

An Affordable Housing Overlay in the Victoria Planning Provisions

Implementation Model for Melbourne's Inner Urban Region

Inner Region Affordable Housing Working Group

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This Report has been prepared for:

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comprising representatives from
City of Yarra
City of Port Phillip
City of Melbourne
City of Stonnington

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Executive Summary

Early in 2006, SGS Economics & Planning Pty Ltd (SGS) was commissioned by the Inner Region Affordable Housing Working Group to provide advice on mechanisms which might be included in the Victoria Planning Provisions (VPP) to advance affordable housing objectives in the Region. The Working Group covers the municipalities of Melbourne, Port Phillip, Stonnington (western portion) and Yarra.

The brief required SGS to build on the firm's earlier work, completed for the Inner Region Housing Statement, which called for the application of 'Inclusionary Zoning for affordable housing' across these municipalities and elsewhere. In advancing this work, specific proposals were to be developed for an 'Affordable Housing Overlay' or similar device.

The agreed methodology included facilitation of a 'Chatham House' rules discussion with key developers to define the territory of agreement and disagreement, and to establish the types of incentives and 'compensating benefits' which would need to be offered to the development sector to win support for this modification to the VPP.

'Inclusionary Zoning' is a development control instrument which requires proponents to incorporate certain features in their projects in the interests of maintaining environmentally responsible or 'sustainable' outcomes. Inclusionary Zoning provisions have long been applied to several aspects of project design including; provision of on-site parking; retention of stormwater flows; maintenance of heritage features; and incorporation of energy and/or water saving features.

This paper explores how 'Inclusionary Zoning' might be applied in the Inner Urban Region of Melbourne to support the provision of affordable housing.

For the purposes of this discussion, 'affordable housing' is defined as permanent rental housing which is available to households in the bottom two quintiles of the income distribution at less than 30% of their gross income.

It is possible to apply Inclusionary Zoning for affordable housing under the provisions of the Victoria Planning and Environment Act. This is so because the Act and the Victoria Planning Provisions define 'environment' broadly, to include questions of social and cultural sustainability. As social and cultural factors are recognised as 'environmental values', it becomes possible to apply planning controls such as Inclusionary Zoning to ensure that successive developments preserve or contribute to these values by incorporating a degree of social mix, through the on site or neighbourhood provision of affordable housing.

Application of Inclusionary Zoning for affordable housing would require a new **Overlay in the VPP**. This would include an Affordable Housing Plan, showing;

- the targeted Region-wide acquisition of permanent affordable housing under the Inclusionary Zoning provisions;
- the developer's obligations in terms of incorporation of a given proportion of floorspace for affordable housing and/or the provision of cash-in-lieu so that this obligation may be met elsewhere;

- where funds generated by the Inclusionary Zoning requirement would be deployed; and
- how these funds and stock will be managed in a transparent, fair and accountable way.

The Overlay should apply on a uniform basis across the designated area, in this case, the whole of the Inner Urban Region. With the exception of minor projects or shifts in land use within a similar employment band, all developments, regardless of scale and land use type, should be caught by the Overlay.

Assuming that funds and stock generated by the Overlay will comprise 50% of total acquisition cost for the targeted quantum of affordable housing (that is, the other 50% would be funded out of State and Commonwealth or other revenues), a uniform Inclusionary Zoning cash in lieu rate of some \$17.66 per square metre of floorspace (both residential and non-residential) would be required to maintain the existing proportion of social housing in the Region in the period 2006 - 2031.

Funds and stock generated via the Overlay should be directed to registered Housing Associations. These would provide all required tenancy support services; developers would have no ongoing obligations in terms of tenancy support under the Overlay provisions.

Under the strict supervision of the Registrar appointed under the Housing Agencies Act 2004, the Overlay funds and stock would be deployed as permanent affordable rental housing, allocated according to transparent, fair and prudent tenant management policies.

With the prudential supervision of the Registrar, these Housing Associations would be free to leverage their assets to optimise affordable housing yields.

In time, management of the funds and stock generated via the Overlay should be opened up to a wider range of providers, also operating under the supervision of the Registrar. This will lift competition and innovation in the use of these resources.

