Shelter
NEW SOUTH WALES

The Affordable Housing Height and Density Bonus Scheme

Report Commissioned by Shelter NSW

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November 2023

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Glossary

CHP: Community Housing Provider. A not-for-profit organization charged with the responsibility for procuring and managing housing for clients in housing need. CHPs are regulated through a licensing process enabled by a Government Registrar.

PEXA: Property Exchange Australia.

1. Introduction

This short report examines the affordable housing planning bonus scheme proposed by the NSW Government. Under the proposed scheme a developer would be given a height and density bonus of 30% over current LEP planning controls if they provided 15% of the GFA as affordable housing for 15 years. In addition, projects that have a capital value of over $75 million will also have a new planning pathway by being classified as State Significant Development.

The report will examine the benefits and costs to developers who use the scheme and discuss the likely market reaction to the scheme. It will also suggest some potential improvements.

2. How does a bonus scheme operate

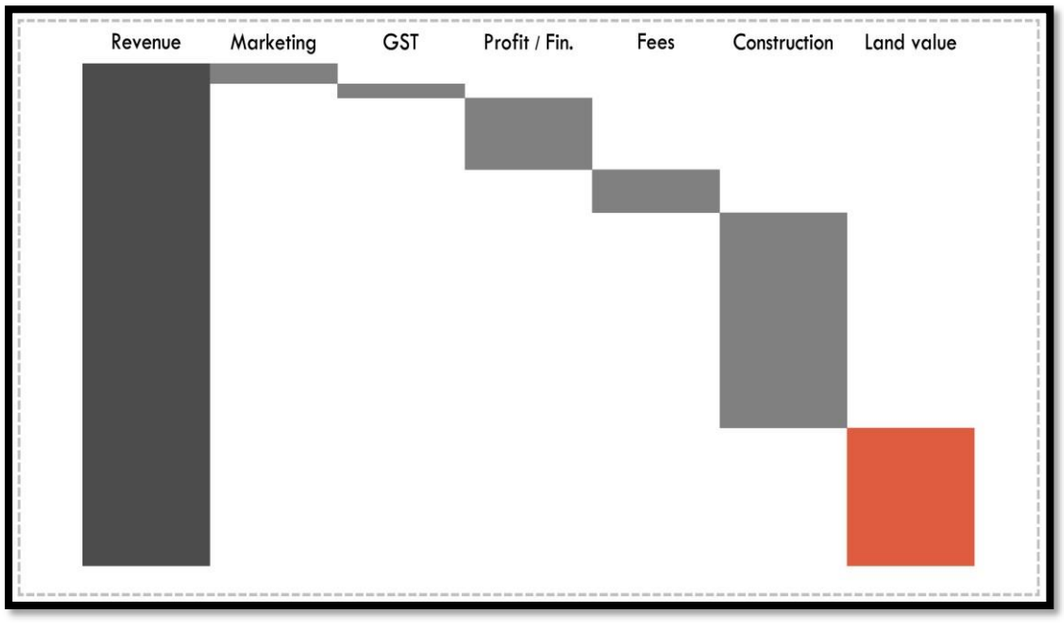
A planning bonus scheme operates by reducing the land costs to developers for an apartment project. Normally an apartment's site's value increases as more apartments can be delivered on a site. Property analysts often calculate the land value per apartment of a development site. This number varies across a city depending on the value of the underlying residential property market. In the Eastern Harbour City land value per apartment can be as high as $500,000 per apartment (see Table 2). In Western Harbour City it can be as low as $50,000 per apartment. The land value is determined through a process called residual value analysis (see Figure 1). The land residual land value is calculated by subtracting from the sales price all the costs associated with development. Because apartments in Wollahara (2023 median value of $1.5 million) sell for much more than those in Penrith (2023 median value of $0.575 million), and the costs are reasonably similar[1], the cost of apartment development sites (i.e., the land) is much more per apartment than for Penrith.

