenues from section 94 contributions and state infrastructure charges on dwelling construction. For 3,000 dwellings in the Hunter, with a range of \$10,000 to \$20,000 in section 94 and state infrastructure contribution charges, the aggregate revenue per annum would be in the range of \$30 million to \$60 million.

This comparison indicates that enabling housing supply in the Lower Hunter promises a huge return for the NSW government in terms of mining royalties. However, housing supply in the Hunter may prove to be a bottleneck for labour supply. The next section shows that this risk is very real and apparent.

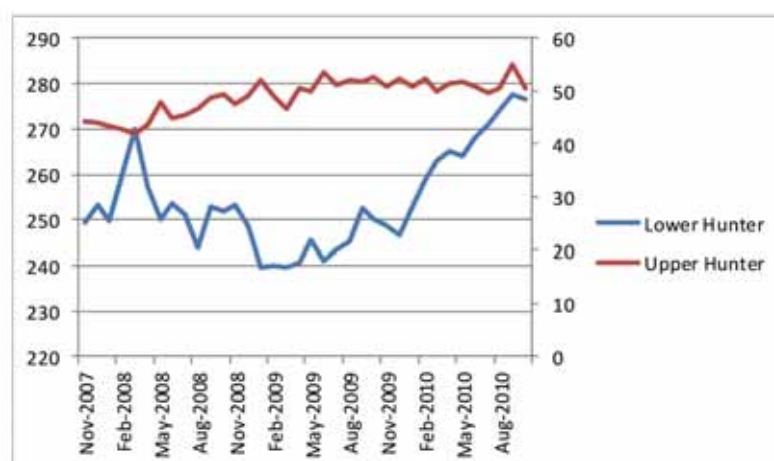
5.6. REQUIRED RISE IN REGIONAL WORKFORCE AND MIGRATION INFLOW

“The planned boom in engineering construction will only be achievable if the required workforce becomes available – and that will require a substantial migration of workers and families to the Lower Hunter region.”

The planned boom in engineering construction will only be achievable if the required workforce becomes available – and that will require a substantial migration of workers and families to the Lower Hunter region.

Total employment in the Lower Hunter is currently 277,000 persons, and the unemployment rate was very low at 4.7 per cent over the second half of 2010. Aggregate construction sector employment in the region is estimated at about 25,000 people. There is unlikely to be many unemployed persons living in the Lower Hunter who would be employable for major construction projects, so the planned expansion of engineering construction work will require migration of workers from Sydney, other states or from overseas.

Figure 43. Employment in the Hunter regions, '000 persons



Source: ABS, MacroPlan

5.7. COMPETITION WITH OTHER REGIONS FOR WORKERS

The potential construction boom in the Hunter region is not a foregone conclusion. It will depend on the ability for project managers to secure a workforce that is suitable, and at wages that do not undermine project feasibilities.

The problem is that there is an enormous pipeline of planned mining construction projects across Australia. The figure below shows the latest capital expenditure planned for the national mining sector and the total for 2010/11 is close to \$45 billion on building and structures (i.e. excluding equipment). That outcome compares to the actual outcome of \$26 billion in 2009/10, so a rise of about \$19 billion is being planned for 2010/11.

Figure 44. National expenditure on mining construction (\$m)



Source: ABS, MacroPlan

The expansion in value of coal mining projects in the Hunter represents only a small proportion of the national total growth, in the range of 3 per cent to 5 per cent. So it is clear that the engineering work in the Hunter is far from being the 'only show in town'. Australia's mining construction phase is gearing to a new level over the next three years.

Consequently, there will be intense competition for workers to enable projects to be undertaken, both in terms of timing and within cost parameters. Our view is that the LNG construction and iron ore mining projects currently have advantages in terms of their overall profitability and scale. Construction contractors for those projects will be better placed to attract workers, both in terms of the longevity of contracts, and in their capacity to offer pay increases.

“The primary advantage for construction projects in the Hunter is that the living arrangements and community environment are likely to be superior to those in remote locations in Western Australia and Queensland.”

The primary advantage for construction projects in the Hunter is that the living arrangements and community environment are likely to be superior to those in remote locations in Western Australia and Queensland. Almost all of the major projects in the Hunter are within commuting distance of the Lower Hunter, so the work and life balance would be much more manageable, compared to fly-in fly-out conditions for remote projects.

The recent experience in Western Australia has shown that construction workers in the eastern states are loath to migrate to Perth for work. Overseas migration was the primary source of construction workforce over the past five years.

However, that period was marked by strong upturns in construction in the eastern capital cities, through commercial building and road projects. Over the next three years, job security in the construction sector in the capital cities will be more tenuous, due to lower rates of non-residential building and road construction. There is likely to be more movement by construction workers from the eastern capitals to mining construction projects.

The Hunter region is in a position to offer a far better work-life balance, but it is unclear how much offset there will be from relatively lower wages compared to projects in Western Australia and northern Queensland.

“A major part of that equation will be the cost of rental housing in the Lower Hunter, because housing costs currently represent a large proportion of after-tax income.”

A major part of that equation will be the cost of rental housing in the Lower Hunter, because housing costs currently represent a large proportion of after-tax income.

Our analysis indicates that the engineering construction workforce would need to be increased by 1,500 persons per annum from 2011 to 2015, in order to enable the planned project pipeline.

That level of increase would make no allowance for any rise in the rate of building activity (residential or non-residential building).

Figure 45. National expenditure on mining construction (\$m)

Additional demand - engineering construction		
Mining construction	750	workers per annum
Other civil projects	750	workers per annum
Total	1,500	per annum

6. PROJECTED POPULATION GROWTH AND UNDERLYING DEMAND

The very substantial pipeline of potential construction work should lead to an increase in migration of construction workers to the Hunter region. Based on the construction project pipeline, we forecast that underlying demand for new dwellings would be about 4,500 per annum over the decade to 2020.

To achieve net supply of 4,500 dwellings per annum, we think that the appropriate target for new release areas is about 80 percent or 3,600 per annum. Infill projects would account for about net supply of 900 dwellings per annum. The capacity to achieve this population gain will be defined by housing affordability.

In the absence of a large expansion in dwelling construction, it seems inevitable that rental growth in the Lower Hunter will remain very high over the next five years. We predict a continued rate of 10 per cent growth in rentals per annum for these regions.

This rise in rental costs would be expected to place upward pressure on worker demands for wages for jobs in the Hunter. It is likely that the least profitable mining construction projects (those with marginal feasibility) would be substantially affected, and some would be deferred or cancelled due to labour costs. That outcome would reduce the potential mining royalties from coal production.

The following section explores these issues.

6.1. ESTIMATION OF UNDERLYING DEMAND FOR NEW DWELLINGS

The strategy contains specific targets for new dwellings, and discusses the sources of underlying demand. A distinction is made between new housing for population growth, and new dwellings that are required to meet changing household demand:

The Lower Hunter currently has approximately 205 000 dwellings. It is estimated that an additional 115 000 dwellings will be required to house the Region's growing population over the next 25 years. Of this number, 80 000 dwellings will be required to house the additional population (160 000 people), while an extra 35 000 dwellings will be required to meet changing housing demands. These changing demands include a reduced occupancy rate, predicted to continue to decline from 2.5 persons per dwelling in 2001 to 2.1 persons per dwelling in 2031. This trend toward smaller households is consistent with national and global trends.⁵¹

Based on the Strategy projections, the ratio of additional population to additional dwellings is just 1.4 times (i.e. each new dwelling supports population growth of 1.4 people). A large proportion of the projected dwelling requirement is for change in the composition of households – presumably focusing on the ageing population, and related retiree demand for medium and high density dwellings. This interpretation would be consistent with the substantial weighting in target numbers towards infill housing, expected to account for 40 per cent of all net additions to the stock.

⁵¹ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 23.

The problem is that the average number of persons per dwelling has almost certainly increased since the data recorded for the 2006 Census. The region's rental vacancy rate has fallen to very tight levels, and there has been much greater occupation of the rental housing, both in terms of vacant properties and empty rooms within occupied properties.

In our analysis and forecasts, we focus on the housing requirements for population growth, rather than the dwellings required to fit with changing household structures. This focus is warranted because there has clearly been an inability to cope with population growth, and this problem should be the primary focus for government policy.

Rather than a ratio of population increase to new dwellings of 1.4 times, we have used a ratio of 1.8 times for estimation and projections of underlying demand (that is, each new dwelling supports population growth of 1.8 people). This higher ratio generates a smaller need for new dwellings, when compared with the corresponding metric in the Lower Hunter Regional Strategy. Under either figure, the recent rate of housing supply has been far lower than underlying demand, so the analysis still points to very large housing shortages.

The expected sources of demand for new housing do have implications for the building types, in terms of detached houses and medium and high density dwellings. There is a related implication for the mix between greenfields and infill housing. The Strategy projections assume that about 30 per cent of all new dwellings are required to meet changing household demands (rather than enable population growth). Accordingly, the Strategy holds that a substantial 40 per cent of all new dwellings would be supplied through infill projects. New medium and high density housing, achieved through infill projects, would tend to meet the needs of empty nesters and retirees.

It is difficult to be too definite about the connection between household formation and demand for new dwellings of specific types in specific locations. The primary problem has been the overall rate of net supply – more dwellings of all types appear to be needed.

We think that the Strategy should focus on the net supply of dwellings to support population growth, rather than addressing changing housing demands. Across Australia over the five years to 2010, detached houses have accounted for about 70 per cent of all dwelling approvals. Excluding the capital cities, the ratio is closer to 80 per cent. It is more difficult to achieve financial feasibility for new medium and high density dwellings in regional areas, because prices for established units tend to be relatively low. We discuss this issue further in a subsequent section.

Overall, we think that detached houses should account for about 80 per cent of all new dwellings in the Lower Hunter. With most of these dwellings being located in new release areas, this percentage is also a reasonable target for the contribution of new release areas. By implication, infill housing projects would then be expected to account for about 20 per cent of the net supply. However, a Regional Strategy that caters to a range of scenarios for the mix of new dwellings remains desirable.

6.2. PROJECTIONS OF POPULATION GROWTH AND UNDERLYING DEMAND

The Regional Strategy goals implied that 4,600 dwellings per annum would be required as an average annual rate of supply, to meet the needs of an additional 6,400 persons per annum. Yet the strategy sold the region short. Over the five years to June 2010, the average annual population increase was above the Strategy target, with an average rise of 6,800 persons per annum.

A jump in the numbers of overseas students was a key driver for the high rate of population growth. We estimate that the increase in student numbers contributed about 1,000 persons per annum from 2007 to 2009. Going forward, we expect that this source of population growth will moderate, and reduce the annual population increase by about 1,000 per annum.

“However, the boom in engineering construction will create a further wave of population gain in the Lower Hunter, as this cycle will require inwards migration of workers from Sydney, interstate and overseas.”

However, the boom in engineering construction will create a further wave of population gain in the Lower Hunter, as this cycle will require inwards migration of workers from Sydney, interstate and overseas. We project an additional 1,500 workers per annum would be required to meet the projects planned for the next five years. Some of these workers will bring families to the Lower Hunter, so the population impact would be greater. An expected rise of about 2,000 persons per annum is projected, directly related to the potential construction upturn.

The net effect of lower student numbers and a rising construction workforce is expected to be positive, and would lead to higher potential population increase. The potential average annual population gain can be expected to rise to 7,500 persons per annum over the next decade, in order to enable the upturn in the region’s economic cycle. This is equivalent to a 1.4 per cent a year annual increase.

It seems unlikely that the rental market can actually enable this rate of population growth, which we discuss in the following sections. Consequently, a shift to higher population growth will be dependent on a much higher rate of dwelling supply. In turn, it seems unlikely that the existing structures for enabling residential development will allow for this to happen. Some major reforms to the development process would be required.

“In the event that the status quo for residential development remains in place, then the region’s potential population growth will be circumscribed.”

In the event that the status quo for residential development remains in place, then the region’s potential population growth will be circumscribed. We should allow for some increase in demand for new dwellings, given that the relative affordability of new lots has improved over the past three years. We think that net supply can increase to 2,700 per annum, up from 2,000 per annum over the 2005-2010 period. An average of about 5,000 persons per annum would be supported by these 2,700 new dwellings.

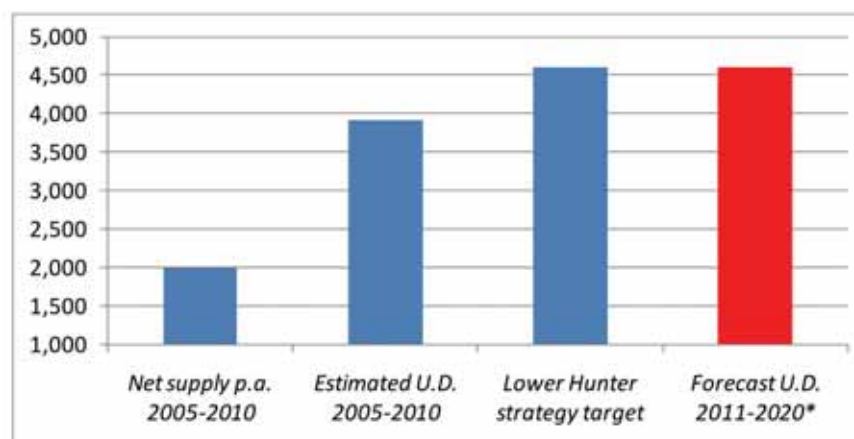
However, there is not expected to be any scope to accommodate population growth through rental properties, as the rental market is extremely tight. Overall, we think that population growth will be limited to about 5,000 persons per annum, down from the actual average of 6,800 observed over the five years to 2010.

Figure 46. Projected population growth in the Lower Hunter region

Lower Hunter Strategy target per annum	6,400	1.3%
Actual 2005 – 2010 per annum	6,800	1.3%
New dwellings	3,600	
Existing rental housing	3,200	
Projected population growth: reform to residential development process		
2010 - 2020	7,500	1.4%
Projected population growth: status quo for residential development process		
2010 - 2020	5,000	0.9%

source: ABS, MacroPlan

Figure 47. Actual dwelling supply, and estimates of past and future underlying demand for new dwellings



*Underlying demand for 2011-2020 based on planned construction projects in the Hunter region

Note: Net supply and underlying demand relate to actual increase in the dwelling stock to sustain local population growth (ie new dwellings constructed, less holiday homes and demolitions)

Source: MacroPlan, New South Wales Department of Planning

The very substantial pipeline of potential construction work should lead to an increase in migration of construction workers to the Hunter region. Based on the construction project pipeline, we forecast that underlying demand for new dwellings would be about 4,500 per annum over the decade to 2020.

To achieve net supply of 4,500 dwellings per annum, we think that an appropriate target for new release areas is about 80 percent or 3,600 per annum. Infill projects would account for a net supply of about 900 dwellings per annum. The capacity to absorb this population gain will be defined by housing affordability.

Having said this, we also note that a future Regional Strategy should also take note of the Productivity Commission's recommendation that land use plans should cater to multiple scenarios,⁵² this would include:

- higher than anticipated population growth;

⁵² Australian Bureau of Statistics, 3222.0 - Population Projections, Australia, 2006 to 2011(2008) <www.abs.gov.au/Ausstats/abs@.nsf/mf/3222.0> at 12 June 2011.

- a lower than anticipated number of persons living in each dwelling; and
- a higher than anticipated demand for more compact housing.

