Proposed Planning Bonus for Affordable Housing

A Review for St George Community Housing

ASTROLABE GROUP

St George Community Housing

21 September 2023

Acknowledgement of Country

At SGCH we acknowledge the traditional Aboriginal and Torres Strait Islander owners of the land on which we operate and provide homes for people, and pay our respects to Elders both past, present and emerging.

St George Community Housing (SGCH)

SGCH commissioned this paper to support the development of policy that will deliver more social and affordable housing.

SGCH has a vision of great places, thriving people, connected communities. With a portfolio of over 7000 social and affordable homes, SGCH is one of the largest Tier 1 Community Housing Providers in Australia. We have a leading track record of bringing together capital and capability in partnership with governments and the private sector to create more social and affordable housing.

www.sgch.com.au

Astrolabe Group

Astrolabe Group assisted in the development of this paper and supporting modelling.

Astrolabe Group are the recognised experts in urban growth and change management with a uniquely empathetic approach to client and community. In preparing the report, Astrolabe has made every effort to ensure the information included is reliable and accurate. Astrolabe is unable to accept responsibility or liability for the use of this report by third parties.

www.astrolabegroup.com.au

Contents

Executive Summary

Housing affordability continues to worsen as market conditions deteriorate, constraining the delivery of new supply.

With rising living costs and projected overseas migration to exceed pre-COVID levels, the Commonwealth and NSW Government's recent moves to increase the supply of housing including social and affordable housing are welcome steps to relieving housing stress.

The size of the task ahead is immense but not insurmountable. The Commonwealth has committed to the delivery of 40,000 new affordable and social housing dwellings over the next five years. While this is commendable, significant change in policy and the delivery of affordable housing is required to truly address housing stress and associated productivity losses from reduced access to talent and key workers, not to mention the human cost of housing stress.

Community Housing Providers

Community Housing Providers (CHPs) such as St George Community Housing play an increasingly critical role in providing access to affordable and social housing and associated services. CHPs address where traditional housing markets fail.

Tier-1 CHPs such as St George Community Housing should be considered essential stakeholders in policy development. They bring the capability, track record and the ability to raise finance and bring knowledge and expertise in the management and delivery of affordable housing.

The proposed planning bonus

The NSW Government's proposed planning bonus for affordable housing is a step in the right direction. St George Community Housing engaged Astrolabe Group to investigate how the bonus could be executed, and what needs to happen to unlock the potential of the planning system in enabling enduring and sustainable supply.

A build-to-sell arrangement will deliver less affordable housing on a site, but likely more affordable housing overall

Developers will act rationally and will only take up voluntary planning bonuses that include affordable housing where the economics provides a mechanism for them to be fairly compensated for the risks they take on.

The current design of the bonus requires a party to hold the affordable housing stock for 15 years before selling to the market, with sufficient capital growth to cover the build and management costs of the affordable housing. This requires a change in the for-profit developer business model and is unlikely to attract the capital required to deliver the volume of affordable housing needed.

A build-to-sell arrangement, where developers immediately transfer affordable housing to CHPs is a more attractive arrangement. However, for this to work the affordable housing component must be reduced from 15% to around 5%.

While less affordable housing would be delivered on site, more affordable housing would be delivered across the board.

Beyond the bonus — inclusionary zoning as 'superannuation for cities'

The bonus helps prepare the sector for the staged introduction of inclusionary zoning that would provide long-term policy certainty to deliver affordable housing at scale. Like superannuation for cities, staged inclusionary zoning would deliver a fair and sustainable distribution of affordable housing that will provide a safeguard for future affordability.

Staged inclusionary zoning will initiate a market adjustment. There needs to be a sufficient runway (for example, four years) for the operating environment — including developers and landowners — to adjust their pricing expectations, and for government programs to help close the development viability gap.

Our modelling suggests a 5% permanent affordable housing component is a reasonable starting point. This should be increased gradually over time, like the nation's superannuation scheme.

Inclusionary zoning should go hand in hand with simplifying and accelerating the planning, development, and building assessment processes. This will help reduce project timeframes. Efforts to address land costs, such as the development of government-owned land, and spiralling construction costs will also be critical.