The introduction of the Overlay should be accompanied by a suite of initiatives to support and facilitate warranted development in the Inner Urban Region, including:

- Guaranteed (timely) release of a pipeline of State Government and local government controlled sites for redevelopment;
- Review of planning standards and design guidelines for these sites and for redevelopment in the Region generally to optimise yields within reasonable environmental envelopes;
- Introduction of innovative planning measures to provide more certainty, particularly for residential developers, for example, agreed infill targets for particular areas where the broad parameters of built form will have been resolved by Council at the Planning Scheme amendment phase, so that advertising of subsequent developments would not be necessary; and
- Introduction of further measures to streamline development approvals and reduce uncertainty, for example, application of the Development Assessment Forum (DAF) model under which approvals are given by technical panels operating at arm's length from the Councils in question.

Four other factors are vital to the successful introduction of the Overlay;

- It should be broadly based with few or no exemptions in terms of scale of project and land use, and contributions should be fully 'scheduled' so as to avoid negotiation uncertainty.
- It should provide developers maximum flexibility in terms of whether the Overlay requirements are met on site or via cash in lieu contributions or some mix of both. This should apply regardless of the scale of the development.
- It should be phased in over a sufficiently long period to enable developers to clear their existing pipelines of projects, so that they might have the opportunity to factor the Overlay cost implications into the land price bids they make for new projects.
- Both State Government and local Councils must demonstrate that they are prepared to shoulder some of the cost burden associated with maintaining a healthy social mix in the inner urban region. Amongst other things, this could include Councils making land available at less than market value so that affordable housing can be successfully incorporated.

While there is a strong case for including an Affordable Housing Overlay in the VPP, it is important not to see planning regulation as a panacea for the affordability problem. Many other elements need to be in place for an effective policy response. These include:

- A substantial 'Third Sector' in the housing market, that is, not for profit, non government providers of tapered subsidy housing (safety net through unsubsidised shared equity).
- A Government guarantee of a minimum stock of 'safety net' (i.e. social) housing across all regions, and appropriate investment of Government capital to back this guarantee.
- A contestable and flexible housing assistance market – allowing the private sector and 'Third Sector' to both collaborate and compete as appropriate regarding government funding for safety net and affordable housing services, and the management of long term affordable housing generated via the planning system.

1 Introduction

Early in 2006, SGS Economics & Planning Pty Ltd (SGS) was commissioned by the Inner Region Affordable Housing Working Group to provide advice on mechanisms which might be included in the Victoria Planning Provisions (VPP) to advance affordable housing objectives in the Region. The Working Group covered the municipalities of Melbourne, Port Phillip, Stonnington (western portion) and Yarra.

The brief required SGS to build on its earlier work, completed for the Inner Region Housing Statement, which called for the application of 'Inclusionary Zoning for affordable housing' across these municipalities and elsewhere. In advancing this work, specific proposals were to be developed for an 'Affordable Housing Overlay' or similar device.

The agreed methodology included facilitation of a 'Chatham House' rules discussion with key developers to define the territory of agreement and disagreement, and to establish the types of incentives and 'compensating benefits' which would need to be offered to the development sector in order to win support for this modification to the VPP.

2 The Planning Justification for Inclusionary Zoning

2.1 Why Reconsider the Role of Planning in Affordable Housing?

Assisting households who are struggling to secure affordable housing has traditionally been the province of the tax transfer and public housing systems in Australia. Lower income households are eligible for subsidized tenancies in dwellings supplied and managed by the State or other social housing landlords who have access to capital or recurrent funding from the State. For those who must rent in the private market, or within the community housing segment of the social housing sector, Commonwealth Rent Assistance (CRA) – an income supplement paid directly to the lower income households in question – is available. Combined outlays under these programs amount to about \$4 billion.

With a few notable exceptions, planning regulation has had no role in the direct creation of housing which is affordable to households in the lower two quintiles of the income distribution. Rather, planning regulation has typically focused on efficiency in the housing production market, particularly with respect to land release and development standards. Unlike some other countries, land use regulation has not been used generate affordable housing stock, funded from 'planning gain', that is, the increase in land value contingent upon up-zoning or the granting of a development approval.

Recent years have seen a growing debate in the Australian urban management community about the role of planning in affordable housing. A number of factors have prompted this. One has been the diminution - over many years now - in fresh capital commitments by the Commonwealth to public housing. State public housing authorities are struggling to maintain their existing stocks let alone invest in stock expansion.