Additionally, such target numbers are intended to reflect new homes actually built and acquired by their end user. The regulatory system should aim to serve up much higher development capacity than any given target suggests; in order to create competitive tension between land owners (see the later section on this issue).

If residential cost structures remain consistent with current levels, then there would need to be a substantial increase in overall property prices to improve developer project feasibilities. However, this outcome would dampen population growth, because it involves deterioration in the affordability of established housing. This trend would be particularly adverse for potential first home buyers, who tend to enter the housing market through the purchase of older properties.

In addition, further strong growth in residential rentals will be an enduring feature of the residential market. Some lower wage or fixed income households will be forced to move elsewhere in NSW, in order to access more affordable rental housing. These movements will dampen overall population growth in the Lower Hunter region.

It is important to note that over the past five years a large proportion of population growth occurred through more intensive use of the existing rental stock. There is now limited scope for this method of sustaining population growth.

"If there is a substantial improvement in the financial feasibility of residential development, then the Lower Hunter region can sustain the higher population growth. This does not necessarily mean more people coming to the Lower Hunter from other regions; in fact, more significantly, it may mean that people, including lower income people, who would otherwise have been forced to leave the region may stay."

If there is a substantial improvement in the financial feasibility of residential development, then the Lower Hunter region can sustain the higher population growth. This does not necessarily mean more people coming to the Lower Hunter from other regions; in fact, more significantly, it may mean that people, including lower income people, who would otherwise have been forced to leave the region may stay.

Our analysis indicates that an annual population increase of about 7,500 persons per annum would be a reasonable target for the next ten years, given the economic potential of the Lower Hunter region.

However, a material improvement in the feasibility of residential development will be required. A decrease in median lot prices would substantially improve the relativity between new houses and established properties. The ratio of the median land price to median house price would be reduced from around 50 per cent to 45 per cent, and would make this ratio more comparable to the levels observed in western Sydney.

6.3. HIGHER GROWTH ALTERNATIVE SCENARIOS

As the Australian Bureau of Statistics observes:

[Population] projections are not predictions or forecasts, but are simply illustrations of the growth and change in population which would occur if certain assumptions about future levels of fertility, mortality, internal migration and overseas migration were to prevail over the projection period.⁵³

While this report suggests an annual population growth of 7,500 persons (1.4 per cent) per annum, there is a strong possibility that growth may need to exceed this number.

The Productivity Commission recommends that any planning strategy should contemplate the possibility of, and provide for higher levels of population growth.⁵⁴

“It is impossible to ignore the fact that many other key regional areas across Australia have been experiencing annual growth far in excess of that currently projected for the Lower Hunter.”

It is impossible to ignore the fact that many other key regional areas across Australia have been experiencing annual growth far in excess of that currently projected for the Lower Hunter - levels of growth consistent with the recent performance of other major regional communities such as Barwon (1.7 per cent) Toowoomba (1.9 per cent), Sunshine Coast (3.1 per cent) Townsville (3.2 per cent).

If the Lower Hunter were to enjoy the robust population growth enjoyed by other regional areas, then the underlying demand for new dwellings would obviously be far higher than the recent historical experience. The table below shows scenarios for population gains in the Lower Hunter, in the event that the growth rates for selected regional areas were to occur in the Lower Hunter. For example, if annual population growth in the Lower Hunter matched the recent trend growth in Victoria’s Barwon region, then the annual population gain would be about 10,040 persons. Assuming 1.8 persons per new dwelling, then the projected underlying demand for new dwellings would be about 5,600 per annum.

Figure 48. Scenarios for population growth and underlying demand for new dwellings

Potential pop. growth rate (percent per annum)	Scenario Lower Hunter population gain 2010-2020	Projected underlying demand for new dwellings
1.7	10,040	5,600
1.9	11,324	6,300
3.1	19,521	10,850
3.2	20,244	11,250

Source: MacroPlan

⁵³ Ibid.

⁵⁴ Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments Volume 1* (2011) xxxiii.

Of course, if the population growth matched the very strong rates observed in some regional areas of Queensland, then the underlying demand would be far higher. Population growth of 3.2 per cent per annum, as observed in Townsville, would push underlying demand up to 11,250 new dwellings.

These higher growth scenarios could come into play in a variety of circumstances. One such circumstance may arise if Sydney's recent inability to absorb growth continues and becomes entrenched. An additional underlying demand for low-density housing in the Hunter may arise from Sydney's apparent inability to provide sufficient volumes of suburban development in its north west and south west growth centres. The Hunter Valley Research Foundation argues that Sydney's difficulty demonstrates the increasing significance of the Lower Hunter as the frontier for traditional greenfield house and land development in NSW.⁵⁵

"Many commentators assert that Sydney is reaching capacity and the growth will need to be diverted elsewhere."

The Foundation's view is not unique. Many commentators assert that Sydney is reaching capacity and the growth will need to be diverted elsewhere.

If this view is correct, the recent growth trajectories of other major regional regions across Australia (1.7 per cent to 3.2 per cent) may turn out to be a better guide to the region's ultimate growth requirements.

Considering the possibility that the Lower Hunter may need to absorb growth that Sydney cannot cope with does not mean that Government should try and cap the size of Sydney.

A separate report, *People Power*, prepared by MacroPlan Australia and the Urban Taskforce, deals with this issue in greater depth. However, it is enough to say that governments are poor judges as to whether a place like Sydney, suffers from over-concentration in a single urban area. A city's optimal size is elusive - highly sensitive to its composition of production, its geographic and regional setting, the quality of governance and administration available to it and its population composition and demographics.⁵⁶ Experts studying this area emphasise that government should not try to regulate city sizes to attain optimal size cities.⁵⁷

Nonetheless, a government can take action to safeguard itself for economically and socially inefficient over-concentration, by providing opportunities for businesses and households to locate themselves outside of key cities, whilst maintaining ready access to them. The World Bank has found that inter-regional transport infrastructure, particularly dense road networks, can significantly reduce urban concentration.⁵⁸ Such investments allow more people and businesses to derive benefits from being effectively part of, or close to a leading city, but nonetheless be geographically located in a distinct urban environment.

By investing appropriately in inter-regional infrastructure linking smaller cities, such as Newcastle and Wollongong, to the biggest cities, those smaller cities will be able to offer the necessary productivity boost.⁵⁹

⁵⁵ Hunter Valley Research Foundation, *Hunter Region Residential Market Outlook* (2009) 4.

⁵⁶ Vernon Henderson, *Urban primacy, external costs, and quality of life* (2002) 24 *Resource and Energy Economics*, 95–106, 98.

⁵⁷ Ibid.

⁵⁸ Vernon Henderson, "How Urban Concentration Affects Economic Growth" (2000) 2326 *Policy Research Working Papers*.

⁵⁹ Ibid.

"There is evidence that governments are moving to take action on this front. The Federal Government has commissioned a study on the feasibility of a high-speed east coast rail link. The focus of the study is on a link between Newcastle and Sydney, as a possible first step towards a Brisbane-Sydney-Canberra-Melbourne connection."

There is evidence that governments are moving to take action on this front. The Federal Government has commissioned a study on the feasibility of a high-speed east coast rail link. The focus of the study is on a link between Newcastle and Sydney, as a possible first step towards a Brisbane-Sydney-Canberra-Melbourne connection. AECOM Australia is due to provide its report to the Federal Government at the end of July 2011 and the report will be made public in August 2011.⁶⁰

According to some experts, a fast train travelling at 250 kilometres per hour (a conservative figure, given that some travel at much higher speeds) would allow Newcastle commuters to travel between home and Sydney in about 45 minutes, even allowing for a Central Coast stop such as Gosford - less than many Sydneysiders would take to drive back to their suburban homes.⁶¹

"The next Lower Hunter Regional Strategy should not make the same mistake as the last one, and assume a single low rate of population growth."

If this rail link were to proceed, the Lower Hunter would almost certainly need to accommodate more rapid population growth than the 1.4 per cent suggested in the above section. Other circumstances may also arise which necessitate higher levels of growth. The next Lower Hunter Regional Strategy should not make the same mistake as the last one, and assume a single low rate of population growth. Such a course of action will easily condemn a plan to failure.

6.4. HIGHER UNDERLYING DEMAND MEANS EVEN GREATER PRESSURE ON RENTALS

"Housing demand was far greater than supply over the past five years, resulting in huge growth in housing rentals."

Housing demand was far greater than supply over the past five years, resulting in huge growth in housing rentals. Given the workforce expansion associated with the planned boom in Hunter engineering construction, the gap between demand and supply is set to become progressively worse over the next three to five years.

⁶⁰ "Minister talks up 'cheap' fast-train link Deborah Gough", *The Age* (12 June 2011) <www.theage.com.au/national/minister-talks-up-cheap-fasttrain-link-20110611-1fy18.html#ixzz1P0pABDrn>.

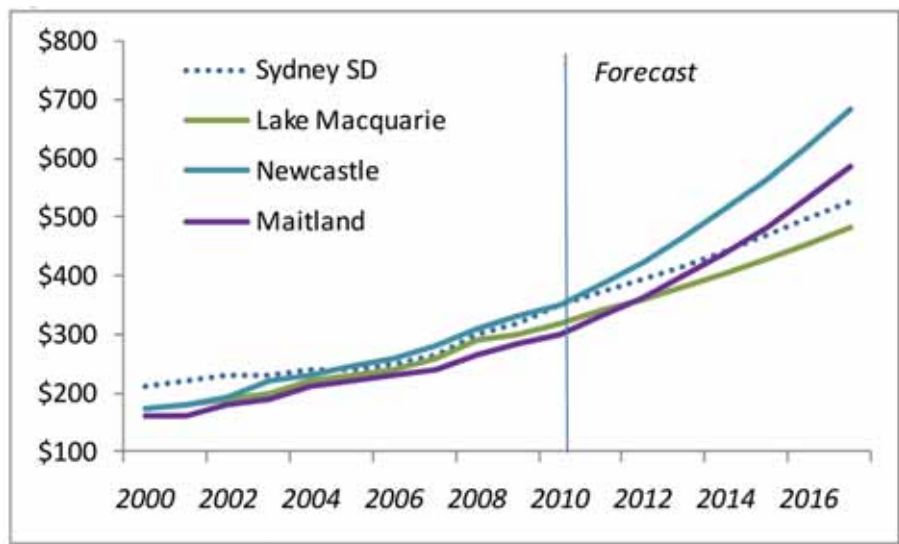
⁶¹ "Labor's high-speed east coast rail proposal brings vision to the election campaign" *The Australian* (7 August 2010).

The problem is that raising the dwelling construction pipeline itself would require a substantial increase in workforce. Hence, it will be difficult to achieve the necessary boost in supply.

“We predict a continued rate of 10 per cent growth in rentals per annum for these regions.”

In the absence of a large expansion in dwelling construction, it seems inevitable that rental growth in the Lower Hunter will remain very high over the next five years. This growth is likely to be strongest in the Maitland, Port Stephens and Newcastle regions, as they are located closer to the engineering construction projects being planned. We predict a continued rate of 10 per cent growth in rentals per annum for these regions.

Figure 49. Forecast increase in 3 bedroom house rentals



Source: MacroPlan, New South Wales Department of Housing

Figure 50. Forecast increase in 3 bedroom rentals

	Cessnock	Lake Macquarie	Maitland	Newcastle	Port Stephens
June 2010	350	270	320	300	350
June 2015	468	435	470	529	514
Growth per annum (per cent)	6	10	8	12	8

Source: MacroPlan, Housing NSW

6.5. IMPACT OF RISING RENTALS ON WORKER MIGRATION

“The impact is likely to be sufficiently large so as to mean that there is no real growth in disposable income.”

Continued strong rental growth in the Lower Hunter will substantially offset wages growth for construction workers. The impact is likely to be sufficiently large so as to mean that there is no real growth in disposable income (ie growth in after housing income less CPI inflation).

ABS figures show that the average earnings for a full-time construction sector worker are \$74,000 per annum. If wages growth is sustained at 4.5 per cent per annum and inflation averages 2.5 per cent per annum, then real income growth would be 2 per cent per annum. However, rental growth of 10 per cent per annum would mean that income after rental payments increases by about 2.6 per cent per annum, so that there is negligible increase in real income for a construction worker.

Figure 51. Construction worker income after rental payments

	Income forecast	Growth rate (per cent)	Income after rental	Growth rate (per cent)
Jun-10	\$74,000		\$57,533	
Jun-11	\$77,330	4.5	\$59,217	2.9
Jun-12	\$80,810	4.5	\$59,234	3.0
Jun-13	\$84,446	4.5	\$60,919	2.8
Jun-14	\$88,246	4.5	\$62,577	2.7
Jun-15	\$92,217	4.5	\$64,197	2.6
Jun-16	\$96,367	4.5	\$65,765	2.4
Jun-17	\$100,704	4.5	\$67,264	2.3

Source: ABS, MacroPlan

“It is likely that the least profitable mining construction projects (those with marginal feasibility) would be substantially affected, and some would be deferred or cancelled due to labour costs.”

This rise in rental costs would be expected to place upward pressure on worker demands for higher wages jobs in the Hunter. It is likely that the least profitable mining construction projects (those with marginal feasibility) would be substantially affected, and some would be deferred or cancelled due to labour costs.

That outcome would reduce the potential mining royalties from coal production.

We previously estimate that there is a pipeline of mining construction projects in the Hunter region which could produce an additional 76 million tonnes of coal per annum.

If a rise in labour costs meant that project returns were rendered inadequate for just 5 per cent of this capacity, then coal production would be reduced by 3.3 million tonnes. At today's average royalties per tonne of coal, that would reduce royalty revenues by about \$30 million per annum.

This value of impact on royalties would be far greater than the current value of government charges for residential development in new release areas of the Lower Hunter, which are estimated to be below \$10 million. This comparison shows that there is potentially a substantial positive impact on government revenues over the long-term, by reducing developer charges, this leads to greater housing supply, weaker rental growth and improved prospects for labour supply at coal mining construction projects.

6.6. FURTHER INCREASE IN HOUSING STRESS FOR RENTAL HOUSEHOLDS

If the rate of housing supply is not raised substantially, then the projected growth in rentals would make housing in the Lower Hunter even less affordable for many lower income households.

We estimate that 56 per cent of rental households in the Lower Hunter currently face housing stress, where rent payments account for more than 30 per cent of household income.

"If rental growth averages 8 per cent per annum across the Lower Hunter over the next five years, then even more households would be in a position of housing stress."

If rental growth averages 8 per cent per annum across the Lower Hunter over the next five years, then even more households would be in a position of housing stress. We project that in five years, 65 per cent of current rental households would be in a state of housing stress.

Renting in the Lower Hunter would become untenable for many households, and there would be increased migration to more affordable areas, most likely further north along the NSW coast.

However, for most rental households, employment and community ties would keep them in the Lower Hunter region. Rental households are a key potential source of first home buyers, but rising rents would make it more difficult to save for a deposit and buy a home.

As a result, the tight rental market undermines the health of owner-occupier demand for residential property. The market becomes more dependent on investors as a source of demand for housing, both in terms of established properties and new dwellings. Investors will need to see evidence of solid growth in property prices before there is a substantial rise in investor demand.

6.7. IMPLICATIONS OF DIFFERENT POPULATION GROWTH PATHS FOR LOWER HUNTER NON-RESIDENTIAL BUILDING AND RESIDENTIAL PROPERTY MARKET

Prospects for population growth will have broader implications for economic conditions in the Lower Hunter region.