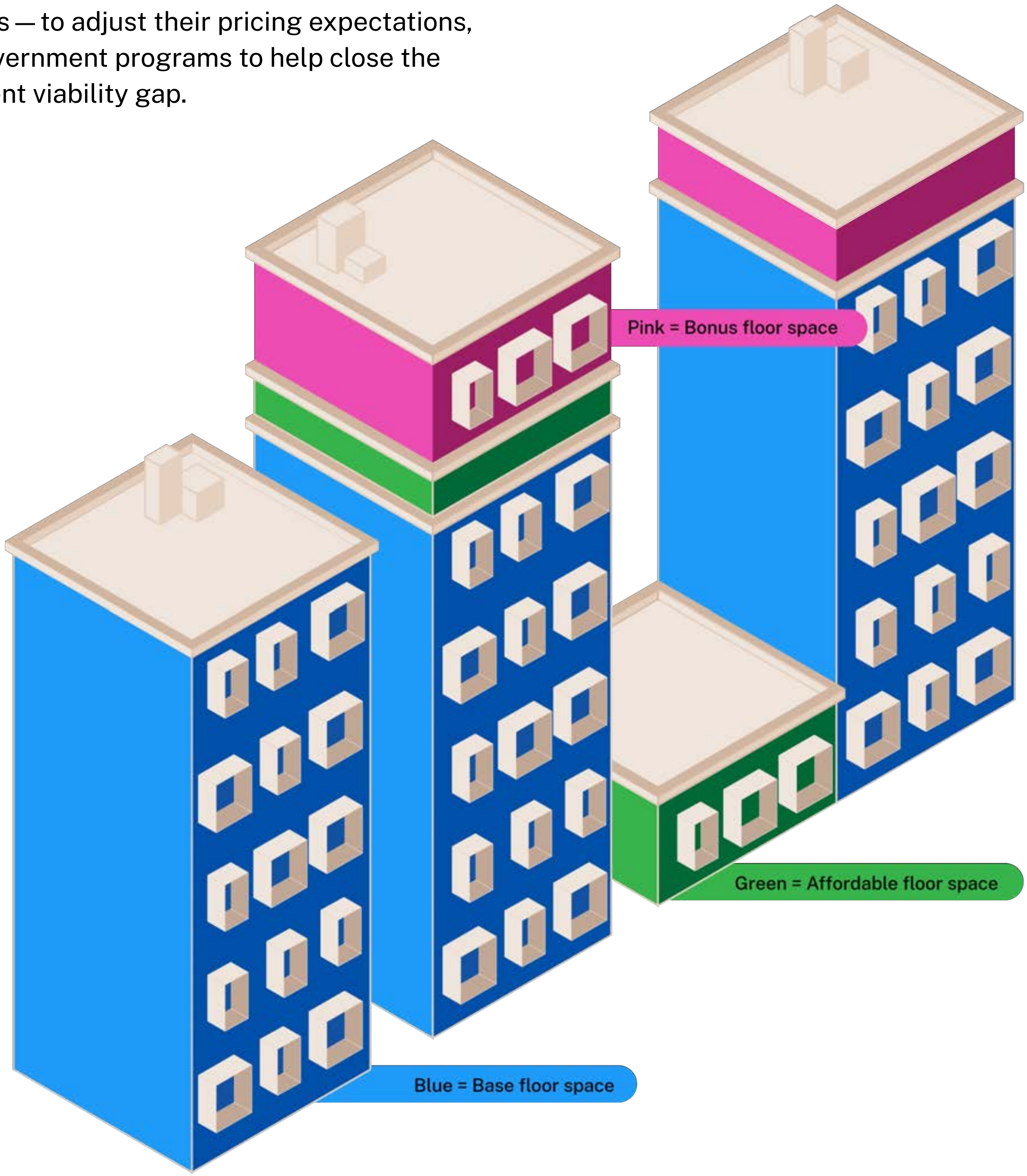

Figure 1: The planning bonus enables developers to access a 30% increase in height and floor space ratio in exchange for including affordable housing.

About the proposed planning bonus

The NSW Government's proposed bonus enables certain developments to access a 30% height/floor space ratio (FSR) increase in exchange for 15% of the total gross floor area being allocated as affordable housing. This would see developers hand the keys over to CHPs for 15 years to manage the affordable housing stock.[1] Unless the owner (which may include a CHP) desires otherwise, the economics dictate that the affordable dwellings produced under this scheme would then return to the private market in order to capture highest and best economic use.

The bonus is intended to apply at the development assessment (DA) stage. Projects must still satisfy other planning controls to access the full 30% bonus, and any reduction in the 30% bonus must still deliver the minimum 15% affordable housing.

The planning bonus will contribute to closing the viability gap for the provision of affordable housing

The planning bonus uses the planning system to attempt to close the gap between what CHPs receive from government subsidies and what is needed to deliver affordable housing in a rising market. It will require CHP-developer partnerships to expand and evolve.

The bonus will likely contribute to the delivery of some affordable housing, and — acknowledging the constraints of the current operating environment and multiple planning reforms being led by the NSW Government — is a step in the right direction.