The need left unmet by shrinking public housing programs has not been addressed by CRA. Notwithstanding these payments, about 250,000 low income private renter households live in housing stress.

Across all tenures, over one million low and moderate income households in Australia are paying more than 30% of their income to meet their housing costs, an internationally recognised measure of housing stress.

Supplementary strategies to expand the flow of affordable housing opportunities have to be found in this context, and planning regulation has become an obvious area of interest.

Equally important in bringing planning under the spotlight is the growing *maldistribution* of affordable housing. Arguably, affordable housing may be found if households are prepared to

travel far enough and put up with poor infrastructure. But this is divisive and wasteful. The inner urban regions of our cities, rich in employment, training, educational and recreational opportunities, and once rich in affordable (albeit poor quality) housing, are rapidly becoming the exclusive domain of higher income groups who are well connected to the global knowledge economy. Meanwhile, the outer suburban reaches of the cities, and peri-urban areas - are increasingly populated by lesser skilled workers who have less secure economic futures.

2.2 Planning Reform Part of a Wider Response to the Affordable Housing Issue

While there is a prima facie case to re-evaluate and refocus the role of planning in affordable housing, it is important not to see planning regulation as a panacea for this problem. Many other elements need to be in place for an effective policy response. These include:

- A substantial 'Third Sector' in the housing market, that is, not for profit, non government providers of tapered subsidy housing (safety net through unsubsidised shared equity).
- A Government guarantee of decent housing standards for everybody.
- A Government guarantee of a minimum stock of 'safety net' (i.e. social) housing across all regions, and appropriate investment of Government capital to back this guarantee.
- A contestable and flexible housing assistance market – allowing the private sector and 'Third Sector' to both collaborate and compete as appropriate regarding government funding for safety net and affordable housing services, and the management of long term affordable housing generated via the planning system.

Notwithstanding the need to address this broader agenda, there is a growing mood that planning should offer more to the affordable housing agenda than simply supply side efficiency in land availability and development standards.

2.3 Foundation Principles in Framing Planning's Role in Affordable Housing

In devising appropriate planning responses to the affordable housing issues, it is important to respect this system for what it is; - a land use regulatory regime intended to optimize environmental values and maintain efficiency in urban development and resource usage. It should not be seen as a general taxing device. Such a view would be constitutionally dubious. But more importantly, it runs the risk of supplanting sustainability driven planning principles with revenue generation objectives. And it renders the planning system much less efficient, which damages productivity generally.

Similarly, the planning system ought not be conceptualised as part of the redistributive apparatus of society. Whilst planning initiatives and decisions will routinely have redistributive consequences (as do most areas of public policy where market regulation is applied), planning and development regulation is not directed at redistribution per se – in the sense that the tax transfer system is explicitly directed at this social goal. To treat the operation of the planning system as if it had this

role would be to embed a continuing and damaging tension between equity and efficiency objectives in urban management. The major thrust of public policy reform in Australia over the past 25 has been to disentangle these two roles of government intervention, in the interests of creating a more socially sustainable as well as competitive Australia.

Another important principle is that transaction costs and compliance requirements through the planning system should be minimized consistent with the maintenance of the environmental values in question. In other words, keep the rules simple and easy to administer.

Planning rules must also be seen to be applied fairly and consistently. Any discrimination between developments in terms of planning treatment should be justified by differences in their environmental impact, rather than the size of the development as such or the 'capacity to pay' of the project proponent.

2.4 The Environmental Case for Using Planning to Advance Affordable Housing Objectives

With these foundation principles in mind, a compelling case can be made out in environmental (i.e. orthodox planning) terms for the application of land and development regulation in pursuit of affordable housing objectives. This case commences with the proposition that modern society no longer limits the definition of 'environmental values' to the natural and built environment. The social and cultural benefits offered by places must also be folded into this definition. Similarly, 'orderly and proper' development is no longer limited to the physical performance and impacts of the constituent projects. Development is now expected to be 'sustainable' in four dimensions – its impacts on the physical / natural environment; its implications for the way the local community interacts and accesses the necessities and diversions of day to day life; its effects in terms of the recognised identity of a place (cultural impact); and its capacity to generate a net community benefit – that is, a viable economic return for the financial, human and environmental resources deployed.