What a bonus scheme does is reduce the land costs per apartment by allowing an additional number of apartments to be produced without the developer "purchasing" any additional land. This is the case where a developer already owns the land or has an option on the land at a fixed price. So, the largest winners from a bonus scheme are the large developers who already hold a number of development sites. The value of their land holdings would increase as a result of the bonus. For developers who are yet to purchase apartment sites bonus schemes are less valuable because the landowner can also see the bonus and will want to claim at least some of their bonus by increasing their asking price for their land. This is the reality of bonus schemes to create affordable housing – they increase the supply of affordable housing whilst at the same time making housing more expensive by increasing land costs. The academic literature (see, for example, Biggar and Friendly shows that over time the value of the bonus gets eroded as more and more land

[1] The main differences are that Woollahra apartments are likely to be larger and include higher quality of finishes. However, the main cost difference is still the land cost.

owners become aware of the value of the bonus to developers and they want a share of the value uplift. For this reason, bonus schemes are often time limited.

Figure 1. The Residual Land Value Method



Source: Murray (2021) Feasibility Guide for Planners, University of Sydney

The other observation about bonus schemes is that they risk encouraging speculation. If the Government has been able to offer a bonus of x%, perhaps it will be possible to lobby them to provide a bonus of x+y% in the future. Once someone builds out a site, they have lost the opportunity to seek an increased bonus. In the case of the current proposed bonus given that it is a reasonably generous fixed percentage it does encourage developers to apply for a rezoning for a site to increase the height and FSR limits so that they can further increase the number of apartments in their development. Let's look at a simple example. If a development currently has a project that can yield 100 apartments the bonus scheme will allow them to provide 130 apartments. However, if they could get their site rezoned to allow 150 apartments on the site, with the bonus they would be able to achieve 195 apartments. This creates an incentive to apply for a rezoning which will slow down the supply response. It also provides an invitation to a segment of developers whose business model is to obtain control of a site, get the planning rules changed and then sell the site. This activity tends to increase land prices without generating any new housing supply (Woodcock et al, 2011).

3. What are the likely benefits and costs and where will it be used?

One of the little-known facts of construction economics is that as buildings get taller, they are more expensive to build. There are some key thresholds. There is a cost increase when we move past 3 storey walk ups as lifts are required and when we move past 7 storeys because at this point buildings have to be able to fight their own fires, with a sprinkler system and their own water supply. On constrained sites where underground parking is required a larger hole will need to be dug which might lead to a sharp increase in costs if the "hole" reaches the water table. This cost penalty for height is often the main constraint on taller apartment buildings. For the developer the increase in height means that the marginal cost of constructing the apartment may be larger than the marginal revenue they will receive from an apartment sale. In parts of the city with access to views (e.g., Eastern Harbour City), this constraint is reduced because as the height in a building increases the selling price of apartments increase. However, in other parts of the city this constraint will still be in place.

Table 1 lists the average construction costs per sq metre of buildings at different heights based on a cost calculator provided by a global firm of quantity surveyors. In some cases, particularly in lower value areas like Western Parkland City, it may not be feasible to build any higher than the existing LEP height limit because the marginal costs of adding an additional storey would be less than the marginal net revenue you would receive from the additional storey.

The other constraint in affordable housing bonus scheme is that the costs of providing affordable housing has to be smaller than the benefit of the reduced land costs. Table 2 shows the costs to the developer of funding a reduction in rent for 15 years in several LGAs in Sydney and the estimated land costs per apartment based on recent development site sales using a low (Penrith), middle (Cumberland) and high (North Sydney) cost area. The costs are based on estimating the Present Value of the discounted rents using some assumptions about the annual rent increase and the discount rate applied.

The data in Table 2 shows that the uplift scheme is unlikely to be utilised in the low and medium cost examples because the cost of providing the Affordable Housing rental discount exceeds the likely benefit of the reduced land costs (in the Penrith case the costs are about 70k and the benefits are about 53k). The scheme will mostly be taken up in the Eastern Harbour City. In some parts of the Eastern Harbour city, it is likely to generate situations where the benefits of the scheme are well in excess of the costs especially when the additional costs of building a taller building are balanced by increasing prices because of better views. The highest returns for the scheme could be in areas with a large number of existing buildings where the height bonus from the scheme generates views by the new building being able to see over the existing buildings which are capped at the current LEP controls.

These simple examples demonstrate the difficulties of having a scheme where the benefits of the scheme vary much more than the costs. So, the benefits increase from Penrith to North Sydney by a factor of 10, but the costs vary by a much smaller factor. A possible adjustment to the scheme would be to require smaller percentages of affordable housing in lower priced areas of the city. Another issue might be that the scheme is likely to have more take-up in more expensive parts of the city but is the resultant housing "affordable" to key workers even with a 25% discount on market rents?