“Population growth tends to have a positive relationship with non-residential building activity, principally in relation to retail and warehouse building, and also in terms of education and health building.”

Population growth tends to have a positive relationship with non-residential building activity, principally in relation to retail and warehouse building, and also in terms of education and health building. Higher population growth provides a broader foundation for household spending, particularly when it is sourced from the workforce age population.

Over the past decade, non-residential building activity across the Lower Hunter was quite weak, which was due to an extended period of moderate population growth.

If the status quo for housing supply persists over the coming decade, then weak population growth will be an enduring constraint on non-residential building in the region.

On the other hand, a reformed residential development process, which enables population growth to be consistent with the economic cycle, would lead to a substantial recovery in non-residential building. Compared to the status quo, an additional population gain of 2,500 persons per annum is projected to underpin an extra \$200 million in non-residential building per annum over the decade.

“Potential population growth of 7,500 persons per annum over the 2011 to 2020 period would have a greater weighting to the workforce age population, by comparison with the experience during the five years to 2010.”

The outlook for residential property markets will tend to be stronger if a higher rate of population growth can be achieved. The average rate of expansion in household income should set the foundation for residential property price growth. Potential population growth of 7,500 persons per annum over the 2011 to 2020 period would have a greater weighting to the workforce age population, by comparison with the experience during the five years to 2010. Potential aggregate household income growth would improve by a full percentage point to about 5 per cent per annum over the 2011 to 2020 period. This rate of growth would also be projected for residential property prices.’

On the other hand, if population growth slows to 5,000 persons per annum, then aggregate household income growth would also moderate. Household income growth is projected to slow to about 4 per cent per annum, leading to an equivalent outlook for residential property price growth.

“Adjusting for inflation, an extra percentage point for income growth would mean that individual income would be about \$6,000 higher by 2020.

In summary, higher population growth enables stronger economic growth and higher incomes over time.”

Average individual taxable income in the Lower Hunter region is estimated to be about \$52,000. Over a ten year period, the cumulative difference between annual growth of 4 per cent and 5 per cent per annum would be substantial. Adjusting for inflation, an extra percentage point for income growth would mean that individual income would be about \$6,000 higher by 2020. In summary, higher population growth enables stronger economic growth and higher incomes over time.

Figure 51. Construction worker income after rental payments

Period	Non-residential building value (average per annum \$m in constant 2009/10 prices)	Median house price growth (average per cent per annum)
2005-2010 actual	800	3.3
2011-2020 projections, based on potential population growth		
7,500 persons per annum	1,000	5.0
5,000 persons per annum	800	4.0

Source: ABS, MacroPlan

7. THE BENEFITS OF COMPETITION BETWEEN LANDHOLDERS

- The process of urban development is extremely capital intensive and lumpy.
- Developers face 'asymmetric adjustment costs', because once they have made their initial commitment it is more expensive for them to adjust production downward, than upward.
- Developers who over-invest, but cannot realise their plans, will face greater cost penalties than businesses in other industries where the costs of increasing or reducing production are comparable.
- The optimal hurdle price triggering new irreversible investment can be two to three times as large as the trigger value when investments are reversible.
- Urban development's capital intensive and lumpy nature influences how land owners behave when confronted by uncertainty that may impact on the net present value of an investment proposition.
- A landowner in a non-competitive market may decline to invest, even though the project has a positive net present value, because the lack of competition offers the opportunity for a greater premium at a later investment date.
- Increased competition reduces the prospect of investment being delayed. The erosion in value of the investment opportunity due to activities of one's competitors creates incentives to invest earlier.
- Under the Lower Hunter Regional Strategy 115,000 new dwellings are required in the 25 year period stretching from 2006 through to 2031, but it provides for just 69,000 dwellings in new release areas over 25 years, and it has identified "sufficient" land to supply this amount.
- In order for the land to be actually rezoned for development, it must also be "sequenced".
- The government is using its powers to delay some land owners from commencing work, on the basis that other land release sites have not yet been fully developed. This action reduces competition between landowners within the Lower Hunter region.
- The government does not appear to have accelerated the sequencing process in response to the lack of development activity clearly evidenced by the Metropolitan Development Program Report.
- A market where market share is simply divvied out amongst a fixed number of land owners is not a competitive market.
- A regional strategy should provide more land for urban development than might be considered strictly necessary.

- The absence of the threat of competition has increased economic incentives for landowners to hold-out and refuse to enter into agreements with developers to realise the development potential of their land.
- The strategy assumes that 40 per cent of new housing can be higher density, but does not consider whether or not land values in the existing footprint will rise enough to lead to increased capital investment in that land (to foster more intense uses). The possibility that this will not happen, further means that underlying demand for detached housing in new release areas has been under-estimated.
- Designing whole communities around new public transport services in the Lower Hunter may be a pointless exercise if the government has no intention of providing them and if commuters would still find their cars a preferable means of transport even when public transport services are available.
- The strategy assumes that all the relevant factors for determining housing demand and supply, land availability, and the inter-relationships between commercial, industrial, and residential land development are known and foreseeable. For example, the document contains 35 separate statements that the strategy will “ensure” that something will take place.
- It is not possible for any strategy for the Lower Hunter, to fully and adequately reveal the inarticulate or implicit knowledge of home buyers and intending funders of new business premises. Ultimately, these preferences are best revealed through observation of market activity. The existing Lower Hunter Strategy is too rigid and prevents that market activity from occurring. Its replacement should not make the same mistake.
- The Lower Hunter Regional Strategy should seek to provide certainty to the private sector by having clear rules, simple processes, swift processing times and low predictable costs. It should not be the role of the strategy to provide certainty to investors in one location, by giving them assurance that they will be protected from competition in other nearby locations.
- A new Lower Hunter Strategy should be broadly framed. It should be highly flexible in its content, and contemplate a range of possible outcome in terms of dwelling mix, employment growth and population and job distribution. It should also actively contemplate that decisions will be made outside of the strategy, as needed, in order to ensure that the market demand for housing and business premises is able to be satisfied.

7.1. THE CAPITAL INTENSIVE NATURE OF URBAN DEVELOPMENT

The process of urban development is extremely capital intensive and lumpy. For example, a greenfield land developer will seek to stage a development, but inevitably an initial investment in land acquisition, road building, utility construction will require a minimum level of lot production. Once a commitment is made, the investment becomes ‘irreversible’ in the sense that the costs of not proceeding will be significant. Developers who have borrowed and used their own cash to pay for infrastructure will incur significant additional holding costs if they allow roads, utility services, etc to remain idle or underutilised. Economists observe that developers face ‘asymmetric adjustment costs’, because once they have made their initial commitment it is more expensive for them to adjust production downward, than upward.⁶²

⁶² Caballero, 1991R.J. Caballero, On the sign of the investment-uncertainty relationship, American Economic Review 81 (1991), , 279.

When adjustment costs are asymmetric, having 'too much' capital stock in place is worse than having 'too little'.⁶³

For example, a road that is big enough to service 1,000 lots will be more expensive than a road that will only need to service 500 lots. If a developer commits to the 1,000 lot road, significant capital will be tied up in unproductive infrastructure if it subsequently turns out the developer can only sell 500 lots into the market.

A developer who had built the larger road will (if market conditions change adversely and lot production is reduced) face much higher holding costs than were anticipated when work commenced on the road. In many instances, if they have committed irreversibly to the road, the developer may find it more cost effective to proceed with the original (higher) level of lot production. That is, the cost of the additional investment may be less than the additional holding costs associated with the otherwise underutilised capital.

"Developers who over-invest, but cannot realise their plans will face greater cost penalties than businesses in other industries where the costs of increasing or reducing production are comparable."

In short, developers who over-invest, but cannot realise their plans will face greater cost penalties than businesses in other industries where the costs of increasing or reducing production are comparable.

The "irreversible" nature of this capital investment is understood by developers and it influences their decision to initially proceed with a venture. Academic modelling has used simulations to show that the optimal hurdle price triggering new *irreversible* investment can be two to three times as large as the trigger value when investments are *reversible*.⁶⁴

7.2. THE IMPACT OF UNCERTAINTY ON URBAN DEVELOPMENT DECISIONS

The urban development's capital intensive and lumpy nature influences how land owners behave when confronted by uncertainty that may impact on the net present value of an investment proposition.

This uncertainty can be induced by market conditions (such as the risk of falls in property prices or changes in consumer preferences) or in regulatory complexities (such as the risk of higher than anticipated development levies, or lower than anticipated lot yields). The property market is highly cyclical and subject to highly discretionary regulation. Many landowners hold portfolios that are concentrated in a particular local market where they hold great expertise, but where there are no existing methods to hedge local market risk.⁶⁵

The impact of uncertainty on business decisions has been subject to extensive academic debate and analysis over a 40 year period.

⁶³ Ibid 279, 286.

⁶⁴ Dixit and Pindyck, 1994A.K. Dixit and R.S. Pindyck, Investment Under Uncertainty, Princeton Univ. Press, Princeton, NJ (1994).

⁶⁵ Laarni Bulan, Christopher Mayer, C. Tsuril Somerville, 'Irreversible investment, real options, and competition: Evidence from real estate development' (2009) 65 *Journal of Urban Economics* 237, 238.

“Increased competitive access to an investment opportunity (for example, the supply of new housing to particular submarket) leads to “a rapid erosion” in the benefits of delaying an investment.”

For example, Columbia University’s Ricardo Caballero published a peer reviewed theoretical analysis suggesting that in the absence of a fully competitive market, there would be a negative association between investment and uncertainty (that is, all other things being equal, the greater the uncertainty, the less investment will occur).⁶⁶ On the other hand, his modelling suggested that in a competitive market the relationship between investment and uncertainty was not strong.⁶⁷ That is, the irreversible nature of an investment was not a determinative factor, even in the presence of increased uncertainty, *if a market is competitive*.

“A land owner in a non-competitive market may decline to invest, even though the project has a positive net present value, because the lack of competition offers the opportunity for a greater premium at a later investment date.”

Stanford University’s Steven Grenadier concluded that the impact of competition on business decision-making was “dramatic”.⁶⁸ In his view, increased competitive access to an investment opportunity (for example, the supply of new housing to a particular submarket.) leads to “a rapid erosion” in the benefits of delaying an investment.⁶⁹ That is, a business decision is more likely to be based solely on the value of the project’s net present value at a given point in time. In other situations (i.e. a non-competitive market) the best time to invest is when the asset value exceeds the investment cost by a large premium.⁷⁰ This means a land owner in a non-competitive market may decline to invest, even though the project has a positive net present value, because the lack of competition offers the opportunity for a greater premium at a later investment date.

Academics from Boston University and the University of Amsterdam concluded that, even with uncertainty, investment may proceed, despite elevated risks, if it lowers not just production costs but also the likely price of future expansion.⁷¹ Future expansion may be rendered less expansive, if early investment offers strategic influence on competitors’ output decisions, inducing them to be less aggressive and increasing the investor’s market share. In this scenario, the key motivator for the investment that takes place is the pre-emption of competitors. If competitors are absent, or unable to act for some time due to regular constraints, the pressure to act strategically in this way diminishes.

In an empirical study, researchers from Brandeis University Columbia Business School and the University of British Columbia, carried out a detailed analysis of a sample of 1,214 medium and high density developments in Vancouver, Canada built from 1979 through to 1998.⁷² They found that, all other things being equal, increases in risk

⁶⁶ Caballero, 1991R.J. Caballero, On the sign of the investment-uncertainty relationship, *American Economic Review* 81 (1991), 279–288.

⁶⁷ Ibid 279–288, 286.

⁶⁸ R. Grenadier, Option exercise games: An application to the equilibrium investment strategies of firms, *Review of Financial Studies* 15 (2002), 691–721

⁶⁹ Ibid 691–721, 718.

⁷⁰ Ibid 691–721, 718.

⁷¹ Kulatilaka and Perotti, 1998N. Kulatilaka and E.C. Perotti, Strategic growth options, *Management Science* 44 (1998), 1021–1031, 1029.

⁷² Laarni Bulan, Christopher Mayer, C. Tsurie Somerville, ‘Irreversible investment, real options, and competition: Evidence from real estate development’ (2009) 65 *Journal of Urban Economics* 237.

led landowners to delay new investments. A one-standard deviation increase in the return volatility reduced the probability of investment occurring by 13 percent. The increase in risk was equivalent to a 9 percent decline in real prices. Significantly, the study found that when there is an increase in the number of potential competitors located near a development, the inverse relationship between (idiosyncratic)⁷³ risk and development disappears.

These results provided firm empirical evidence backing the earlier theoretical analysis by academics, in support of the proposition that:

- in the absence of competition and the presence of risk, investment decisions are delayed; and
- increased competition *reduces* the prospect of investment being delayed.

Accordingly, the study affirms that the presence of competition diminishes the value of waiting to invest.⁷⁴ The erosion in value of the investment opportunity due to activities of one's competitors creates incentives to invest earlier. Hence firms in competitive markets are not able to capture the full benefits to waiting, that a monopolist enjoys.

7.3. INSUFFICIENT COMPETITION BETWEEN LANDOWNERS

The Lower Hunter Strategy proclaims that it is about creating long-term business certainty and attracting more investment and jobs.⁷⁵

However, reducing uncertainty is not an easy task.

Under the strategy 115,000 new dwellings are required in the 25 year period stretching from 2006 through to 2031. However, the Strategy provides that 60 per cent of new dwellings will be provided in new release areas and 40 per cent will be provided in existing urban areas — that is, a 60:40 split in the provision of new dwellings.⁷⁶

The strategy says that:

Sufficient release area land has been identified in the Strategy to supply 69 000 dwellings (60 per cent of total dwellings required) (emphasis added).⁷⁷

The NSW Government has asserted that Lower Hunter region needs 69,000 dwellings in new release areas over 25 years, and it has identified “sufficient” land to supply exactly this amount. Neither more nor less. The Metropolitan Development Program report confirms the government's approach. It says greenfield lands have been identified with the potential to produce 74,000 homes – just 7 per cent above the anticipated need of 69,000 such homes.⁷⁸

⁷³ Idiosyncratic risk is the possibility of variation in the returns on an investment flowing from factors specific to that investment.

⁷⁴ Laarni Bulan, Christopher Mayer, C. Tsuril Somerville, ‘Irreversible investment, real options, and competition: Evidence from real estate development’ (2009) 65 *Journal of Urban Economics* 237, 248.

⁷⁵ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 1.

⁷⁶ Ibid 24.

⁷⁷ Ibid 25.

⁷⁸ NSW Department of Planning, *Metropolitan Development Program 2008/2009* (2010) 238.

There is almost no margin for error. By way of comparison, when projecting population through to 2031 the Australian Bureau of Statistics (which cautions its projections are not predictions), it prepares three scenarios for each capital city, and the highest population project is 42 per cent above the lowest population projection.⁷⁹

Nonetheless, it is a distraction to focus on the overall numbers in the 25 year plan. The key issue is the timeframe that land is made available. If land sufficient for all 69,000 dwellings were to be made available for development immediately, land available for development would definitely exceed demand in the short and medium term. In such a situation, there would be considerable uncertainty as to which land would actually be developed, and this uncertainty would breed competition between landholders looking to sell to or joint venture with developers. As the analysis above showed, such competition reduces the prospect of investment in new housing being delayed.