However, as a point-in-time voluntary solution leveraging the planning system, the bonus is unlikely to deliver a sustainable and enduring mechanism to deliver affordable housing at the scale required. In other words, the planning system cannot solve this crisis on its own.

[1] NSW Government, 2023, New Planning rules mean more affordable housing, https://www.planning.nsw.gov.au/news/new-planning-rules-mean-more-affordable-housing, published 15 June 2023.

Figure 2: Affordable housing policy must consider the needs of all stakeholders within the sector

Meeting the needs of everyone in the sector

Any policy aimed at delivering affordable housing must consider the needs of all stakeholders within the sector:

Tenants

Key workers and low-income earners require affordable housing that offers stability, reasonable rent, well-located residences with short commutes to essential services, and neighbourhoods that are both safe and economically accessible. Ideally, a tenant's rent won't exceed 30% of gross household income.

Developers

Developers play a crucial role in generating housing supply, as they have the resources, expertise, and capacity to construct new developments, renovate existing structures, and collaborate with public and private entities to create housing solutions that meet the diverse needs of communities. Under a business-as-usual scenario, for-profit developers typically look for a return on equity greater than 20% to compensate their investors for the risks being taken compared to alternative investment opportunities. Incentive-based policies for affordable housing need to exceed the business-as-usual model to encourage uptake.

Community Housing Providers

CHPs need a sustainable funding model, strong partnerships with government and developers, and community engagement to make their profit-for-purpose business model work, enabling them to deliver specialised tenant services that the private and government sectors may find challenging to provide.

Broader Community

Communities rely on a mix of housing options and access to key workers to properly function. The community would reasonably expect that there is oversight of the intended outcome of affordable housing policy, which includes ensuring properties are appropriately allocated to eligible tenants and maintained to a reasonable standard.

Local Government

Local governments must plan for the changing needs of their communities driven by population growth and change. The planning system best enables this planning and management of development impacts at the land use zoning stage—for example, by requiring a certain percentage of affordable housing in certain developments through inclusionary zoning—rather than the development assessment (DA) stage. As a boost at the DA stage, the proposed planning bonus has the potential to complicate planning and levying for infrastructure and community facilities.

Key insights & recommendations

Who owns the affordable housing and what is the source of capital?

We envisage the bonus may be applied by three types of developers:

1. Build to sell (BTS) developers

Most developers are BTS developers, meaning they immediately sell product upon completion. For most BTS developers, the business model and sources of capital have been aligned over a long period of time: acquire, develop, sell.

Accessing the bonus requires a fundamental deviation from the BTS business model as a component of value must either be realised through sale of a non-market product or retention over a 15 year period followed by a market based value realisation. The current bonus effectively creates a financial product — developers will speculate if it is in their interests to assume a sufficient compound annual growth rate over 15 years for the affordable housing component.

This fundamentally shifts the business model and likely requires a different (and unproven at scale for BTS developers) pool of capital to support retention to a year 15 value realisation event. The policy would likely require a different profile of investor capital and it is unclear if there is an established investment market in Australia that would support this.

At scale, BTS developers are most likely to look for a take out partner to acquire the affordable housing upfront.

2. Build to Rent (BTR) developers

Market rate BTR is a relatively new concept in Australia. It is large-scale, purpose-built rental housing that is held in single ownership, professionally managed, and typically backed by institutional investors. Application of the bonus is likely to be considered for some BTR schemes.

3. Community Housing Provider (CHP) and government developers

CHPs such as St George Community Housing and government developers such as NSW Land and Housing Corporation have delivered significant schemes with high proportions of social and affordable housing. Application of the bonus is likely to be applied to increase the number of social or affordable housing outcomes or reduce reliance on other direct government subsidies.

There is an opportunity for the CHP to bring the capital solution to the table for affordable housing to create long-term benefits. By enabling CHPs to take an equity stake, CHPs can decide at the end of the 15 years whether to retain or sell some or all the housing, helping them scale their contribution and impact. This would also provide the benefit of enabling tenants to stay in place, connected with their communities.

Key recommendation 1:

Government support for CHPs to acquire properties aims to build a viable capital solution at scale that can leverage the outcomes delivered by the planning system.

How do the economics stack up for a build-to-sell developer?

BTS developers are the main source of production of new apartment supply in NSW. BTS developers will act rationally when assessing a project and various planning options, choosing pathways that will most likely optimise risk-adjusted returns. In our modelling, the bonus will, at best, deliver affordable housing for 15 years. The economics do not work to provide a longer-term outcome such as in perpetuity affordable housing. This would require a build-to-sell model, which in turn is not feasible unless the affordable housing is reduced to around 5%.