Table 1. Residential Apartment Construction Costs. High standard

Number of storeys	Costs per sq metre
1 to 3	$4,800
4 to 10	$5,000
11 to 20	$5,400
21-40	$6,800
41-80	$7,500
Source: RLB Cost Calculator	

Table 2. Comparing the costs and benefits of the proposed NSW Bonus Density Scheme

Costs Assumptions			PV of rental discount
Rental growth rate	3%	**Penrith**	**$70,040**
Discount rate	5%	**Cumberland**	**$89,759**
"Affordable" discount	25%	**North Sydney**	**$222,689**
Median strata weekly rents June 2023 – 2 bedrooms			
Penrith	$430		
Cumberland	$550		
North Sydney	$780		
Source NSW Rent and Sales Report			

Potential Benefits

Development Case study LGA	Address	Sale Price of Land Parcel (1)	No of apartments (2)	Land price per Apartment (1)/(2)
Penrith	50 Lethbridge St Penrith	$3,050,000	58	$52,586
Cumberland	45-47 Essington St Wentworthville	$1,720,000	21	$81,905
North Sydney	173-179 Walker St North Sydney	$98,305,199	189	$520,133
Source: Search of recent development sites on stashproperty.com.au				

4. Suggested improvements to the scheme

If the intention of the bonus scheme is to help accelerate housing supply rather than simply encouraging land speculation, one potential strategy is to time limit the scheme. This might be done by timing out any DAs generated using the bonus scheme using a shorter time period than the current 5 years. The scheme itself may be limited say a 2-year period with a review at the end of the 2-year period to decide whether the scheme would be renewed for a further two years. Creating some uncertainty over the scheme's length will reduce the likelihood of landowners "baking in" the benefits of the scheme into the value of their property. It will also bring forward some development decisions. This approach will also discourage land owners from applying for a rezoning first in order to magnify the benefits of the bonus (double dipping).

It might also be feasible to apply the scheme using different bonus levels and time periods across the city. At the moment, it appears the scheme is overly generous in the Eastern Harbour City and unlikely to be taken up in other parts of Sydney. Consideration should be given to increasing the length of time for affordable housing provision in the Eastern Harbour City (say 30 years) and reducing it in other parts of Sydney (say 10 years). If these changes are introduced it will generate some take up of the scheme in lower cost parts of Sydney but still provide significant increases in profitability for Eastern Harbour City developers. An alternative strategy would be to foreshadow that the Government would increase the affordable housing time period in the Eastern Harbour City in the second two years of its operation, in order to encourage early adopters.

In terms of the operation of the scheme, it would be beneficial if the affordable housing requirements were attached to the title for the relevant apartments through a collaboration with PEXA. This would provide an efficient method for counting the properties that have taken advantage of the scheme, and also ensure that all stakeholders are aware of the affordable housing requirements in developments which take up the bonus scheme.

5. Conclusion and recommendations

Whilst the impact of bonus schemes like the current proposed schemes are often blunted by the aspirations of land owners to capture the uplift for themselves, the current proposal will have a positive impact in terms of unlocking some apartment developments that although approved are not being built because they are no longer feasible as a result of construction cost and interest rate increases. It is likely that the scheme will bring forward a range of apartment developments in Eastern Harbour City which would be a benefit to housing supply as well as affordable housing provision. However, the scheme could be improved by not making it open ended, and varying the nature of the bonus and/or the duration of the affordable housing provision to better reflect the large variations in land values across Sydney.

It is recommended:

1. That the NSW Government time limit the current bonus scheme to promote early delivery; this can be achieved by limiting the validity of the bonus scheme to a 2year period with a review at the end of the 2-year period to decide whether the scheme would be renewed for a further two years.
2. The NSW Government consider applying the scheme using different bonus levels and time periods across the different City Districts in the Sydney Metropolitan Area in recognition of the differential benefits applicable to these locations.
3. That the NSW Government mandate that the affordable housing requirements are attached to property titles for the relevant apartments through a collaboration with Property Exchange Australia (PEXA).

References

Biggar, J., & Friendly, A. (2022). Balancing equity-based goals with market-driven forces in land development: The case of density bonusing in Toronto. *Environment and Planning A: Economy and Space*, 0(0). **https://doi.org/10.1177/0308518X221087243**

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