Social mix has already been identified as a defining environmental value of many parts of our cities – especially the inner cities. Social mix is also recognised as a pre-requisite for sustainable development and sustainable communities generally.

If social mix is a key environmental value, and planning systems are intended to optimise conservation of environmental values, it is appropriate, indeed, necessary, for planning systems to make provision for the preservation or creation of these values in urban development.

Genuine social mix cannot be achieved other than through an adequate local stock of affordable housing. Thus, it is appropriate for the planning system to play a part in preserving or creating such a stock of affordable housing.

This case can be critiqued on the basis that it could be used to justify planning 'demands' on development proponents for all manner of social infrastructures which are ordinarily funded through other programs – schools, health care, museums etc. In other words, where do the scope of planning regulation and the responsibilities of the development proponent stop? Moreover,

won't governments routinely shirk their responsibilities for funding social infrastructures through the tax transfer system and defer to planning conditions to achieve sustainable development?

The rejoinder to this critique is that planning and planners have an obligation to apply the precautionary principle in managing urban development. An assumption cannot be made that the vital social mix dimension of sustainable urban development can simply be 'left to' other government programs outside of planning, particularly where all the evidence shows that these outside programs – CSHA and CRA – are patently not coping with the demands placed upon them and have little prospect of doing so in the future. In this context, planning regulation must be applied to prevent the entrenchment of demonstrably 'unsustainable' patterns of development.

2.5 The Environmental Argument for Applying Planning to Affordable Housing is Separate from the 'Planning Gain' Argument

Conceptually, the use of planning measures to pursue affordable housing objectives is justified on environmental grounds, that is, within the core mission of this regulatory system.

This environmental justification ought not be confused with other arguments which have been advanced from time to time for using the planning system to generate affordable housing. These include that using the planning system in this way would promote social justice and that it would help claw back some of the uplift in land value conferred upon property owners as a result of development approvals and changes to planning rules.

As noted, planning regulation is not, strictly speaking, directed at social justice per se, and there are sound public policy reasons for not deploying it deliberately as an instrument of redistribution policy.

As for the betterment capture argument, it is certainly appropriate, in our view, to tax betterment and compensate for worsenment. But, it does not follow that there should be an up front nexus between such a policy and the provision of affordable housing. The net proceeds from a betterment capture policy should be invested in accordance with local and regional priorities determined in the relevant governance forums; these priorities may or may not include affordable housing.

In other jurisdictions, most notably the UK, the introduction of planning measures to promote affordable housing failed to separate and properly assign these arguments regarding the conservation of environmental values represented by social mix, progressive redistribution and the capture of betterment. The result is a system whose conceptual basis is murky and whose operation is prone to great uncertainty and high transaction costs.

Introduction of a nationally consistent approach to this field of policy in Australia needs to take into account this 'downside' of the UK experience.

2.6 Inclusionary Zoning

2.6.1 Preferred Tool

There would appear to be a wide palette of options in terms how planning might be deployed to meet the environmental objectives associated with social mix. These include;

- Impact Mitigation Payments;
- Development Bonuses;
- Infrastructure Contributions;
- Development Taxes; and
- Inclusionary Zoning.

In previous assessments of the most appropriate tools for inner Melbourne¹, Inclusionary Zoning has been found to offer the 'best fit' with both the foundation principles regarding the role of the planning system, and the environmental case for involving planning in affordable housing. This is so because Inclusionary Zoning;

- Is explicitly premised on the environmental argument, as opposed to redistributive or betterment taxation; and
- Is capable of being applied across a broad spectrum of land uses with minimal compliance costs.

2.6.2 Application in Inner Melbourne

To remain consistent with the principles and arguments outlined earlier, the application of Inclusionary Zoning in Inner Melbourne should meet some key performance requirements, namely:

- It should apply to **all types of land use** on the basis that all land uses – residential, commercial, retail, industrial and institutional – are obliged to contribute to maintenance of the identified environmental value of social mix (in the same way as all land use types are required to respect and conserve heritage values regardless of whether the development in question is residential, commercial, retail, industrial or institutional).
- It should apply to all forms of development and changes of use which **materially affect the social mix** in the region, either in terms of housing composition or worker composition. By implication it should exempt minor development and shifts in uses which are within a similar employment band.
- It should be as **simple as possible** and avoid litigation and undue transaction costs.