For the planning bonus to be attractive to a BTS developer the scheme must:

- Improve or sustain the project return noting the additional risks inherent in delivering a larger scheme, such as greater exposure to construction cost increases. This ensures that the developer is fairly compensated for the risks they are taking compared to a base case sell-to-market option with no affordable housing.
- Revert to market usage: in our modelling and discussions with two leading developers, we note that the affordable housing must revert to a market usage at the end of year 15 to achieve an acceptable return. This means a loss of affordable housing.
- Line up with a capital solution: while some smaller, privately held development businesses may have capital to invest over a 15 year horizon, this is not expected to be a significant source of capital to deliver affordable housing at scale. The best solution is that a BTS developer can partner with a CHP who can access funding to acquire the affordable housing at a price reflecting its usage as affordable housing upfront, thus retaining the BTS developer model and capital solution.

Key recommendation 2:

Government should support Community Housing Providers to acquire properties delivered under the bonus scheme as the best means to incentivise build-to-sell developers and build long-term outcomes in the system.

Government should consider options to reduce the 15% requirement where this is transferred to a Community Housing Provider as in perpetuity affordable housing.

Who operates the affordable housing?

The bonus is a government intervention to create an affordable housing outcome.

The public would reasonably expect that there is oversight of the intended outcome which includes ensuring that the property is appropriately allocated to eligible tenants and maintained to a reasonable standard. Safeguards are required to ensure the continued operation of the dwelling for affordable use.

This requires a form of prudential and consumer regulation. The planning system is not equipped for this task.

Requiring the affordable housing to be operated by a CHP registered under the National Regulatory System for Community Housing (NRSCH) provides an assurance mechanism. BTR and BTS developers who may wish to retain properties are able to either partner with a CHP or can seek registration under the NRSCH.

As profit-for-purpose driven and regulated organisations with a deep understanding of the sector, CHPs are best placed to service this need.

A note on title that is extinguished after 15 years would ensure the property is visible and the outcomes are accounted for in the system through the annual regulatory process.

Key recommendation 3:

Government should require all affordable housing produced under the bonus scheme to be operated by a registered Community Housing Provider.

1-2 years | 15 years | 15+ years

Plan | Develop | Operate | Release

Planning Bonus

What's Included

Partnerships between developers, CHPs' and financiers'.

Feasibility of the development project to construction and 15-year operation.

Capital for planning and delivery.

What's Needed

Product suited to low-income and vulnerable populations, including accessible housing.

Capital to manage the asset approximately $9,000 p.a. such as maintenance, insurance and tenant services.

Sufficient capital growth to cover the cost of operation expenditure and capital borrowing costs, and to close the CHP subsidy gap for affordable housing.

Risk appetite and management to speculate on sufficient capital growths relative to opening and borrowing costs over 15 years.

Affordable use safeguards for a property title/ planning instrument extinguishable only by an appropriate planning authority after 15 years to ensure use as affordable housing in the event the owner ceases to operate or much relinquish ownership.

Tenant safeguards to manage product quality and tenant protection for vulnerable households as regulated by the National Regulatory System for Community Housing.

Tenant services for specialised services for low-income and vulnerable households delivered by CHPs.

What Happens

Through equity stake, CHPs positioned to aquire affordable housing component if aligned with their strategy.

Figure 3: The bonus is a point-in-time mechanism to deliver affordable housing. This diagram shows additional requirements during the operational phase. This differs to a build-to-sell model where a developer immediately transfers affordable housing to CHPs in a less complex and less speculative approach.

Will the bonus deliver affordable housing at the scale needed?

The bonus will help prepare the sector for the staged introduction of inclusionary zoning that would provide long-term policy certainty and stability to deliver affordable housing at scale. Inclusionary zoning ensures that certain developments require an affordable housing component.

Like superannuation for cities, staged inclusionary zoning would deliver a fair and sustainable distribution of affordable housing that will provide a safeguard for future affordability while meeting the needs for tenants, CHPs and developers alike.

The policy could be flexible to account for varying site constraints, local market conditions and community needs.

Staged inclusionary zoning will initiate a market adjustment. There needs to be a sufficient runway (for example, four years) for the operating environment — including developers and landowners — to adjust their pricing expectations, and for government programs to help close the development viability gap.

Our modelling suggests a 5% permanent affordable housing component is a reasonable starting point. This should be increased gradually over time, like the nation's superannuation scheme. We explore inclusionary zoning further in this report.

Key recommendation 4:

Government should position the bonus as the first step in the staged introduction of inclusionary zoning.