However, the reality of the Lower Hunter Strategy is that the majority of the supposed 69,000 dwellings will not be green-lighted by authorities for development in the short and medium term. Instead, the Strategy says:

To initiate the Urban Development Program a working group will be established comprising executive level members from State and local authorities. The working group will help to prepare an initial staging and sequencing plan, which will then be reviewed annually based on a Monitoring and Forecasting Program. The Monitoring and Forecasting Program will be prepared by the Department with input from State and local authorities and the development industry, to review housing supply and demand (emphasis added)⁸⁰

The “initial staging and sequencing plan” has not been publicly released, nor have any subsequent versions (if any) been made available. We have seen no evidence of the promised industry consultation. Generally speaking the Department of Planning discontinued its program of high level consultation with industry over demand and supply issues around the time that the Lower Hunter Regional Strategy was finalised.

“In order for the land to be actually rezoned for development, it must also be sequenced. We are aware of landowners who are keen to progress the development of their land (as identified under the Lower Hunter Strategy), but are unable to proceed because it has not yet been “sequenced” by the Department of Planning.”

Nevertheless, it is not enough that land has been identified for release in the strategy. In order for the land to be actually rezoned for development, it must also be sequenced. We are aware of landowners who are keen to progress the development of their land (as identified under the Lower Hunter Strategy), but are unable to proceed because it has not yet been “sequenced” by the Department of Planning.

⁷⁹ The highest projection for Darwin is 42 per cent of the lowest projection for that city. For the ACT the same figure is 32 per cent; for Adelaide the figure is 27 per cent; for Brisbane the figure is 23 per cent; for Perth the figure is 21 per cent; for Melbourne the figure is 12 per cent; and for Sydney the figure is 4 per cent: 3222.0 *Population Projections, Australia, 2006 to 2101*. It is evident that the smaller the population unit being examined, the more sensitive long-term projections are to changes in assumptions. This raises significant issues for any long-term strategic land use planning outside of capital cities or across subregions within a capital city.

⁸⁰ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 25.

The strategy says that:

Progress on targets established in this Regional Strategy will be monitored annually. The delivery of new housing and employment lands will also be monitored annually as part of the Urban Development Program, so that an appropriate additional supply of new residential land can be rezoned and brought into supply as needed.⁸¹

The only annual monitoring that is apparent to the community is the Metropolitan Development Program Report which contains actual dwelling completion figures that are generally at 18 months old by the time they are released. However the government does not appear to have accelerated the sequencing process in response to the lack of development activity clearly evidenced by the Metropolitan Development Program Report.

Essentially, the government will not allow some landowners, who wish to proceed, to commence the process of statutory and infrastructure planning. The government is using its powers to delay some land owners from commencing work, on the basis that other land release sites have not yet been fully developed. This action reduces competition between landowners within the Lower Hunter region.

Modern public policy does not generally seek to limit the potential number of suppliers or quantity of a product to predicted need. Imagine if the government passed a law that said we will only have two domestic airlines, and each one may only offer a certain number of seats for sale?⁸² While empirical evidence might suggest the market only requires two domestic airlines and the number of seats allocated may align with anticipated demand, the airlines would effectively be shielded from competition. That's because there would be no risk of new entrant airlines attempting to wrestle market share from the incumbents. The two airlines that benefit would be under very little pressure to provide a high quality, low cost service. Neither would they need to fear the prospect of a young upstart company coming in and breaking up their duopoly.

"A market where market share is simply divvied out amongst a fixed number of land owners is not a *competitive* market."

A market where market share is simply divvied out amongst a fixed number of land owners is not a *competitive* market. If land owners were to do that themselves it would be subject to action under trade practices law. It should not be any more acceptable merely because the government does it via a regional strategy. A regional strategy should provide more land for urban development than might be considered strictly necessary. This creates the possibility of competitive tension between land owners and developers who acquire the right to develop land.

The absence of the threat of competition has increased economic incentives for landowners to hold-out and refuse to enter into agreements with developers to realise the development potential of their land.

The 2005 Sydney Metropolitan Strategy, which was finalised one year before the Lower Hunter Strategy, seemed to recognise the need for a competitive land market. It said that

⁸¹ Ibid 44.

⁸² There used to be such a law when airlines were regulated and was repealed in 1980s – no-one looks back to that era.

the supply of land available for development should always exceed market demand to ensure that land values are not unreasonably raised and lower the intended level of development (emphasis added).⁸³

It is odd that the 2006 Lower Hunter Strategy did not articulate the same pro-competitive approach – this issue should be addressed in the review of the strategy.

7.4. PLANNING WILL NEVER BE PERFECT

The idea of the all-encompassing plan is an attractive one. However, any government planning process is vulnerable to some key institutional problems. They have been spelt out by Dr Sam Staley, Director of Urban and Land Use Policy for the Reason.⁸⁴ The following discussion employs his analysis.

7.4.1. Closed systems and hierarchies

Government planning is done in a “closed” framework where means and ends are simultaneously determined. For example, the relationship between population growth and housing is a complex one. To some extent, a lack of housing supply will dampen population growth. An excess housing supply can assist in encouraging people who may have otherwise departed a region to stay, and might provide opportunity for more people to locate in an area to take advantage of its relative affordability. By simultaneously determining both population growth and housing supply, a strategy hopes to be self-fulfilling. Essentially, a strategy supplies dwelling numbers (means) and the targeted population and jobs (ends) at the same time. If the plan works, excess population is discouraged because there is insufficient housing.

Of course, to be successful this process assumes (and requires) that either:

- land development activity will take place as a response to a government strategy, rather than the preferences of consumers, i.e. home buyers, shoppers and employers; or
- that those who developed the strategy perfectly understood the requirements of consumers, so that the strategy reflects their preferences with precision.

Ostensibly planning authorities will say that they have taken to account the “needs” of consumers, but usually they do not claim to understand their preferences. The distinction is simple. The preferences of consumers reflect what they actually want and are willing/able to pay a market price, if given the opportunity. The “needs” of consumers, in a planning context, will reflect the outcome of a demographic study, which involves making a series of assumptions about household requirements, and imposing the planning authority’s own preferences as to how those requirements might be addressed.

For example, the strategy acknowledges that greenfield housing represented 75 per cent of all new housing, with the remaining 25 per cent of housing located in existing zoned urban areas.⁸⁵ Since then, the contribution from new release areas has fallen sharply, moving down below 20 per cent. This trend has developed due to a plunge in lot production from new release areas. The strategy’s shift to 60 per cent of new housing from greenfield, with 40 per cent from infill development (46,000 dwellings), is not justified by any reference to the willingness/ability of home buyers to pay a commercial price (i.e. a price that covers land acquisition, development and construction cost

⁸³ Ibid 123.

⁸⁴ Samuel Staley, ‘Urban Planning, Smart Growth, and Economic Calculation: An Austrian Critique and Extension’ (2004) 17:2/3 *The Review of Austrian Economics* 274-275.

⁸⁵ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 5.

plus a developer's margin) for that dwelling type in the Lower Hunter. Instead the strategy asserts that shrinking household sizes will create a preference for smaller homes.

The rationale of the strategy, in this regard, is a gross over-simplification. One reason household size is likely to shrink, is the ageing of the population. An ageing population leads to a higher incidence of single and couples living without children. The planning authority interprets this as proof that a larger share of new dwellings in the Lower Hunter must be made up of the kind of compact home normally found in infill development. This is not necessarily the case.

A recent study by the UNSW-UWS Research Centre, funded by the government-backed Australian Housing and Urban Research Institute, found that there was a strong preference for older Australians to remain in their own home for as long as possible. The study concluded that 'downsizing' may have appeal for some home owners and those who see a benefit in releasing overly-large land and dwellings to younger, larger households; the demand is not for very small dwellings or one-bedroom units, as might be suggested by the predominance of single and couple-households.⁸⁶ While this does not necessarily mean that demand for infill housing won't increase at some point in the future if/when preference of older Australians change, such a change cannot be treated as fait accompli. The possibility of this shift must be allowed for in a strategy, however, the possibility that this shift will not take place should also be accommodated. This necessitates for flexibility about the future dwelling mix (between, say, infill and greenfield) that is provided for in the Lower Hunter Strategy.

"It is evident that the strategy was prepared without consideration of whether or not land values in the existing urban footprint will rise enough to lead to increased capital investment in that land (to foster more intense uses)."

In any event, the economic evidence makes it clear that the intensity of land use is determined by the value of land.⁸⁷ The propensity for this to occur varies across different metropolitan areas.⁸⁸ It is evident that the strategy was prepared without consideration of whether or not land values in the existing urban footprint will rise enough to lead to increased capital investment in that land (to foster more intense uses). Certainly, as the analysis in this paper suggests (see earlier discussion) that point has not been reached yet, and is unlikely to be reached in the short to medium term.

Dense cities are known to boost productivity through the agglomeration benefits of having so many workers, consumers and businesses together in close proximity. Nevertheless, some research suggests that the productivity differences required to justify, in economic terms, high levels of density considerably exceed estimates of the higher productivity such crowdedness offers.⁸⁹ That is, the economic value of high density locations cannot be justified by the benefits of proximity alone, some external factor must be present which contributes to additional productivity boost to establish the economic viability of the dense urban area.

Economists suggests the additional element needed to provide the economic justification for density may depend on locational fundamentals such as easy access to raw materials, navigable waterways, seaports, and other

⁸⁶ Bruce Judd, Diana Olsberg, Joanne Quinn, Lucy Groenhart and Oya Demirbilek, *Dwelling, land and neighbourhood use by older home owners: AHURI Final Report No. 144* (2010).

⁸⁷ John F. McDonald, *Capital-land substitution in urban housing: A survey of empirical estimates* (1981) 9(2) *Journal of Urban Economics* 190, 209.

⁸⁸ *Ibid.*

⁸⁹ Jordan Rappaport, A productivity model of city crowdedness (2008) 63(2) *Journal of Urban Economics* 715, 721.

transportation infrastructure.⁹⁰ Productivity may also depend on government policies such as regulation, taxes, and service provision.⁹¹

The difference might also be accounted for by high consumption amenities.⁹² That is, individuals may be willing to live in a more dense urban environment in return for the chance to enjoy nice weather, nearby beaches, mountains and lakes or they may be willing to do so in order to obtain desired government policies, such as the efficient provision of low pollution, low crime and good schools.⁹³ Consumption amenities may also arise due to the wide product variety and cultural amenities that high density can support.⁹⁴

"It is clear that at the current time, and in the foreseeable future (say, the next five years) the economic justification for the level of infill development projected in the strategy is absent."

The Lower Hunter is blessed with many of these things. However, due to the relative ease by which people can travel about the Lower Hunter, it is questionable whether the benefits are, or will be, exclusively, or preferentially available to those living in a higher density environment, or whether home buyers will be able to have their cake and eat it to (i.e. live in a low density suburban environment, while also enjoying the benefits of the locational fundamentals and consumption amenities of Newcastle and the Lower Hunter generally. It is clear that at the current time, and in the foreseeable future (say, the next five years) the economic justification for the level of infill development projected in the strategy is absent. That is, the preference of homebuyers does not align with the preferences of the planning authority.

(We note that, in Sydney, there is a very strong unmet demand for high density living, but the locational fundamentals and consumption amenities of the Lower Hunter and Sydney are clearly very different. Sydney's congestion means that there are significant differences between the benefits available to those living in a higher density in inner suburban Sydney, versus people living in outer suburban Sydney. This difference is clearly providing the additional economic boost necessary to make higher density development viable).

"The costs faced by the public authorities charged with preparing a plan are inevitably given greater weight than the costs that would be borne by households and businesses."

Whatever regard is ostensibly given to the desires of consumers, the sheer uncertainty of the future means that a series of value judgements must be made by planning authorities. As a result, the strategies inevitably are influenced by the ideologies, preferences of the authors, and the political environment in which the plan is devised. Significantly, any strategy they construct is designed to impose a hierarchy of land development activities that public authorities find convenient, rather than the businesses and households that depend on the new homes

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² Ibid.

⁹³ Ibid.

⁹⁴ Ibid.

and premises. That is, in evaluating competing options, the costs faced by the public authorities charged with preparing a plan are inevitably given greater weight than the costs that would be borne by households and businesses.

For example, the current emphasis on 40 per cent of the Lower Hunter's housing needs being met through infill development, conveniently boosts the notional overall housing figure to be provided to 115,000, when in truth, a very large part of the 46,000 infill dwellings are unlikely to be economically viable. This allows planning authorities to assert that sufficient dwellings will be provided, but without planning for the infrastructure necessary to support that number (were the dwellings to be provided in a composition that reflected home buyer preferences). The strategy meets the needs of government and planning authorities, but does not meet the needs of home buyers.

The Lower Hunter Strategy frankly admits the fact that the convenience of public authorities has been given greater weight than the preference of home buyers:

Whilst the [historical] amount of greenfield development to some extent reflects consumer preferences, it also places a significant burden on State and local governments in terms of infrastructure provision and the ability to identify sufficient new urban areas to meet demand.⁹⁵

"The system set up by the regional strategy is vulnerable to significant outside shocks if some goals or unintended consequences are not adequately addressed (e.g., supply-side shifts in the housing market, higher building costs or unanticipated behaviour by key market players, such as major landowners)."

More generally, we can say that the system set up by the regional strategy is vulnerable to significant outside shocks if some goals or unintended consequences are not adequately addressed (e.g., supply-side shifts in the housing market, higher building costs or unanticipated behaviour by key market players, such as major landowners).

7.4.2 End-state planning

In general terms, strategic planning is motivated by an idealised end-state. Planning authorities adopt a vision of an ideal form and conception of how the community will function. Often this end state is higher density and more traditionally urban than currently found in conventional suburbs.

Even here, however, the end-state is often envisioned in contradictory ways. In some cases, the vision is positive—an urban area's future form is specified. In other cases, the end state is expressed negatively as excluding certain types of development (e.g. development of large rural, open spaces).

In the Lower Hunter strategy various end-states are contemplated. Some are innocuous. Others are not.

For example, the strategy envisages that new release areas will be designed based on "neighbourhood planning principles". Among other things these principles require

⁹⁵ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 5.

[p]ublic transport networks that link frequent buses into the rail system.⁹⁶

Infill development will, apparently,

maximise use of existing and future infrastructure, including public transport ...⁹⁷

The residents of the Lower Hunter are currently heavily reliant on motor vehicles to get themselves to and from work; more so than either the Illawarra's or Sydney's residents.⁹⁸ Lower Hunter residents produce more vehicle km travelled (VKT) per capita,(26.2) than Sydney residents (19.7).⁹⁹ Ninety-one per cent of the Lower Hunter's commuters travelled to work by motor vehicle in 2006.¹⁰⁰ In February 2010 AECOM, a consultancy firm, was appointed by Transport NSW to develop a "transport management and accessibility plan" for the Newcastle City Centre.¹⁰¹ The State Plan sets the target of increasing the share of commute trips made by public transport to and from Newcastle central business district during peak hours to 20 per cent by 2016.¹⁰² According to AECOM, the existing (in 2006) public transport journey to work mode share to Newcastle City Centre during the peak period is 14.1 per cent.¹⁰³

According to the report, with no improvements to public transport or the road network in Newcastle's City Centre, the proportion of people travelling by public transport would increase only slightly from 14.1 per cent in 2006 to 15.1 per cent in 2031 because more people are expected to live near bus and train services.¹⁰⁴ Even with more dense urban development around Wickham, Civic and Newcastle stations, AECOM estimates that there would only be a 10 per cent increase in train travel, increasing the proportion of public transport travel from 14.1 per cent (in 2006) to 15.2 per cent in 2016, and 15.9 per cent in 2031.¹⁰⁵

The AECOM report identifies a barrier to further increases in the use of public transport for commute's to the Newcastle City Centre:

Nearly 11,000 car parking spaces are provided in the Newcastle City Centre and immediate surrounds, with a fairly even split between on-street, off-street and private off-street parking. With only 7,500 car trips into the same area each day, there is an *oversupply* of parking. *Managing* the parking supply (both in *the price and the number of spaces*) would reduce private vehicle usage and encourage more public transport trips.