In the next section we set out a possible mechanism to meet these requirements.

¹ Insert reference to SGS report for Inner Regional Housing Working Group

3 An Affordable Housing Mechanism for the VPP

Set out below is one example of how an Inclusionary Zoning mechanism for affordable housing could be incorporated into the VPP via the Overlay facility.

43.08 AFFORDABLE HOUSING PLAN OVERLAY

Shown on the planning scheme map as **AHPO** with a number.

Purpose

To implement the State Planning Policy Framework and the Local Planning Policy Framework, including the Municipal Strategic Statement and local planning policies.

To ensure that affordable housing is provided in the most accessible parts of the region.

To ensure a coordinated approach to the provision of affordable housing.

To provide certainty in the provision of affordable housing.

43.03-1 Affordable Housing Plan Overlay

A permit must not be granted to subdivide land, construct a building or construct or carry out works until affordable housing has been provided in accordance with the affordable housing plan schedule to this overlay.

This does not apply to the construction of a building, the construction or carrying out of works or a subdivision specifically excluded by a schedule to this overlay.

A permit granted must:

- Be consistent with the provisions of this affordable housing plan overlay
- Include any conditions required to give effect to any affordable housing contributions or requirements set out in the relevant schedule to this overlay.

43.03-2 Preparation of an Affordable Housing Plan

The Affordable Housing Plan may consist of plans or other documents.

The Affordable Housing Plan must:

- Specify the area to which the plan applies
- Specify the existing social mix
- Specify the adopted targets for future social mix
- Specify the projected development, redevelopment, and adaptive re-use of land in the area to which the plan applies
- Relate the need for affordable housing to the existing and projected development of land in the area.

- Specify the amount of floor space required for affordable housing if affordable housing is to be provided on-site.
- Specify the calculations of the cash-in-lieu rates per total floor area for the provision of affordable housing if affordable housing is not provided on-site.
- Provide for the procedures for the collection of a cash-in-lieu payment in respect to any development for which a permit is not required.

The Affordable Housing Plan may:

- Exempt certain land or certain types of development from the provision of affordable housing or from the collection of a cash-in-lieu payment for the purposes of providing affordable housing.
- Provide for different rates or amounts to be payable in respect of different types of development of land or different parts of the area.

SCHEDULE 1 TO THE AFFORDABLE HOUSING PLAN OVERLAY

Shown on the planning scheme map as **AHPO1**

1.0 Area covered by this Affordable Housing Plan Overlay Schedule

This Schedule applies to all land within the boundaries of the Municipalities of **X**. The Schedule details the required amount of floor area required for affordable housing and provides for cash-in-lieu amounts to be payable in specified areas, which are shown on the Plan to this Schedule.

2.0 Summary of Affordable Housing cash-in-lieu rates and floor area requirements

1. The permit applicant must pay a monetary contribution to the Responsible Authority, to be used for the purpose of providing affordable housing, of the following total amount:

(i) **\$n** per square metre of the net floor area to which the application relates as is intended to be used exclusively for residential purposes, and

(ii) **\$n** per square metre of that net floor area as is not intended to be used exclusively for residential purposes.

OR

2. If that total amount is sufficient:

(i) The dedication in favour of the consent authority, free of cost, of land of the applicant comprised of one or more complete dwellings with a net floor area of not more than that total amount, each dwelling having a net floor area of not less than **xx** square metres, and

(ii) If the amount of net floor area of the complete dwelling or dwellings is less than that total amount, the payment of a monetary contribution to the consent authority by the applicant that is the value, of the net floor area equivalent to the difference between those amounts, to be used for the purpose of providing affordable housing.

NOTE: The cash-in-lieu rates listed in the above table are to be charged per net floor area of the development.

Payment is to be made in cash, prior to the commencement of the development permitted.

Council, in its discretion, may consider accepting works in kind in lieu of cash contributions.

These contribution amounts are current as at XX Xxx XXXX. They will be adjusted annually on July 1st to cover inflation, by applying the "percentage change from the corresponding quarter of the previous year" (June) in the All Groups Melbourne HPI, as set out in the ABS publication "Housing Price Index Australia XXXX.X". A list showing the current cash-in-lieu amounts will be held at Council's Planning Department.