Government should consider options for Transferable Development Obligations where a developer must deliver (or pay a partner such as a CHP to deliver) an offsite equivalent amount of affordable housing within the Local Government Area in lieu of on site. This could be a condition of development consent to avoid delays in delivery.

Scale the affordable housing requirement in line with the realisable bonus uplift after other planning controls are applied.

Modelling

Build-to-hold and sell

The bonus proposes that a developer will build and hold the affordable housing component for 15 years. Under a 30% uplift and 15% affordable housing scenario, assuming a required capital growth return of 9%, a developer will need a compound annual growth rate (CAGR) in the order of 2.8% for the property each year for 15 years.

However, a developer is unlikely to access the entirety of the 30% bonus due to the impact of other planning controls. Reducing the bonus to 20% while retaining the affordable housing component at 15% requires a higher CAGR of 3.31%.

Table 1: Compound annual growth rates required to achieve varying capital growth return goals

		Return Target			
Bonus	Affordable Housing	7%	8%	9%	10%
		Compound annual growth rate required to achieve return target			
30%	15%	1.32%	2.06%	2.80%	3.53%
30%	11.5%	0.75%	1.48%	2.22%	2.96%
20%	15%	1.82%	2.56%	3.31%	4.05%
20%	8.3%	0.71%	1.46%	2.20%	2.95%

Build-to-sell to CHP as affordable housing in perpetuity

An alternative build-to-sell arrangement where a developer immediately transfers the affordable dwellings to a CHP does not require developers to change their business model and would help deliver long-term affordable housing owned and managed by CHPs.

Under this approach, a 5% affordable housing component and 30% planning bonus are needed to provide an equal or better return on equity for developers.

This approach does however introduce a spatial bias toward the Eastern Harbour City and areas with high-value airspace, where premium products can be delivered to sufficiently offset the cost of the affordable housing component.

Limitations

Our reference model included core planning and build costs including land, construction, professional services costs, development contributions, the Housing and Productivity Contribution (HPC) and project contingency.

The Housing Australia Future Fund (HAFF) is welcome but not yet sufficiently predictable to model, and should operate independently but in harmony with the planning system.

Our model investigated example development sites being led by a mid-sized and large-scale developer. In practically applying the model, every development site should be modelled to consider the site's planning, development, infrastructure and market context.

The developers with whom we workshopped the planning bonus offered different perspectives to a CHP partnership model.

The large-scale developer preferred to work with set build costs and sale price parameters for the affordable housing component. The moderate-scale developer preferred to work closely with the CHP to deliver affordable housing, adjusting the project design and price points for the other build-to-sell dwellings to meet the capital constraints of a CHP.