Availability and pricing of parking is a particular challenge in achieving the State Plan mode share target. ...

In the longer-term, parking prices in Newcastle should be increased to a level comparable with other major centres in NSW reflecting the true costs of parking, which include the need to provide road space or land and the need for the road infrastructure to enable more cars to drive into the city centre. This would see the price of long-term commuter parking double over the next five to ten years. (emphasis added).¹⁰⁶

As part of this, the city council would "specify maximum parking amounts for new developments" in its development

⁹⁶ Ibid 26.

⁹⁷ Ibid 9.

⁹⁸ Ministry of Transport, *TransFigures April 2008* (2008) 7.

⁹⁹ James Naylor, *Lower Hunter Transport Needs Study* (2009) 22.

¹⁰⁰ Ministry of Transport, *TransFigures April 2008* (2008) 7.

¹⁰¹ AECOM, *Newcastle City Centre Renewal: Transport Management and Accessibility Plan: Summary Volume* (2010) 1.

¹⁰² NSW Government, *NSW State Plan: Investing in a Better Future* (2010) 11.

¹⁰³ Ibid 7.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ Ibid 17.

control plan.¹⁰⁷ The paper says this would be about “allowing developers to provide less parking with supporting justification”,¹⁰⁸ but of course, “maximum” car parking limits are about preventing developers from ensuring that new developments have sufficient car parking places. Such policies have been tried and failed in South Sydney and North Sydney, where more cars were forced to park on the street. Such a policy approach has also been contentious in Parramatta.

AECOM believes its proposals would achieve a 15.7 per cent peak period public transport mode share in 2016, increasing to 16.5 per cent in 2031,¹⁰⁹ although this still falls well short of the State Plan target of 20 per cent in 2016.

The problem with end-state planning is that once a future state of affairs is deemed to be desirable, the clumsy regulatory powers of the state then begin to be employed to try and engineer the outcome. When faced with evidence that consumers would stay in their cars because of the relative convenience in that form of travel, and the availability of car parking, the government’s consultants start to devise regulatory measures that will create a problem (insufficient car parking) in order to achieve an outcome. AECOM cannot be blamed for this. As the government’s consultant, they were not permitted to question the underlying policy (i.e. whether achieving the State Plan 20 per cent target) was desirable or necessary.¹¹⁰

“Designing whole communities around new public transport services in the Lower Hunter may be a pointless exercise if the government has no intention of providing such services and that if commuters would still find their cars a preferable means of transport even when public transport services are available.”

Designing whole communities around new public transport services in the Lower Hunter may be a pointless exercise if the government has no intention of providing such services and that if commuters would still find their cars a preferable means of transport even when public transport services are available.

7.4.3. Complete knowledge

The presumption underlying modern strategic planning is that all the relevant factors for determining housing demand and supply, land availability, and the inter-relationships between commercial, industrial, and residential land development are known and foreseeable.

Uncertainty is rarely acknowledged or adequately addressed. Thus, plans are adopted with the intention they will be modified on rare occasions and amendments are subject to onerous review and approval processes. This limits opportunities for innovation or spontaneity.

The Lower Hunter Strategy exhibits these characteristics.

¹⁰⁸ Ibid.

¹⁰⁹ Ibid 8.

¹¹⁰ It should be noted that the former Minister for Transport, John Roberston has declared that “[t]he NSW Government doesn’t support the introduction of a congestion charge in the Newcastle CBD, nor would we support a doubling of parking fees”: Office of the Minister for Transport, Media Release “NSW Government releases transport studies”, 15 November 2010.

For example, the document contains 35 separate statements that the strategy will “ensure” that something takes place. This overlooks the fact that the strategy in itself:

- does not guarantee government investment in infrastructure;
- cannot guarantee rezoning decisions or development approval;
- cannot guarantee either the presence of homebuyers or businesses in particular market segment; and
- nor can it guarantee private capital to achieve the strategy’s outcomes.

Typical of the strategy are the following statements:

the Strategy will ... ensure activity within the Lower Hunter complements rather than competes with the economies and communities of adjoining regions.¹¹¹

Isn’t competition a good thing? How will this assurance be implemented?

The Strategy goes to say that it will

[p]rovide for up to 115 000 new dwellings by 2031 ensuring the potential to accommodate both the changing housing demands of smaller households and reduced occupancy rates of the existing population as well as meeting the housing demands for an additional 160 000 people (emphasis added).¹¹²

Are we sure that 115,000 homes will meet the needs of additional people? What if projected occupancy rates are wrong? They have been before. What if there are more than 160,000 people?

Ensure a mix of housing types in proximity to employment to provide the necessary supply of labour locally (emphasis added).¹¹³

What if the strategy’s mix of housing types turns out not be commercial or does not match homebuyer preference? What if the strategy does not accurately comprehend the future distribution of the labour force?

These uncertainties are largely not addressed in the document. Although, there is a limited acknowledgement of the issue:

Monitoring of population growth will ensure that the Strategy can respond to growth rates higher or lower than expected.¹¹⁴

The document does not explain how the strategy will respond.

Since the strategy was finalised in 2006, a single “update report” was published in 2009 that made no changes. The strategy itself says:

¹¹¹ NSW Department of Planning, *Regional Strategy Update Report 2009* (2009) 7.

¹¹² Ibid 10.

¹¹³ Ibid 22.

¹¹⁴ NSW Department of Planning, *Regional Strategy Update Report 2009* (2009) 4.

Strategy is to be comprehensively reviewed every five years, so that it can adjust to any demographic and economic changes. This will assist local councils with their five-yearly review of local environmental plans, required under recent reforms to the planning system.¹¹⁵

Given the exceptionally long lead times involved in land supply (15 years according to the National Housing Supply Council, but, much longer, in our view, in NSW) it's difficult to imagine how this process of five yearly review will ensure that the strategy remains relevant.

7.4.4. Political optimisation

The presumption underlying modern strategic planning is that planners and policymakers will include all the relevant information in their decisions about what kinds of factors influence the growth of a community, and that all relevant preferences will be revealed accurately and optimally through the political process.

Notionally, the legislative role in policy making offsets the technical role played by professional planners. In theory, the political process helps ensure that the work of strategic planning is not purely technocratic and the outcomes reflect the community's requirements.

The need for political oversight of strategic planning arises from the modern planning system's reliance on the principle of democratic deliberation of land use.¹¹⁶ This is said to provide for more holistic decision-making practices and enable people to re-assert collective social control over urban development patterns, allowing for the widest consideration of the costs and benefits to society at large.¹¹⁷ This is said to require a commitment to the notion of "consensus-building" and "citizenship" rather than "competition" and "consumerism" and involves a subordination of private markets to collective democratic control.¹¹⁸ According to dominant urban planning theories, individuals may only be reconnected with their communities based on "voice" mechanisms that can transform peoples' values through a process of democratic deliberation in which the virtue of different ends is judged according to the articulation of the "best reasons".¹¹⁹

This is a key area of tension in any strategic planning process. Strategic urban plans are not merely a process of aligning urban development to infrastructure capacity. It has morphed into a system of regulatory control ostensibly directed to re-shaping urban communities based on a stated 'vision' (see end-state planning above). Therefore when we talk about "planning rules" we are rarely referring to regulatory impositions based on strictly objective criteria (as would be the case with engineering or building standards). What we tend to be talking about is rules that are informed by subjective responses to competing arguments about the ideal shape, look and feel of urban communities.

Government planners fulfil what they believe is a technical function and often resent the political direction they receive as to the content of their plans. A draft plan prepared by public servants will rarely even make it to public exhibition without substantial re-writes courtesy of the political process. Once exhibited, many plans are further revised based on community feedback.

Plans may be improved or made worse as a result of political oversight in the preparation, public exhibition and finalisation stages. It's worth considering both these situations.

¹¹⁵ Ibid 44.

¹¹⁶ J Forester, *Planning in the Face of Power* (1989); P Healey, *Collaborative Planning* (1997).

¹¹⁷ Ibid.

¹¹⁸ P Healey, *Collaborative Planning* (1997)

¹¹⁹ Ibid 216.

Firstly, the purpose of the public exhibition and other community consultation on a plan is to ensure that the views of key players in the community are fully addressed by the technical staff preparing a plan. If the technical staff fail to appreciate the desires of homebuyers, business owners, etc, the consultation process is an opportunity for them to speak up and draw attention to the flaws in the proposed planning direction.

In our experience, plans can often be improved as a result of direct dialogue with developers. Regretfully, most draft plans are not revised as much as they should be. Politicians are often concerned that the community will react negatively if governments are seen to be too responsive to the views of developers.

However, there are other more significant limitations to the effectiveness of the political process for corrected errors and gaps in strategic planning.

Most home-buyers are not engaged in government strategic planning processes and would not know how to relate their own preferences for a home to a government policy document. In fact, a strategic plan is typically intended to have a life of between five and thirty years, and most people who will buy a home in this timeframe will not be in the housing market at the time that plans are prepared. For example, at the time a plan is prepared someone may be happily married and think they will never need to buy a new home again, but three years later they may be on the road to divorce, and find themselves thrown back into the housing market.

Future homebuyers would generally not be alert to the government's intentions at the time that the strategic plan was prepared.

Similarly, most businesses that might be willing to invest their capital in commercial ventures in a region over a given timeframe were probably not on the scene at the time that the government prepared its land use strategy. There is no meaningful way for these home buyers or businesses to engage in any strategic planning process that takes place years before they were even aware that they might want to make an investment in, or purchase a property.

Even in relation to the current preference of home buyers and businesses, it can be difficult for the political process (i.e. community consultation) to draw out their preferences and adequately reflect them in a strategy. Dr Sam Staley has explained that:

[F]ormal public planning [is] inherently incapable of collecting or processing the information that would be socially relevant. Producers (and by extension planners) are faced with a "knowledge problem," understanding what consumers want and finding the most efficient means for producing those goods and services. **Knowledge itself is comprised of two components: articulate and inarticulate** ... Articulate knowledge represents the tangible expression of wants and preferences. This is the kind of information that could be gleaned from market surveys, focus groups, or interviews with buyers. Moreover, this is information that can be objectively measured. In the residential housing market, objective information could include criteria such as the size of a preferred house in square feet, the number of bedrooms, the size of the lot, access to shopping or work in time or linear miles, etc.

The more important component, however, is inarticulate or implicit knowledge. While consumers may be able to express certain aspects of their preferences, other key ingredients may not be articulable. Often, customers will buy a product based its look or feel and an expectation about whether that product will satisfy

their needs. Some of this inarticulate knowledge may be aesthetic; other aspects may be functional. In the real-estate market, how a house sits on a lot may have important impacts on the perception (or expectation) of privacy, or its functionality (e.g., steep driveways in winter climates). Similarly, objective criteria may not be able to capture key aspects of a neighborhood that are important to future residents and consumers.

Actual buying behavior reflects a complex interaction of articulate and inarticulate knowledge. Part of the consumer's decision reflects an assessment of measurable tradeoffs—how much lot is the consumer willing to trade off for the size of a house? Other parts of the decision are inarticulate or unknowable—will this house serve the needs of a growing family?

These are tradeoffs that consumers make based on objective information, experience, expectations about future events, and personal preference. Inarticulate knowledge is the source of most uncertainty in the market and the primary component of its dynamic nature. Articulate knowledge by its very nature can be measured and, in theory, be forecasted with a reasonable degree of precision.

Market prices serve as an intermediating data point that provides summary information to consumers about products (and potential revenue for producers). ... The decision to purchase (or produce) a product depends on a synthesis of our understanding of preferences as well as hunches, "feelings," and judgements based on inarticulate information from experience. Economic preferences can only be known when they are "revealed" through their decisions about what to buy and for how much. **The inarticulate knowledge cannot be replicated in formal planning, and thus accurate predictions or forecasts about consumer buying patterns are virtually impossible.**

Markets, in contrast, are capable of processing this knowledge because of the dynamic institutional context in which consumer information is processed. Money prices provide a commonly accepted metric that intermediates between entrepreneurs and consumers who can act only on partial information. Money facilitates these transactions because it is tangible, has a commonly accepted value (under a stable monetary regime), and is fungible. Thus, movements in prices emerge as reflections of the subjective values of consumers and producers about goods and services available in the market. ...

But **the information provided by market transactions is not completely transparent.** On the contrary, entrepreneurs are constantly looking for market opportunities "missed" by others ... Thus, the market process is an institution of discovery, where buyers and sellers are constantly assessing what customers want, what consumers are willing to pay for, and what production methods most effectively and efficiently provide those goods and services ... The dynamism of the market process allows the revealed preferences of consumers to be incorporated into future decisions on both the producer and consumer side of the ledger. The market is disciplined by the profit and loss system (absent third-party intervention such as a government) (bold added).¹²⁰

"It is not possible for any type of political process, such as community consultation, to fully and adequately reveal the inarticulate or implicit knowledge of home buyers and intending funders of new business premises."

¹²⁰ Samuel Staley, Urban Planning, "Smart Growth, and Economic Calculation: An Austrian Critique and Extension", *The Review of Austrian Economics*, 17:2/3, 265–283, 2004, 274-275.

It is not possible for any type of political process, such as community consultation, to fully and adequately reveal the inarticulate or implicit knowledge of home buyers and intending funders of new business premises. Ultimately, these preferences are best revealed through observation of market activity. The Lower Hunter Strategy is too rigid and prevents that market activity from occurring.

Secondly, strategic plans can be made worse as a consequence of political oversight and community consultation because strategies can be used as a vehicle for introducing rules and prohibitions that are based on public opinion or ideology, rather than a sound technical basis. (Although we would note that the “technical” work of government planners is usually not value neutral.)

The evidence consistently shows that political ideology can influence decisions made concerning the regulation of land use.¹²¹

The ideological basis of many planning controls can lead to arbitrary, inconsistent and irrational rules. You do not need to accept our word for it; consider the recent words of the majority in the NSW Court of Appeal (Justice Basten, with President Allsop agreeing):

[I]t has also been said with some justification that a search for logic and consistency within planning instruments is often doomed to fail. As has been explained by Tobias JA, **to seek “planning logic in planning instruments is generally a barren exercise** ... Why one use is permissible and another similar use is prohibited will often be a matter of speculation. ... [In the present case it] may be conceded that there is no obvious logic ... (bold added).¹²²

Rules that lack the rigour of a technical standard are more easily challenged when they are preventing good social and economic outcomes (and rightly so). Inevitably, people question the need to rigidly apply a strategy, or support a departure from the strategy when:

- public opinion changes;
- the market demand for new development changes (e.g. the emergence of widespread consumer demand for apartment living in the largest capital cities); and/or
- the social and economic costs of a given restriction or prohibition have increased or have become more apparent.