3.0 Land or development excluded from affordable housing

Exemptions from providing affordable housing apply in the following cases:

- xxxxxxxxxxxxxxxxxxxxxxxxxxxx.
- xxxxxxxxxxxxxxxxxxxxxxxxxxxx.

4.0 Affordable Housing Plan Overlay Map

(TO BE INCLUDED AT END OF SCHEDULE)

4 Affordable Housing Overlay Contribution Rates – Some Scenarios

The identification of Inclusionary Zoning contribution rates for affordable housing within a defined precinct requires estimates of future development activity in the area. Once the amount of development activity in the various residential and non-residential use categories (commercial, retail, industrial etc) is known, it is possible to relate this aggregate floor space addition to the targeted expansion of affordable housing in the region to arrive at a contribution rate per square metre of new floor space.

This section of the report provides an overview of housing and non-housing development activity in the Inner Urban Region and provides a forecast of floor space demand over the next 25 years. Based on the development activity analysis, a simple model is then developed to determine the Inclusionary Zoning cash in lieu rate that may be applied in the Inner Urban Region.

4.1 Study Area

The Inner Urban Region is defined to include the Cities of Melbourne, Port Phillip, Yarra and part of Stonnington. In this report, the Region is further divided into the following ABS Statistical Local Area and Local Government Area categories:

- Melbourne (C) – Inner
- Melbourne (C) – Southbank and Docklands
- Melbourne (C) – Remainder
- Inner Melbourne (C) – Total
- Port Phillip (C)
- Stonnington (C) – Prahran
- Yarra (C)

4.2 Inner Urban Region Floor Space Trend and 2031 Outlook

This section sets out the data sources and methodology used to determine the likely floor space growth trends in the Inner Urban Region over the next 25 years from 2006 to 2031.

The following floor space demand analysis relies on data drawn primarily from the 2001 Census of Population and Housing, supplemented with data from various sources. Key data protocols and assumptions made in the analysis include:

- The amount of residential and non-residential use development calculations are based on total net floor area rather than 'gross floor area';
- The average size of one dwelling unit (private or social housing) is 100 m²; and
- The non-residential use categories used in the analysis are based on the 2004 City of Melbourne Census of Land Use and Employment (CLUE) occupational classifications.

4.2.1 Inner Urban Region Total Housing Stock, 2006 to 2031

The total housing stock for 2006 is derived from dwelling estimates obtained from the 2001 Census of Population and Housing, supplemented with data available from ABS Building Approvals Survey. The quarterly Building Approval Survey compiles statistics on the number of new dwelling units approved or commenced.

The forecasts of the likely additions in total housing stock in the Inner Urban Region are based on the population projections set out in the 2004 DSE *Victoria In Future* (VIF) report. The projected change in the number of household is calculated over the next 25 years to 2031 and this change in total household is then translated into total housing additions. This occurs through the application of occupancy rates derived from 2001 ABS Census.

Table 1 indicates the estimated total dwelling additions in the Inner Urban Region between 2007 and 2031. The analysis suggests that in the next 25 years, there will be a net addition of around 87,000 new dwellings in the Region.

Table 1 Housing Development Activity, 2006-2031

	2006 Total Housing Stock (units)	Estimated 2031 Total Housing Stock (units)	Housing Development Activity (2007-2031)
Melbourne (C) – D'land & S'bank	7,725	17,257	9,532
Melbourne (C) – CBD	8,339	17,408	9,069
Melbourne (C) – Remainder	25,626	54,660	29,034
Melbourne (C) – Total	41,690	89,195	47,505
Port Phillip (C)	49,059	68,307	19,248
Yarra (C)	35,056	47,395	12,339
Stonnington (C) – Prahran	26,485	34,654	8,169
Inner Urban Region Total	152,290	239,551	87,261

Source: 2001 ABS Census; Building Approval Survey; SGS estimates

4.2.2 Inner Urban Region Demolitions, 2006 to 2031

Housing (and other) development activity within the Region will exceed forecast net demand, as there will be a certain amount of demolition and replacement of obsolete dwellings and other buildings.

Statistics on the total number of demolitions of dwellings in the Inner Urban Region in this report were obtained from Building Commission Victoria. These were obtained for every year from 2001 to 2005. The annual average rate of demolitions of dwellings over this period was calculated for each Council.