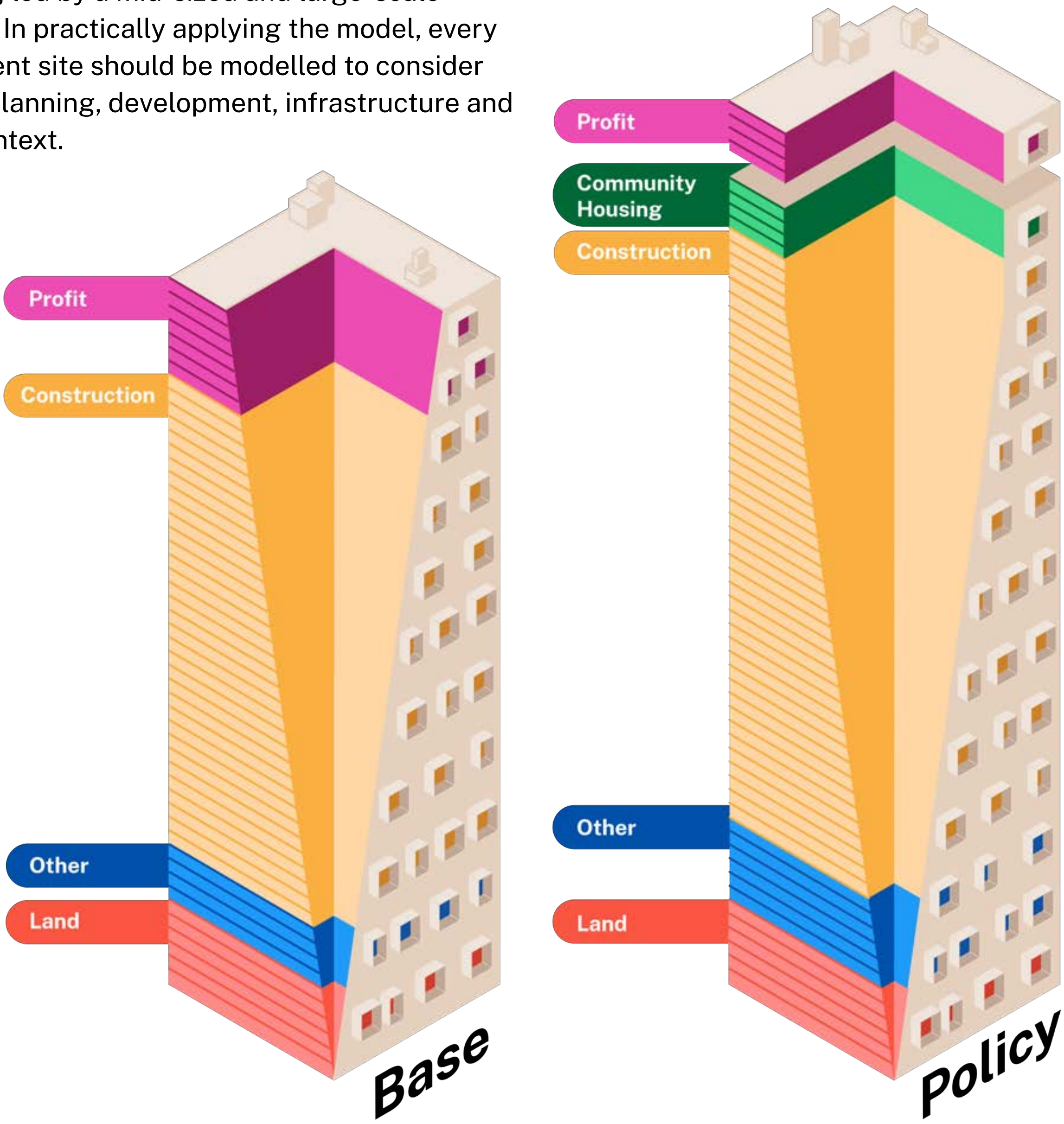

Figure 4: Costs of doing business – under a business as usual (base case) scenario, developers build and sell product based on an expected return on equity in the order of 20%. Under the bonus scheme, sufficient capital growth of the affordable housing over the 15 year hold period is required to cover the cost of building cost and managing the affordable housing. An alternative approach is for developers to build and sell to CHPs. This requires a reduction of the 15% affordable housing component.

Beyond the bonus:

what is ultimately needed to deliver a large supply of affordable and social housing?

The task ahead requires a broader scope of policy reform

Overseas migration, an aging population, increasing compliance and delivery costs are on a collision course to further depress housing construction and exacerbate housing stress.

Analysis by the UNSW City Futures Research Centre identified over 7% of NSW households (200,000 households) with an unmet need for social or affordable housing in 2021, and that approximately 5% would likely qualify for social housing.[2]

To meet this challenge, the stakeholder ecosystem needs to tackle all elements of the crisis and create long-term enduring solutions. This requires zooming out and considering all factors that affect the sector's ability to produce affordable housing and the ability for CHPs to access affordable housing.

Figure 5: A wider scope of policy reform is needed to ensure sustainable and long-term affordable housing supply

[2] Van den Nouwelant, R., 2022, Social and affordable housing: needs, costs and subsidy gaps by region, City Futures Research Centre, https://cityfutures.ada.unsw.edu.au/social-and-affordable-housing-needs-costs-and-subsidy-gaps-by-region/

Staged inclusionary zoning can provide certainty, stability and flexibility in changing market conditions

Inclusionary zoning requires that a number of affordable homes are included in developments as a condition of planning approval. The number required is determined by either negotiated agreements made between a developer and planning authority during the planning assessment process, or fixed requirements specified as a proportion of housing or development value. [3]

The staged introduction of mandated inclusionary zoning that replaces or augments existing ad-hoc schemes would provide policy certainty for developers, CHPs and government infrastructure planners to enable the consistent and sustainable delivery of affordable housing.

Transferable Development Obligations, where a developer must deliver (or pay a partner such as a CHP to deliver) an offsite equivalent amount of affordable housing within the Local Government Area in lieu of on site, could provide added flexibility to ensure the scheme's success, and reduce managing different strata types within the same building. This could be a condition of development consent to avoid delays in delivery.

The National Cabinet has agreed to a National Planning Reform Blueprint with planning, zoning, land release and other measures to improve housing supply and affordability. This requires the NSW Government to consider the phased introduction of inclusionary zoning and planning to support permanent affordable, social and specialist housing in ways that do not add to construction costs. [4]

Community Housing Providers need to co-design the policy

Tier-1 Community Housing Providers (CHPs) such as St George Community Housing should be considered essential stakeholders in policy development. They should be actively involved in discussions and decision-making alongside developers and international financial institutions. Their role should be elevated from merely seeking opportunities to collaborate, to being recognised as crucial partners in addressing issues of national significance.