The social and economic costs of rules originally imposed for subjective reasons often involve:

- inefficient use of public infrastructure;
- increased motor vehicle use;
- increased congestion;

¹²¹ Jeffrey Dubin, , Roderick Kieweit, Charles Noussair, 'Voting on growth control measures: preferences and strategies'(2009) 4(2) Economics and Politics 191; Elisabeth Gerber, Justin Phillips, 'Development ballot measures, interest group endorsements, and the political geography of growth preferences' (2003) 47(4) *American Journal of Political Science* 625; Matthew Kahn 'Do liberal cities limit new housing development? Evidence from California' (2011) 69 *Journal of Urban Economics* 223.

¹²² *Hastings Co-operative Ltd v Port-Macquarie Hastings Council* [2009] NSWCA 400 [39].

- reduced competition in the retail sector;
- reduce competition amongst land owners to sell potential development sites to developers;
- an inadequate supply of housing in places of high demand;
- higher residential, retail and commercial rents; and
- lack of housing affordability.

It is also important to understand that most members of the “community” being consulted on a given strategic plan would not actually be aspiring home buyers (or business owners looking to acquire new business premises). As a result community consultation is likely to be skewed in favour of home owners and businesses already established in an area. Existing home owners in a local area have a financial incentive to discourage new construction because it reduces the scarcity value of their property asset.¹²³ Incumbent business operators, who play an important role for local government at election time, have strong vested interest in mobilising campaigns against new developments that may place them under competitive pressure.¹²⁴

This closed system approach tends to exclude consideration of the interests of future residents, neighbouring regions and non-resident third parties.¹²⁵ This becomes particularly problematic when communities are faced with accommodating innovative development proposals.¹²⁶ By their nature, innovative proposals break from traditional existing patterns of development.¹²⁷ Yet, planning procedures give the most weight to participants with an inherent interest in preserving existing development patterns, and the least to the future residents or the beneficiaries of community changes.¹²⁸

“Good plans will allow the market to operate flexibly. The Lower Hunter Regional Strategy needs to be re-drafted to permit much greater market flexibility.”

Political oversight of strategies is essential in any democratic society. However, that political oversight will not deliver perfect plans. Good plans will allow the market to operate flexibly. The Lower Hunter Regional Strategy needs to be re-drafted to permit much greater market flexibility.

¹²³ William Fischel, ‘Does the American way of zoning cause the suburbs of metropolitan areas to be too spread out?’ In: Altschuler, Alan et al. (Eds.), *Governance and Opportunity in Metropolitan America*. National Academies Press, Washington, pp. 151–191; Fischel, William A., 2001. ; Carolyn Dehring, Craig Depken, Michael Ward, ‘The Homevoter Hypothesis: How Home Values Influence Local Government Taxation School Finance and Land-use Policies’ (2008). ‘A direct test of the homevoter hypothesis’ *Journal of Urban Economics* 64, 155.

¹²⁴ A Fels et al. *Choice Free Zone* (2008).

¹²⁵ Ibid. See also: Edward Glaeser, Bryce Ward, ‘The causes and consequences of land use regulation: evidence from greater Boston’ (2009) 65(3) *Journal of Urban Economics* 6 265.

Laarni Bulan, Christopher Mayer, C. Tsurie Somerville, ‘Irreversible investment, real options, and competition: Evidence from real estate development’ (2009) 65 *Journal of Urban Economics* 237.

¹²⁶ Ibid.

¹²⁷ Ibid.

¹²⁸ Ibid.

7.5. EFFORTS TO PROMOTE CERTAINTY ARE MISDIRECTED

Participants in the planning system often complain about uncertainty. It is true that there is not much uncertainty in the planning system and some type of uncertainty is a reason for a lack of investment, or may lead to investment only taking place when there is a sufficiently high risk premium.

However, policy-makers should not take such complaints as a call to seek to eliminate all risk (and therefore all uncertainty) from the development process. The process of urban development is fundamentally a higher risk business, at the opposite end of low-return, low risk business opportunities such as a utility provision.

Policy makers must distinguish between regulatory risk and market risk. The planning system should seek to minimise the former, but avoid tampering with the latter.

“It should not be the role of the planning system to provide certainty to investors in one location, by giving them assurance that they will be protected from competition in other nearby locations.”

That is, the planning system should seek to provide certainty to the private sector by having clear rules, simple processes, swift processing times and low predictable costs. It should not be the role of the planning system to provide certainty to investors in one location, by giving them assurance that they will be protected from competition in other nearby locations. Planning systems should reduce regulatory risk, but not market risk.

Regretfully, rules are often put in place in the planning system to protect sections of the private sector from market risks. All this will do is provide certainty for oligopolistic landlords and provide few options for those seeking to satisfy unmet market demand. Reformed planning systems should focus on minimising unnecessary regulatory risks.

Eliminating a regulatory risk means, for example, that if a strategy identifies a particular landowner's land for urban release, the landowner can expect that government agencies will work to make this happen. If this is the case, the strategy has played an important role in reducing the developer's regulatory risk, and therefore it has lowered the risk premium that is needed for the landowner to attract capital for the development of the land.

On the other hand, a landowner whose land has been flagged for release under a strategy, might also want market risk eliminated. The landowner would therefore insist that the land outside the strategy should not be released until land, expressly within the strategy is fully developed. The landowner might also demand that previously adopted sequencing plans be rigidly adhered to. This would be in the landowner's interests because it would reduce competition. Such a public policy approach would reduce the market risk the landowner faces when seeking to develop land. However, does the reduction in the market risk mean that the landowner will proceed with the investment in a timely way? The academic and empirical analysis suggests not (see the discussion in the earlier part of this chapter).

Additionally, there will be instances where capital investment can and should take place in spite of regulatory risk. For example, if strategy has not provided for sufficient land supply, and the market is severely constrained, there

is likely to be rapid escalations in rents and prices. In such circumstances a landowner/developer may be willing to spend money to seek to develop land, even though the land has not clearly identified in a sequencing plan or a strategy. Clearly they will face higher regulatory risks, but the land supply shortage has pushed up rents and prices, so they may feel that the increased regulatory risk will be offset by a higher anticipated rate of return. There is nothing wrong with a developer/landowner acting in this way. It is, in fact, desirable. The reality is, strategies and sequencing plans are often not revised, even in the face of clear evidence that they are wrong and creating shortfalls in supply. The last thing policy makers should be doing is dissuading people from seeking to develop their land to satisfy unmet demand, merely because the land was not flagged in a strategy.

“The Lower Hunter Strategy is both rigid in its content and its implementation.”

The Lower Hunter Strategy is both rigid in its content and its implementation. It is rigid in its content because it only aims to supply “sufficient” land, and, sequencing is used to ensure that only sufficient land is made available at any given time.

It is rigid in its implementation, because it does not envisage decisions being made that are inconsistent or outside of the strategy. Instead it says that:

strategies are not static reports, but living documents that respond to changing circumstances. They will be kept under review, including in relation to the latest demographic and population data.¹²⁹

This statement sounds good, but what it is really saying is that if circumstances change, the strategy must be amended. The reality is, the political process involved in reviewing and changing a strategy is long and complex. It rarely happens in any period of time shorter than two years, and will often take longer. Typically, this process in itself, guarantees no outcome, and further decisions to actually implement a revised strategy will take several years.

“Strategies, including a new Lower Hunter Strategy, should be broadly framed. They should be highly flexible in their content, and contemplate a range of possible outcome in terms of dwelling mix, employment growth and population and job distribution.”

Strategies, including a new Lower Hunter Strategy, should be broadly framed. They should be highly flexible in their content, and contemplate a range of possible outcome in terms of dwelling mix, employment growth and population and job distribution. They should also actively contemplate that decisions will be made outside of the strategy, as needed, in order to ensure that the market demand for housing and business premises is able to be satisfied.

¹²⁹ NSW Department of Planning, *Regional Strategy Update Report 2009* (2009) 1.

We note that this view accords with the recent conclusions of the Productivity Commission that land use strategies should contain:

provisions to facilitate adjustment to changing circumstances and innovation ...¹³⁰

The Commission also favoured

broad and simple land use controls to: reduce red tape, enhance competition, help free up urban land for a range of uses and give a greater role to the market in determining what these uses should be ...¹³¹

¹³⁰ Productivity Commission, *Performance Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessments Volume 1* (2011) xlii.

¹³¹ Ibid xviii.

8. STRATEGY GOVERNANCE

- The Lower Hunter Regional Strategy was prepared without an infrastructure implementation plan. Instead, the existing Lower Hunter Strategy merely invokes the previously published State Infrastructure Strategy 2006–07 to 2015–16.
- Existing home owners in a local area have a financial incentive to discourage new construction because it reduces the scarcity value of their property asset.
- Incumbent business operators, who play an important role for local government at election time, have strong vested interest in mobilising campaigns against new developments that may place them under competitive pressure.
- The closed system approach tends to exclude consideration of the interests of future residents, neighbouring local government areas and non-resident third parties.
- Local councils, as elected institutions, are politicised. By their very nature their ideology is subject to change with the election and by-election cycle, which usually are not aligned with any forward looking strategic plan.
- It is quite likely that, at any given point in time, the ideology of at least some councils within the Lower Hunter region will not align with the underlying philosophy inherent in the regional strategy.
- In the absence of a single council for the whole Lower Hunter region, other changes to the planning system will be required to overcome the governance problems identified in both the academic literature and by the Commonwealth Government.
- The Lower Hunter Regional Strategy may ultimately count for nothing when time comes to implement the strategy by making decisions under the Environment Planning and Assessment Act.
- The difficulty is that a regional strategy, which purports to be forward looking, may not survive a change in government, or even a change in minister.
- The substance of the reviewed Lower Hunter Regional Strategy should, once it is finalised, immediately be enacted in a state environmental planning policy (SEPP).
- The Minister, local councils and other consent and concurrence authorities (such as the joint regional planning panels, the Planning Assessment Commission and the Roads and Traffic Authority) should be required to approve proposals that are in-line with strategy, as embodied in the SEPP, in considering rezoning and determining development applications.
- This would necessarily be accompanied by an explicit duty for a consent authority to consider the financial constraints on the economic viability of a desirable planning development when the applicant has elected to provide information on the subject.

Any strategy document is only useful if there is a genuine commitment to its implementation by all the relevant authorities. The difficulties that can emerge when there is insufficient commitment and/or co-ordination across state government agencies have recently been highlighted by the Commonwealth:

A major failing with many metropolitan plans is poor implementation due to inadequate administrative processes or inadequate policy commitment. This creates uncertainties and inefficiencies for all stakeholders, whether it be a local government seeking certainty of state investment in infrastructure to support an urban growth area; a developer wishing to market land as being close a public transport; individual community members making choices of where to live based on what facilities and services they will have access to; or lack of protection from encroachment of incompatible uses resulting in major pieces of economic infrastructure, such as a freight corridor or airport, not being able to be used to their maximum productive potential.¹³²

8.1. STATE AGENCIES

At a state government level, the leading implementation agency is the NSW Department of Planning and Infrastructure, but other agencies also play a vital role such as NSW Treasury, Transport for NSW, NSW Road and Maritime Services, the Office of the Environment and Heritage, NSW Health, the Department of Education.

The Commonwealth observes that:

Ideally state agencies/departments, with input from relevant external stakeholders, including local government, would contribute to the development of a state development strategy and infrastructure implementation plan, which works in conjunction with a metropolitan/regional scale plan.¹³³

“The existing Lower Hunter Strategy merely invokes the previously published State Infrastructure Strategy 2006–07 to 2015–16 and identifies pre-existing infrastructure projects.”

This process did not take place prior to the preparation and release of the Lower Hunter Strategy. Instead, the existing Lower Hunter Strategy merely invokes the previously published State Infrastructure Strategy 2006–07 to 2015–16 and identifies pre-existing infrastructure projects in the short-to-medium term that (among other things) support population growth and demographic change in the Lower Hunter.¹³⁴

The lack of agreement between state government agencies after the finalisation of the Lower Strategy has been evidenced by the difficulty individual developers have had determining what, if any, payment should be made to government as an appropriate contribution to state infrastructure.¹³⁵ This process was plagued by disagreement and dispute – not only between developers and agencies, but between the agencies themselves.

¹³² Australian Government, *Our Cities: The Challenge of Change: Background and Research Paper 2010* (2010) 112.

¹³³ Ibid.

¹³⁴ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 43.

¹³⁵ The Lower Hunter Strategy provided that where development or rezoning increases the need for state infrastructure, the Minister for Planning may require a contribution to the infrastructure having regard to the State Infrastructure Strategy and equity considerations: NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 11.

Arguably, after the finalisation and publication of the Lower Hunter Regional Strategy, the NSW Government *did* undertake a more intensive process of infrastructure assessment. However, the outcome of this process was not published until January 2011, more than four year after the Lower Hunter Strategy itself was finalised.¹³⁶ It is not yet clear whether or not this will represent the final word on the subject of infrastructure funding and delivery.

8.2. LOCAL GOVERNMENT

Under the state's planning laws, local government also has a vital role to play in the implementation of the strategy. The Lower Hunter's five local councils (Newcastle, Lake Macquarie, Port Stephens, Maitland and Cessnock) are charged with:

- reviewing and revising local environmental (zoning) plans and development control plans (setting out controls such as minimum and maximum lot size, height controls, site coverage requirements) that may impact on the implementation of the strategy;
- determining whether individual rezoning proposals (necessary to translate the broad text of the strategy into legally enforceable land use controls) will be considered by the NSW Department of Planning and Infrastructure in the "gateway" process;
- assessing individual development applications for residential, commercial and retail development;
- formulation of local council development levies ("section 94 contributions") which, if set too high, or are uncertain, can impact on the commercial viability of development; and
- delivery of infrastructure that may be important to the success of development plans.

The Commonwealth recently observed that:

A factor in the successful implementation of the approach to local coordinating planning with State budgets ... is likely to be the number of local government authorities within each city region. The fragmentation of the capital cities, except Brisbane, into numerous councils, and similarly some of the smaller regional cities like Wollongong, Newcastle and Launceston having multiple councils, presents a major challenge to the effective management of cities.¹³⁷

The problem of fragmented local councils in the implementation of broader community-wide goals has long been a subject of analysis. Many urban researchers have argued that the planning system is a "closed system decision making process."¹³⁸ Development systems become closed primarily through two factors – the basic preferences of local voting population, who tend to be averse to change, and the planning laws, which tend to magnify the preference of those resident voters.¹³⁹ Existing home owners in a local area have a financial incentive to discourage new construction because it reduces the scarcity value of their property asset.¹⁴⁰ Incumbent business

¹³⁶ On 21 January 2011, the NSW Government released the public consultation documents for its proposed \$8,800 levy on new homes in the Lower Hunter and a \$42,100 levy on each hectare of new Lower Hunter industrial land. The material included a brief schedule of state infrastructure that was said to be attributable to the 25 years worth growth provided for under the Lower Hunter Strategy.

¹³⁷ NSW Department of Planning, *Lower Hunter Regional Strategy* (2006) 113

¹³⁸ S Staley, "Markets, smart growth and the limits to policy", *Smarter Growth* (2001) 201-217.