The methodology for projecting the total number of demolitions of dwellings over the next 25 years simply involved multiplying the average annual rate for 2001-2005 to the number of out-years. This methodology is likely to yield a conservative (low) estimate of demolition activity.

The level of demolition for non-residential buildings is difficult and complex to estimate as it comprises various use categories with varying rates of demolition. In this study, the annual rate of demolitions for all non-residential use in Inner Urban Region is assumed to be 1% of existing stock, reflecting an average economic life for building fabric of some 100 years.

Table 2 provide an overview of the estimated total number of housing and non-housing stock demolished over the period of 2006 to 2031. (The next sub-section explains how estimates of existing non-residential floorspace were made.)

Table 2 Changes in Level of Demolitions, 2006-2031

	Estimated annual average total housing demolitions 2006 -2031 (units)	Estimated total housing demolitions 2006 -2031 (units)	Estimated total non- housing demolitions 2006 – 2031 (Floor space, sqm)
Melbourne (C) – D'land & S'bank	0	0	818,101
Melbourne (C) – CBD	0.4	10	1,975,374
Melbourne (C) – Remainder	34	894	2,169,038
Melbourne (C) – Total	35	905	7,737,099
Port Phillip (C)	43	1128	1,344,166
Yarra (C)	47	1232	1,036,805
Stonnington (C) – Prahran	48	1243	393,614
Inner Urban Region Total	209	5,413	15,474,198

Source: Building Commission Victoria; SGS estimates

4.2.3 Inner Urban Region Non-Residential Use Floor Space Forecasts, 2006 to 2031

Past and future floor space demand is directly linked to past and future population and employment growth as well as general trends in floor space requirements per employee. A floor space demand model is utilised in this study that relies on ratios per employees and projected employment growth in the region to forecast the future floor space demands of particular occupational classifications.

The model initially forecasts employment growth in each occupational categories using Input-Output Modelling techniques and subsequently translates this to the future floor space required for given non-residential uses. This translation occurs through the application of a ratio estimating total floor space demand per employee to the projected growth in employment number for each occupational classification.

Known ratios of floor space requirement for the various non-residential uses are derived from the 2004 City of Melbourne's Census of Land Use and Employment (CLUE). The City of Melbourne CLUE data is used, as it is the latest and only comprehensive land use survey undertaken for an Inner Melbourne council. The CLUE report details the floor space and total number of person employed for each of the industry/occupational classifications. Therefore, given the total floor space occupied and share of employment in a particular occupational classification, the ratio of floor space per employee can be calculated. These ratios of floor space per employee for each sub-industry/occupational classification derived based on CLUE are then applied to the projected employment growth for each sub-industry in Melbourne, Yarra, Stonnington (part) and Port Phillip.

As shown in Table 3, the total addition of non-residential use floorspace over the period of 2006-2031 is estimated to be 19,835,395m² for the Inner Urban Region of Melbourne.

Table 3 Non-housing Development Activity, 2006-2031

	2006 Non-Housing Floorspace	Estimated 2031 Non-Housing Floorspace	Estimated addition of non-housing floorspace (2006-2031)
Melbourne (C) – D'land & S'bank	3,146,543	4,074,211	927,667
Melbourne (C) – CBD	7,597,594	10,902,008	3,304,414
Melbourne (C) – Remainder	8,342,453	10,787,435	2,444,982
Melbourne (C) – Total	29,758,073	39,675,771	9,917,697
Port Phillip (C)	5,169,869	6,851,160	1,681,292
Yarra (C)	3,987,713	5,189,494	1,201,782
Stonnington (C) – Prahran	1,513,901	1,871,462	357,560
Inner Urban Region Total	40,429,556	53,587,887	13,158,331

Source: 2004 CLUE; ABS Census; SGS estimates

4.2.4 Inner Urban Region Total Social Housing Stock, 2006 to 2031

A critical issue in the assessment of Inclusionary Zoning contribution rates is the targeted expansion of affordable housing.

Data on the current social housing stock in the Inner Urban Region is derived from the ABS 2001 Census of Population and Housing database. ABS Census collected information on the total number of occupied private dwellings that were rented under State/Territory Housing Authority. For the purposes of this paper, it is assumed that these dwellings represent the total social/community housing stock in the Inner Urban Region.