Tier-1 CHPs bring the capability, track record and the ability to raise finance to the table. St George Community Housing, for example, has mobilised over $1.05 billion of investment into social and affordable housing.

[3] AHURI, 2017, Understanding inclusionary zoning, https://www.ahuri.edu.au/analysis/brief/understanding-inclusionary-zoning

[4] Prime Minister of Australia, 2023, Media Release: Meeting on National Cabinet – Working together to deliver better housing outcomes, 16 August 2023, accessed 28 August 2023, https://www.pm.gov.au/media/meeting-national-cabinet-working-together-deliver-better-housing-outcomes#:~:text=That's%20why%20National%20Cabinet%20has,states%20and%20territories%20last%20year.

Inclusionary zoning will require a market adjustment over time but deliver what is needed

Policy reform must respond to rising supply costs and the increasing cost of debt. Factors that most influence development feasibility are eroding the value created from the proposed planning bonus.

The introduction of the HPC and National Construction Code 2022 sustainability and disability accessibility reforms, while important and necessary, will further diminish development feasibility.

Staged inclusionary zoning will initiate a market adjustment. There needs to be a sufficient runway (for example, four years) for the operating environment — including developers and landowners — to adjust their pricing expectations, and for government programs to help close the development viability gap.

Our modelling suggests a 5% permanent affordable housing component is a reasonable starting point. This should be increased gradually over time, like the nation's superannuation scheme.

Such a policy could target areas with better access to transport and services. For example, any new development within 800 meters of a train or light rail station, or rapid bus corridor. This will require market adjustments but ensure affordable housing is accessible and well-connected.

Where new rezoning creates uplift, inclusionary zoning should be more ambitious and target 15% affordable housing assuming the zoning uplift makes this feasible. On government land we support the NSW Government's ambition to include 30% affordable housing noting they must value the land accordingly to make projects feasible.

Case study: London inclusionary zoning model

The London model for affordable housing effectively utilises a partnership between build-to-sell developers, housing associations, and government agencies. Under this framework, the requirement for a certain percentage of affordable housing units is built into the initial cost projections for new development projects. This ensures that developers have a clear roadmap and can plan their investments accordingly.

Housing associations — the equivalent of CHPs — bridge the financial gap by securing grants and accessing capital in the private market. They purchase a stake in new developments, thereby increasing the overall number of affordable units available.

Through the planning system and financial support for housing associations, the public sector stimulates housing development and allocates a share of the created value to affordable housing.

The planning system should operate independently but in harmony with other government programs

The planning system should enable the sustainable and long-term supply of affordable housing that is not dependent on other government initiatives, but other government initiatives should lever off planning policy to create a multiplier effect.

Programs such as the Commonwealth's Housing Australia Future Fund (HAFF) are critical but will come and go. These can supplement the planning system and allow CHPs to deepen subsidies, for example, to serve lower-income households, or allow CHPs to take the 15 year terminal value of the affordable housing and to retain that value for purpose.

A simpler planning system and streamlined pathways for affordable housing is needed

Simplifying and accelerating the planning, development, and building assessment processes will help reduce project timeframes and costs.

This efficiency is particularly beneficial when it comes to meeting hurdle rates — the minimum rate of return on an investment that a company expects to earn. When projects are bogged down by outdated assessment methods or inefficient planning the time and resources spent can eat into the project economics, reducing development feasibility and dampening the market.

The planning bonus will require eligible projects to be assessed as State Significant Development. This pathway does not guarantee reduced assessment timeframes and in some cases can add greater complexity.

The cost of land must be addressed

The cost of land is a significant barrier to the feasibility of the planning bonus. This could be as simple as delaying payment of the land until project completion to support cashflow and reduce interest/holding costs.

Partnerships between the NSW Government and CHPs to develop government-owned land will markedly improve development feasibility. The NSW Government's pre-election commitment to ensure that developments on surplus public land include a minimum of 30% affordable, social and universal housing is a welcome announcement.[5] By strategically leveraging its land assets, the government can stimulate the construction of affordable housing while ensuring a fair and competitive process.

[5] NSW Government, 2023, New Planning rules mean more affordable housing, https://www.planning.nsw.gov.au/news/new-planning-rules-mean-more-affordable-housing, published 15 June 2023.

Construction innovation is necessary to deliver quality affordable housing faster and at scale

Construction costs are the largest cost of a development.