¹³⁹ S Staley and EW Claeys, "Is the future of development regulation based in the past? Toward a market-oriented, innovation friendly framework", *Journal of Urban Planning and Development* (December 2005), 202-213, 203.¹

¹⁴⁰ William Fischel, 'Does the American way of zoning cause the suburbs of metropolitan areas to be too spread out?' In: Altschuler, Alan et al. (Eds.), *Governance and Opportunity in Metropolitan America*. National Academies Press, Washington, pp. 151–191; Fischel, William A., 2001. ; Carolyn Dehring, Craig Depken, Michael Ward, 'The Homevoter Hypothesis: How Home Values Influence Local Government Taxation School Finance and Land-use Policies' (2008). 'A direct test of the homevoter hypothesis' *Journal of Urban Economics* 64, 155.

operators, who play an important role for local government at election time, have strong vested interest in mobilising campaigns against new developments that may place them under competitive pressure.¹⁴¹

This closed system approach tends to exclude consideration of the interests of future residents, neighbouring local government areas and non-resident third parties.¹⁴² This becomes particularly problematic when communities are faced with accommodating innovative development proposals.¹⁴³ By their nature, innovative proposals break from traditional existing patterns of development.¹⁴⁴ Yet, planning procedures give the most weight to participants with an inherent interest in preserving existing development patterns, and the least to the future residents or the beneficiaries of community changes.¹⁴⁵ Growth management and consistency requirements create a presumption against change.¹⁴⁶

Planning authorities will reduce their own legal risks if they continue to enforce the status quo, but considerable litigation and judicial review if they pursue policies that favour spontaneous or unanticipated changes.¹⁴⁷

"It is quite likely that, at any given point in time, the ideology of at least some councils within the Lower Hunter region will not align with the underlying philosophy inherent in the regional strategy."

Local councils, as elected institutions are politicised. By their very nature their ideology is subject to change with the election and by-election cycle, which usually are not aligned with any forward looking strategic plan. The evidence consistently shows that political ideology can influence decisions made concerning the regulation of land use.¹⁴⁸ It is quite likely that, at any given point in time, the ideology of at least some councils within the Lower Hunter region will not align with the underlying philosophy inherent in the regional strategy.

At present (particularly since Part 3A was discontinued for residential, commercial and retail development) there is no mechanism to ensure that the high level approach taken by the state in the interest of the whole region is adopted by each of the local councils within the region.

The Commonwealth has observed that

there is debate over wasted resources and opportunities associated with smaller local authorities versus a local desire for adequate representation and decision-making power.

¹⁴¹ A Fels et al. *Choice Free Zone* (2008).

¹⁴² Ibid. See also: Edward Glaeser, Bryce Ward, 'The causes and consequences of land use regulation: evidence from greater Boston' (2009) 65(3) *Journal of Urban Economics* 6 265.

Laarni Bulan, Christopher Mayer, C. Tsurriel Somerville, 'Irreversible investment, real options, and competition: Evidence from real estate development' (2009) 65 *Journal of Urban Economics* 237.

¹⁴³ Ibid.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

¹⁴⁷ S Staley and L Gilroy, "Smart Growth and housing affordability: Lessons from statewide planning laws", *Policy Study No 287*, Reason Foundation, Los Angeles.

¹⁴⁸ Jeffrey Dubin, , Roderick Kieweit, Charles Noussair, 'Voting on growth control measures: preferences and strategies'(2009) 4(2) *Economics and Politics* 191; Elisabeth Gerber, Justin Phillips, 'Development ballot measures, interest group endorsements, and the political geography of growth preferences' (2003) 47(4) *American Journal of Political Science* 625; Matthew Kahn 'Do liberal cities limit new housing development? Evidence from California' (2011) 69 *Journal of Urban Economics* 223.

In cities that have many small councils there may be merit in a national and community discussion involving all levels of government on reforming Local Government through the creation of larger entities that can plan, finance and coordinate over larger population areas, and achieve greater economies of scale in service delivery and asset management.¹⁴⁹

In the absence of a single council for the whole Lower Hunter region, other changes to the planning system will be required to overcome the governance problems identified in both the academic literature and by the Commonwealth Government.

8.3. IMPROVING GOVERNANCE AND IMPLEMENTATION

Failing the kind of serious and wide-ranging local government reform that this would require, a strategy is more likely to be implemented if the following factors set out below are addressed.

The current planning system works by prohibiting all development that is not identified as being permitted. The tools for these prohibitions are “environmental planning instruments”. These are generally known as either “state environmental planning policies” (SEPPs) or “local environmental planning plans” (LEPs).

Regional strategies identify the future development needs of a community, and therefore, the bulk of the development is generally prohibited by existing environmental planning instruments.

It might be natural to assume that, when a strategy is finalised and published, it is published as SEPP, so that its provisions have immediate effect under the state’s planning laws. However, it is not the practice of the government. Instead, these documents exist as non-statutory ghosts outside the explicit terms of the Act.¹⁵⁰

As a result, such strategy documents, while lauded by government as evidence of their forward planning, may ultimately count for nothing when it comes time to implement the strategy by making decisions under the *Environment Planning and Assessment Act*.

For example, if a developer is ready to proceed with a housing development that was envisaged under the Lower Hunter Strategy, a casual bystander might assume that he or she could simply lodge an application. Regretfully, this is not how things work.¹⁵¹ The Land and Environment Court have made it clear an unequivocal environmental planning instrument takes precedence over non-statutory regional planning policies. So if land identified for urban release in a regional strategy is currently zoned *rural* under an environmental planning instrument, a developer has no right to lodge an application for approval of a non-rural development.

In practice, an application can only be made under Part 4 (the development approval stream) if the local council, and then the Minister for Planning and Infrastructure, have agreed to rezone the land and if this process has been completed. The power to grant a rezoning is more in the nature of a quasi-legislative or policy making power rather than an administrative decision.¹⁵² Accordingly, a decision-maker is not compelled to rezone land in response to a request from the applicant, even when acceding to such a request would give effect to a non-statutory strategy.

¹⁴⁹ Australian Government, *Our Cities - building a productive, sustainable and liveable future* (2010) 53.

¹⁵⁰ *Direct Factory Outlets Homebush v Strathfield Municipal Council* [2006] NSWLEC 318 [24].

¹⁵¹ *Ibid* 318 [26].

¹⁵² *Bienke v Minister for Primary Industries and Energy* (1994) 125 ALR 151, 163; *Minister for Urban Affairs and Planning v Rosemount Estates Pty Ltd* (1996) 91 LGERA 31, 48; *Save the Showground For Sydney Inc v Minister for Urban Affairs and Planning* (1997) 95 LGERA 33, 53.

An alternative to the cumbersome process of first securing a rezoning and then making a development application was Part 3A. Until April 2011, an application could only be made under Part 3A if the Minister for Planning had elected to authorise the making of a concept plan application. This was a discretionary decision and again, a Minister could not be compelled, through any legal mechanism, to exercise this discretion in favour of an application, even when it would give effect to a non-statutory strategy. In any event Part 3A has now been discontinued for new residential, commercial and retail development proposals.

The difficulty is that a regional strategy, which purports to be forward looking, may not survive a change in government, or even a change in minister. The strategy need not formally be abandoned - all that might happen is that the minister ceases use of it as a reference point for his or her decisions. (This certainly was the case with the 2005 Sydney Metropolitan Strategy, which fell out of favour with government after the key personnel who authored the strategy moved on and there was a change in premiers.) Even when the same government or minister remains in office, local councils are independent, yet are charged with making discretionary decisions by planning laws, without any obligation to actually implement the strategy.

"The substance of the reviewed Lower Hunter Strategy should immediately be transferred into a state environmental planning policy (SEPP). The Minister, local councils and other consent and concurrence authorities (such as the joint regional planning panels, the Planning Assessment Commission and the Roads and Traffic Authority) should be required to approve proposals that are in-line with strategy, as embodied in the SEPP, when considering rezoning and determining development applications."

The substance of the reviewed Lower Hunter Strategy should immediately be transferred into a state environmental planning policy (SEPP). The Minister, local councils and other consent and concurrence authorities (such as the joint regional planning panels, the Planning Assessment Commission and the Roads and Traffic Authority) should be required to approve proposals that are in-line with strategy, as embodied in the SEPP, when considering rezoning and determining development applications.

An obligation to approve, in-line with a strategy, would be meaningless if development was approved with conditions that made desirable projects commercially unviable. As a result, such an obligation to approve would necessarily be accompanied by an explicit duty for a consent authority to consider the financial constraints on the economic viability of a desirable planning development when the applicant has elected to provide information on the subject.¹⁵³

¹⁵³ Under existing planning law, a consent authority is lawfully able to consider whether desirable development is not economically feasible, and modify apply planning requirements, so as to ensure that such development is still able to take place (*R v Westminister City Council, Ex parte Monahan* [1990] 1 QB 87. This case has been applied in the context of NSW planning law by both the Land and Environment Court and the Court of Appeal. *City West Housing Pty Ltd v Sydney City Council* [1999] NSWLEC 246 [139]; *Randall Pty Ltd v Willoughby City Council* [2005] NSWCA 205 [36] (Basten JA with Giles and Santow JJA agreeing). However, under the current law, a planning authority is under no compulsion to consider whether conditions sought by the authority will render desirable development economically unfeasible. That is, a decision to consider economic feasibility does not invalidate their decision, but there is not necessarily any positive obligation to consider economic feasibility issues if the consent authority is reluctant to do so.

9. CONCLUSION

- Any new strategy must be sufficiently flexible to accommodate the different scenarios that unfold after the strategy is prepared. It should be highly flexible in its content, and contemplate a range of possible outcomes in terms of dwelling mix, employment growth and population and job distribution.
- A strategy should also explicitly contemplate that decisions will be made outside of the strategy, as needed, in order to ensure that the market demand for housing and business premises is able to be satisfied.
- Such a strategy's flexibility will help it to swiftly accommodate household and business preferences as they evolve and ensure that the strategy is a more robust, longer lived, document.
- The new strategy should contemplate population growth not only at 1.4 per cent a year, but also include scenarios that have the region growing in-line with growth consistent with the recent performance of other major regional communities such as Barwon (1.7 per cent) Toowoomba (1.9 per cent) and Townsville (3.2 per cent).
- The existing 'all the eggs in one basket' 4,600 a year annual dwelling target, should be replaced with a more sophisticated target of 5,400 to 14,500 new homes a year for the region.
- Any new strategy must reduce the risk of undersupply of detached housing for the Hunter region's families, by providing for sufficient land release to generate competitive tension between landowners for developer capital.
- Among other things, this means that assumptions that baby-boomers will migrate into infill housing should be treated with caution. Such an assumption should form the basis of just one of a strategy's scenarios (in order to ensure that development capacity for infill housing is there, if needed), but should not be the only basis of the plan (in the event that baby-boomers stay put, and a greater level of detached housing is therefore required).
- The new strategy should recognise, and accommodate the need for holiday homes owned by non-residents, but ensure additional capacity also exists for the resident population.
- Rather than the existing single target of 2,760 greenfield dwellings a year, the new strategy should provide a target of 4,300 to 13,100 homes a year, with home buyers preference and market realities determining the actual number.
- Rather than the single annual target of 1,840 medium and higher density dwellings, the new strategy should ensure capacity of between 1,100 and 5,800 medium and higher density homes a year.
- Planning authorities should err on the side of making more land available for development, rather than less. The new strategy should actually include a requirement that there is a supply of undeveloped land equivalent to a number of years worth of projected need. We favour a 20 year benchmark, although we recognise that planning authorities in other jurisdictions regard a 15 year benchmark is acceptable. The current absence of a benchmark is inexcusable.

- The promotion of competition should be an enduring feature of any new strategy. It should not be the role of the strategy to provide certainty to investors, in one location, by giving them assurance that they will be protected from competition in other nearby locations.
- The substance of the reviewed Lower Hunter Regional Strategy should, once it is finalised, immediately be enacted in a state environmental planning policy (SEPP).
- The Minister, local councils and other consent and concurrence authorities (such as the joint regional planning panels, the Planning Assessment Commission and the Roads and Traffic Authority) should be required to approve proposals that are in-line with the strategy, as embodied in the SEPP, when considering rezoning and determining development applications.
- This would necessarily be accompanied by an explicit duty for a consent authority to consider the financial constraints on the economic viability of a desirable planning development, when the applicant has elected to provide information on the subject.
- Maintaining a rigid policy favouring development levies may cost the community far more in lost coal mining royalties.
- Development levies are inefficient, poorly administered, complex, non-transparent and set too high — they discourage investment in housing
- State infrastructure contributions and local council development levies should be abolished, or if they are not to be abolished, lowered, made more certain and robust, and restructured so that they do not have a distortionary impact on housing supply.

9.1. THE EXISTING STRATEGY

In this paper we have seen that the existing Lower Hunter Regional Strategy missed the mark in a number of key respects:

- It failed to anticipate the region's need for population growth – with strategy numbers (6,400 a year) falling short of actual numbers (6,800 a year).
- Levels of supply in both new release areas and existing urban areas have fallen well short of the Regional Strategy's targets – and the strategy itself has delivered almost nothing to the supply of residential lots.
- The restrictions on the supply of detached housing have been heavy handed, and there has been insufficient incentive for landowners to compete with each other to sell their land to developers.
- Its attempts to use regulatory controls to shift home buyers into infill housing have not worked.

As a result, the actual outcome on the ground in the Lower Hunter does not satisfy the community's needs.

Even though the Strategy failed to deliver housing at anywhere near the required levels, population growth still exceeded to Strategy's original targets. In one sense this is counter-intuitive, because government planners typically seek to control population growth by restricting the housing supply. However, the outcome seems obvious, when one considers how truly low-balled the Lower Hunter's population targets really were.

This report compared the Lower Hunter region against other regional areas in the eastern states, to show that population growth has been greatly inferior to the Barwon region in Victoria, and to the Sunshine Coast, Townsville and Toowoomba regions in Queensland.

The Lower Hunter's lack of housing supply has placed important constraints on the region:

- The housing supply gap has been most obvious in relation to the low rate of construction in new release areas, but the level of medium and high density housing at urban centres has also been low, compared with the Strategy's projections.
- We have seen that the weak supply of housing relative to overall population growth has stunted the region's ability to accommodate "potential upgraders" (35 to 49 years). If this trend is allowed to continue the composition of the region's population base may become mal-apportioned, and be out-of-kilter with the rest of NSW. No-one wants the Lower Hunter to become known as a region which families avoid, due to housing unaffordability.
- We have seen increased dependence on rental housing. Nearly half the annual population the region saw over the period 2005 to 2010 was only possible because of the more intensive use of existing rental housing. To the extent that the Lower Hunter Strategy has forced a shift away from home ownership to renting, it also has led to increased social costs. These social costs will become more apparent as time progresses.
- In the absence of a large expansion in dwelling construction, it seems inevitable that rental growth in the Lower Hunter will remain very high over the next five years. This report predicts a continued rate of 10 per cent growth in rentals per annum for these regions.
- More intensive use of existing housing stock will have delivered reduced living standards. Rooms set aside as studies, or TV rooms, must be converted to bedrooms. Dilapidated premises that would otherwise have been regarded as unsuitable for rental (pending renovation) may instead be tenanted.
- A rationed supply of housing will increasingly pit the region's existing residents seeking housing against those moving into the region. From 2000 to 2010, median rentals for a 3 bedroom house in the Lower Hunter have risen by between 82 per cent (Port Stephens) and 100 per cent (Newcastle). Rental growth has far outstripped Sydney, which suffered a 67 per cent rise over the same period. The proportion of rental households in stress is estimated to have risen to 56 per cent. The break on housing supply induced by limits to net growth does not merely mean a reduction in the number of new people coming to the region; it will inevitably mean that many local people who have a preference to stay in the region will find themselves priced out of the local housing market.
- A consequence of the relatively low population growth has been a weaker jobs growth. Again, this isn't surprising. Higher population growth creates more demand for commercial and industrial building space,

and can thereby underpin the viability of new projects. If population growth had been sustained at a similar rate to the Barwon region (home to Victoria's second largest city Geelong) at 1.7 per cent per annum over the five years to 2009, then this report estimates that the annual rate of jobs growth would have been about 2 per cent per annum (nearly double the Lower Hunter's average annual job growth rate of 1.1 per cent).