Innovation in construction and local supply chains is crucial for reducing the costs of delivering housing, especially in the context of rising land prices, labour costs, and regulatory burdens.

The European modular housing model demonstrates that manufactured housing can achieve economies of scale, reduce construction timelines, and minimise waste, all while maintaining stringent quality standards.

Modular housing projects — where components are pre-manufactured off-site to enable rapid assembly on-site — can be delivered 20-50% faster than traditional builds.[6]

New developments in additive manufacturing and digital planning also hold promise. Support for the construction sector is warranted, with opportunities to leverage social housing subsidies and partnerships.

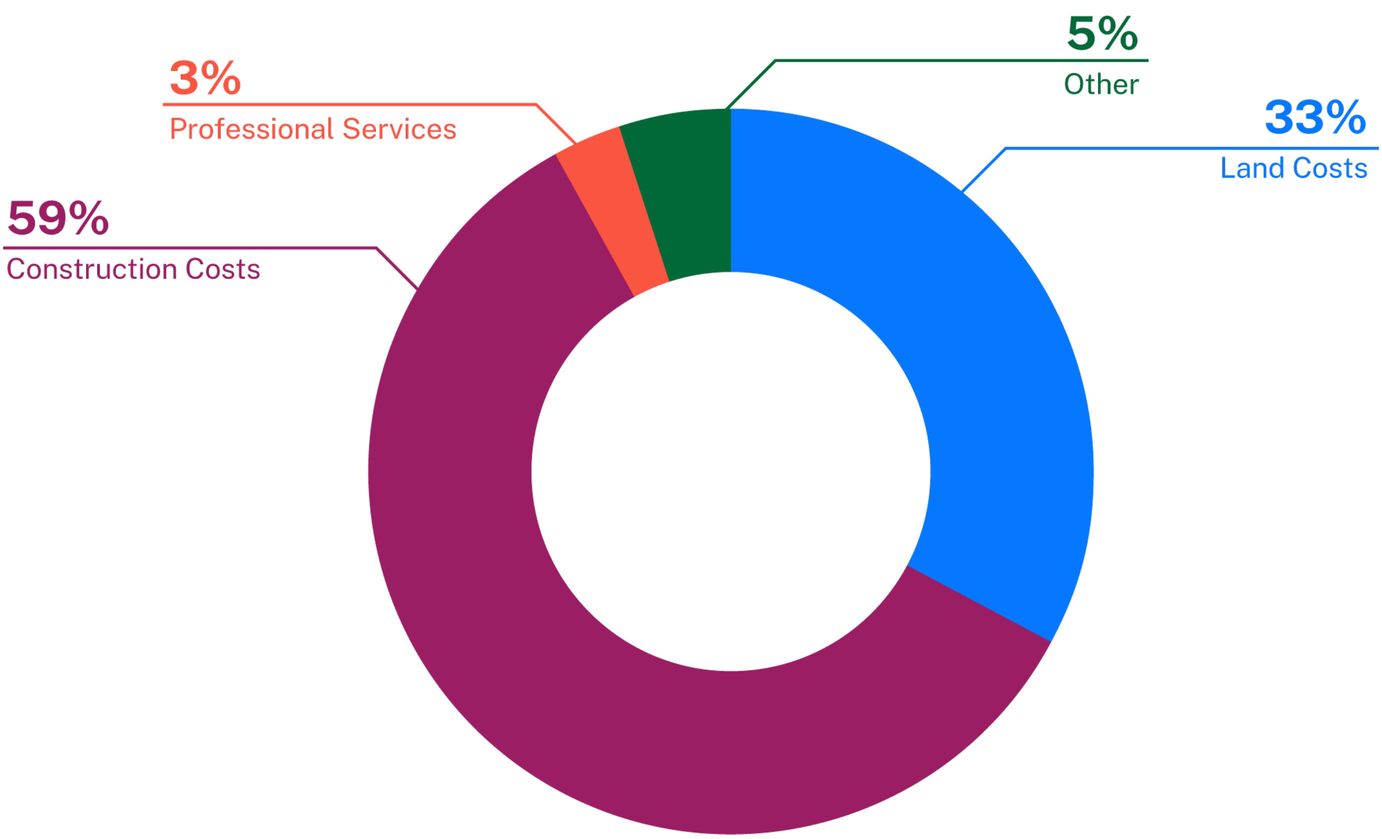

Figure 6: Land and construction costs are major barriers to development feasibility

[6] Betram, N, et al. 2019, Modular construction: From projects to products, McKinsey & Company, https://www.mckinsey.com/capabilities/operations/our-insights/modular-construction-from-projects-to-products

St George Community Housing

ASTROLABE GROUP