- If population growth had been as robust as in Barwon, residential building would have been \$150 million greater per annum over the five years to 2010. In that event, rather than having a flat profile for non-residential building, activity would have been about 30 per cent higher on average over the five year period.

9.2. THE NEW STRATEGY

If there is no reform to the Lower Hunter's residential development process, population growth will be stunted to just 5,000 people a year (0.9 per cent a year). That would see the Lower Hunter, the region that should be NSW's economic powerhouse, growing at roughly the same rate as Launceston, Burnie-Devonport and Lismore.¹⁵⁴ This will clearly have economic consequences, but the social consequences should also not be ignored. For example, if rental growth averages 8 per cent per annum across the Lower Hunter this report projects that in five years, 65 per cent of current rental households would be in a state of housing stress.

The existing strategy's errors must not be replicated in any new document. **Any new strategy must be sufficiently flexible to accommodate the different scenarios that unfold after the strategy is prepared.**

This report has projected that the Lower Hunter's annual population growth should at least increase to an average of 7,500 people over the next decade (1.4 per cent a year). However, any population projection, including the one favoured by this study, will be sensitive to its underlying assumptions. That's why this report considers a range of higher growth scenarios, as well as a "business-as-usual" no-reform scenario. **A new Lower Hunter Regional Strategy should also encompass a diversity of growth scenarios. Such a strategy's flexibility will help it to swiftly accommodate household and business preferences as they evolve and ensure that the strategy is a more robust, longer lived, document.**

The Urban Taskforce recommends that the next Lower Hunter Regional Strategy contemplate population growth not only at 1.4 per cent a year, but also include scenarios that have the region growing in-line with growth consistent with the recent performance of other major regional communities such as Barwon (1.7 per cent) Toowoomba (1.9 per cent) and Townsville (3.2 per cent).

These higher growth scenarios could come into play in a variety of circumstances. One such circumstance arises if Sydney's recent inability to absorb growth continues and becomes entrenched, and sufficient investment in transport infrastructure (such as high speed rail) occurs to make the services and employment opportunities of Sydney more accessible to Lower Hunter residents.

Figure 53 summarises the key scenarios that feature in this report.

¹⁵⁴ An average annual growth rate of 0.7 per cent, 0.8 per cent and 0.9 per cent respectively over the period 2005 to 2010, according to the Australian Bureau of Statistics, 3218.0 *Regional Population Growth, Australia*.

Figure 53. Scenarios for population growth and underlying demand for new dwellings

Potential pop. growth rate (percent per annum)	Growth in-line with	Scenario Lower Hunter annual population gain 2010-2020	Projected annual underlying demand for new dwellings	Projected annual underlying demand for new dwellings	Projected annual jobs growth
			1.8 persons per dwelling	1.4 persons per dwelling	
0.9	Lower Hunter status-quo, without reform	5,000	2,800	3,550	2,050
1.3	Existing Lower Hunter Strategy target	6,400	3,600	4,600	2,650
1.4	Lower Hunter, with reform	7,500	4,500	5,350	3,100
1.7	Barown, Vic	10,040	5,600	7,150	4,150
1.9	Toowoomba, Qld	11,324	6,300	8,100	4,700
3.1	Sunshine Coast, Qld	19,521	10,850	13,950	8,100
3.2	Townsville Qld	20,244	11,250	14,450	8,400

Source: MacroPlan

It is difficult to predict with precision, in advance, what the socially optimal level of growth is going to be. But it is vital that the region's growth is not inappropriately restrained by land use planning failures. In particular, it is important that the mining and engineering projects that are vital to NSW are not delayed or cancelled due to constraints in housing supply or workforce.

As a consequence, we believe the new Lower Hunter Regional Strategy should cater to three of the possible growth scenarios outlined in figure 53. That is, an average annual population growth of:

- 1.4 per cent, which equates to 6,400 extra people a year and annual job growth of close to 2,700;
- 1.7 per cent, which equates to around 10,000 extra people a year and annual job growth of 4,200; and
- 3.2 per cent, which approximates 20,200 extra people a year, with an annual job growth of 8,400.

The overall number of new homes that must be built to support each of these scenarios will vary depending on the view which planning authorities take on the average number of persons who will occupy each dwelling. The current strategy assumes that 1.4 persons will occupy each dwelling, but the body of this report uses 1.8 persons per dwelling as a reference point, given the more intensive use of housing stock that has occurred in the intervening period.

Planning authorities often regard more intensive use of housing stock as intrinsically a good thing. Of course, more

intensive use can also represent a drop in living standards, as houses that would otherwise be regarded as too derelict are put in use, and/or rooms that might otherwise be used as studies, family rooms or play rooms are deployed as bedrooms.

If planning authorities are prepared to 'lock in' recent trends in housing occupation, they might favour assuming 1.8 persons per dwelling, which necessitates annual dwelling supply around:

- 4,500 a year (for 1.4 per cent annual population growth);
- 5,600 a year (for 1.7 per cent a year annual population growth; and
- 11,300 a year (for 3.2 per cent a year population growth).

If planning authorities are households the option of improving their living standards, by making it easier for young people to set up their own household and allowing existing housing stock to be used less intensively when it suits householders, land use controls might assume 1.4 persons per household, as per the existing strategy. This necessitates annual dwelling supply around:

- 5,400 a year (for 1.4 per cent annual population growth);
- 7,200 a year (for 1.7 per cent a year annual population growth; and
- 14,500 a year (for 3.2 per cent a year population growth).

In short, the existing 'all the eggs in one basket' 4,600 a year annual dwelling target, should be replaced with a more sophisticated target of 5,400 to 14,500 new homes a year for the region. Of course, the actual number built within this range will be for the market to determine. The important thing is that, within these boundaries, land use planning should not be the hand break on the community's clear housing needs.

Any new strategy must reduce the risk of undersupply of detached housing for the Hunter region's families, by providing for sufficient land release to generate competitive tension between landowners for developer capital. Among other things, this means that assumptions that baby-boomers will migrate into infill housing should be treated with caution. Such an assumption should form the basis of just one of a strategy's scenarios (in order to ensure that development capacity for infill housing is there, if needed), but should not be the only basis of the plan (in the event that baby-boomers stay put, and a greater level of detached housing is therefore required).¹⁵⁵

This report has favoured a break-up of 80 per cent greenfield and 20 percent infill. This is consistent with a more moderate movement of baby-boomers into infill housing, than originally anticipated by the Lower Hunter Regional Strategy. It also recognises that higher density housing in most locations in the Lower Hunter is unable to offer benefits equal to higher density housing in the inner suburbs of Sydney. That is, insufficient relative value is attached by home buyers to geographic proximity to town centres to justify paying the necessary price to warrant large scale, ongoing, investment in higher density housing for a permanently resident population. Nonetheless, the Lower Hunter Regional Strategy should contemplate scenarios where this changes, for example, due to a dramatic

¹⁵⁵ In Newcastle, new two-bedroom apartments currently sell for about \$500,000 and three-bedroom apartments for \$650,000. Those prices equate to selling values of \$4,300 to \$4,500 per square metre. Taking out agent selling fees, the revenue expected is \$4,000 to \$4,200 per square metre. This report's analysis indicates that overall costs of delivery are in the order of \$3,900 per square metre. Given these estimates, developers will normally be unable to earn a sufficient return on their capital to justify their investment, and there would be significant risks of outright losses. In short, there will be insufficient home buyers who will pay the sort of price that would be required to justify a significant ramping up of infill development in the Lower Hunter.

change in preference by baby-boomers, or radical carbon reduction policies by the Federal Government.

The new strategy should recognise, and accommodate the need for holiday homes owned by non-residents, but ensure additional capacity also exists for the resident population.

Figure 54. Scenarios for break-up between infill and greenfield

Annual underlying demand for dwellings	Greenfield / Infill Split					
	90/10		80/20		60/40	
	Annual Greenfield Dwelling no.	Annual Infill Dwelling no.	Annual Greenfield Dwelling no.	Annual Infill Dwelling no.	Annual Greenfield Dwelling no.	Annual Infill Dwelling no.
5400	4900	500	4300	1100	3200	2200
7200	6500	700	5800	1400	4300	2900
14500	13100	1500	11600	2900	8700	5800

Source: Urban Taskforce Australia

Figure 54 not only shows dwelling requirements if this report's preferred 80/20 split is adopted, but also considers dwelling requirements under the 60/40 split favoured by the current strategy (which may still arise in certain circumstances). Prudence dictates a third 90/10 scenario where the demand for infill development is lower than the level anticipated by this strategy.

On this basis, we can see that annual dwelling supply around:

- 4,300 greenfield homes a year and 1,100 infill homes a year would be necessary for 1.4 per cent annual population growth – with the possibility that infill supply might need to rise as far as 2,200 homes a year, and greenfield supply might need to rise to as much as 4,900 homes a year;
- 5,800 greenfield homes a year and 1,400 infill homes a year would be necessary for 1.7 per cent annual population growth – with the possibility that infill supply might need to rise as far as 2,900 homes a year, and greenfield supply might need to rise to as much as 6,500 homes a year;
- 11,600 greenfield homes a year and 2,900 infill homes a year would be necessary for 3.2 per cent annual population growth – with the possibility that infill supply might need to rise as far as 5,800 homes a year, and greenfield supply might need to rise to as much as 13,100 homes a year;

In short, rather than the existing single target of 2,760 greenfield dwellings a year, the new strategy should provide a target of 4,300 to 13,100 homes a year, with home buyers preference and market realities determining the actual number.

Similarly, rather than the single annual target of 1,840 medium and higher density dwellings, the new strategy should ensure capacity of between 1,100 and 5,800 medium and higher density homes a year.

The potential for disconnection between the land identified in planning strategies for development, and the commercial reality of development, suggests that planning authorities should err on the side of making more

land available for development, rather than less. **A supply of undeveloped land equivalent to 20 years worth of projected need will be more likely to achieve this outcome than Sydney's 7 year goal, or the more commonly cited 15 year target. In any event, the existing strategy, inexcusably, has no target at all.**

The promotion of competition should be an enduring feature of any new strategy. This means the new strategy should seek to provide certainty to the private sector by having clear rules, simple processes, swift processing times and low predictable costs. It should not be the role of the strategy to provide certainty to investors in one location, by giving them assurance that they will be protected from competition in other nearby locations.

A new Lower Hunter Strategy should be broadly framed. It should be highly flexible in its content, and contemplate a range of possible outcomes in terms of dwelling mix, employment growth and population and job distribution. It should also actively contemplate that decisions will be made outside of the strategy, as needed, in order to ensure that the market demand for housing and business premises is able to be satisfied.

The substance of the reviewed Lower Hunter Regional Strategy should, once it is finalised, immediately be enacted in a state environmental planning policy (SEPP). The Minister, local councils and other consent and concurrence authorities (such as the joint regional planning panels, the Planning Assessment Commission and the Roads and Traffic Authority) should be required to approve proposals that are in-line with the strategy, as embodied in the SEPP, when considering rezoning and determining development applications. This would necessarily be accompanied by an explicit duty for a consent authority to consider the financial constraints on the economic viability of a desirable planning development when the applicant has elected to provide information on the subject.

9.3. REDUCING THE COST-BASE OF RESIDENTIAL DEVELOPMENT

This report demonstrates that, in part, the cost base of developing each new home does not allow developers to produce new housing that is sufficiently competitive with existing housing stock. All the targets in the world will mean nothing if the private sector is expected to build the new housing, but it is not possible for a private enterprise to earn an income doing so.

Part of the answer lies in a more flexible regional strategy as outlined in the previous section. This can lower the cost base of development by:

- reducing the lead times in securing rezoning and development approval and thus reducing holding costs;
- reducing uncertainty as to whether or not regulatory approval will be granted, thus reducing the risk premium demanded by the providers of capital; and
- providing for development capacity over wide areas, creating competitive tension between passive land owners, and potentially lowering the acquisition costs of raw land.

However, more reform will be required. This report shows that the current regime of development levies is inconsistent with a robust housing supply. Our view is the report finds that, if dwelling supply is not raised substantially over the next three years, the workforce expansion will not be sustained, and the mining construction phase will be truncated.

Based on projects underway, and those in the planning process, a substantial expansion in the level of engineering construction work in the Hunter is expected. By 2014, the Hunter is expected to account for about 30 per cent of total engineering construction work in NSW, up from about 18 per cent in 2010. This report projects that an additional 1,500 workers per annum would be required to meet the projects planned for the next five years. Some of these workers will bring families to the Lower Hunter, so the population impact would be greater. An expected rise of about 2,000 persons per annum is projected, directly related to the potential construction upturn.

If this population growth cannot be accommodated, the region will risk losing this vital mining and infrastructure investment (due to insufficient and more expensive labour).

Setting aside potential increases in coal prices, the predicted volume of production would increase state government royalties by almost \$600 million per annum (over the productive life of the projects). If a rise in labour costs means that project returns were rendered inadequate for just 5 per cent of this capacity, then coal production would be reduced by 3.3 million tonnes. At today's average royalties per tonne of coal, that would reduce royalty revenues by about \$30 million per annum.

The potential royalty revenue is far greater than the likely revenues from section 94 contributions and state infrastructure charges on dwelling construction (estimated to be below \$10 million in the Lower Hunter). For 3,000 dwellings in the Hunter, with a range of \$10,000 to \$20,000 in local council and state infrastructure contribution charges, the aggregate revenue per annum would be in the range of \$30 million to \$60 million.

Aggregate government development charges for new release areas amounts to less than 1 per cent of the state's coal mining production royalties.¹⁵⁶ **Maintaining a rigid policy favouring development levies may cost the community far more in lost coal mining royalties.**

It is important to understand that this is not a call for some hand-out. The urban development industry does not make such pleas. Instead, **this a call for the abolition of a tax that last year's federal tax review by Ken Henry, recognised and acknowledged as inefficient.** The charges are poorly administered, complex, non-transparent and set too high — they discourage investment in housing.

Development levies are generally determined through complex and lengthy negotiations with developers on a project-by-project basis. This approach creates uncertainty about the value of financial contributions, and diminishes the likelihood that residential development will proceed.

For example, the state government's "state infrastructure contribution" which notionally was not finalised, but is effectively in force, is highly uncertain. If actual yields in the Lower Hunter are six lots per "net developable hectare" the levy jumps from just under \$8,800 per lot to \$17,600 per lot. This would make it more or less equal to the Western Sydney levy, but makes up a much higher percentage of the final sale price (due to the lower land values in the region). In some instances, for example in the "large lot residential" zone, it is clear that the levy may easily range from \$5,000 to \$52,000 per lot.

In short, state infrastructure contributions and local council development levies should be abolished, or if they are not to be abolished, lowered, made more certain and robust, and restructured so that they do not have a distortionary impact on housing supply.

¹⁵⁶ In 2009/10, the state government earned about \$1 billion in royalties from coal mining.

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