For the future floorspace demand analysis, the projected increase in social housing stock via non-Inclusionary Zoning sources is assumed to be zero. This may be an overly pessimistic view on future social housing provision but plausible given the apparent difficulty and costs faced by the Office of Housing in maintaining and increasing its housing stock against today's rising property values seen throughout the entire Inner Urban region. Table 4 indicates the current and unchanged future level of social housing provision for the Inner Urban Region of Melbourne.

Table 4 Changes in Social Housing Stock, 2006-2031

	2006 Total Social/Community Housing (units)	Estimated 2031 Total Social/Community Housing (units)
Melbourne (C) – D'land & S'bank	3	3
Melbourne (C) – CBD	14	14
Melbourne (C) – Remainder	1485	1485
Melbourne (C) – Total	1502	1502
Port Phillip (C)	1899	1899
Yarra (C)	3435	3435
Stonnington (C) – Prahran	1161	1161
Inner Urban Region Total	7,997	7,997

Source: 2001 ABS Census; SGS Estimates

4.3 Estimation of Affordable Housing Overlay Cash in Lieu Rate

4.4 Methodology

The intention of incorporating an Inclusionary Zoning provision is to ensure an appropriate social mix is achieved in an area as redevelopment proceeds. In many cases, this requirement will be achieved through actual provision of social housing stock within successive developments. However, this may not always be practical or desirable. The purpose of developing an Inclusionary Zoning cash in lieu rate is to allow development proponents the option of paying for the social housing requirement generated by their development to met elsewhere within the general area. These contributions are to reflect the cost associated with the provision of social housing over time.

An example of the calculation required to establish a cash in lieu rate is provided as follows:

2031 Policy Scenario with Affordable Housing Overlay

Key input/assumptions in the Overlay calculation:

Average size of 1 unit of dwelling/affordable housing	100m ²
Average cost of providing 1 unit of affordable housing	\$250, 000
Additional social housing units required in 2031	3,718 units
% of additional social housing funded by IZ	50%
Estimated total housing development activity including demolition and replacement (2006-2031)	8,726,100m ² +541,300m ²
Estimated total non-residential development activity including demolition and replacement (2006-2031)	13,158,331m ² +15,474,198m ²

Equivalence ratio: 1m² residential development = 1m² non-residential development

$$\begin{aligned}
 \text{Total on-site contribution} &= \frac{\text{Cost of providing the social housing target}}{\text{Total housing and non-housing development activity}} \\
 &= \frac{3718 * \$250,000 * 50\%}{(8.726\text{m} + 0.541\text{m} + 13.158\text{m} + 15.474\text{m})} = \text{approx } \$12.26/\text{m}^2 \text{ of total floor area}
 \end{aligned}$$

For residential and non-residential development where the contribution is provided cash-in-lieu, \$12.26 per square metre of total floor area should be contributed towards funding social or community housing development.

4.5 The Model

SGS has developed a simple model to calculate the Overlay cash in lieu rate that might be applied in the Inner Urban Region based on the above formula. This model is designed to determine the contribution rate per square metre of new floorspace testing different scenarios with varying standards of provision on the desired future social housing mix. Scenarios can also be tested with different assumptions about the acquisition costs of social housing, the proportion of cost of additional social housing to be funded via an Inclusionary Zoning mechanism, and equivalence ratios between land uses.

4.6 The Scenarios

4.6.1 The Base Case – ‘Business as Usual’

The Base Case is the ‘business-as-usual’ scenario. It reflects the current policy setting where there is no Inclusionary Zoning mechanism and where the current rate of provision is maintained i.e. zero net addition to the future social housing stock. As indicated in Table 5, it is estimated that the proportion of social and community housing in the Inner Urban Region is currently at 6.2%. If the current social housing stock is maintained, the proportion of total stock represented by social housing in the Inner Urban Region in 2031 will drop to 4.0%.

4.6.2 The Alternatives Scenarios

In the alternatives scenarios, the targeted social housing mix is tested at 5.0%, 6.2 % (maintaining current social housing mix) and 10%. In all three scenarios, the funding mix is maintained at 50%. The unit costs of providing social housing can also be varied. For the purposes of this paper, the median cost of providing social housing (land plus development costs) is assumed to be \$250,000 per unit. This community housing development cost in the Inner Region of Melbourne is based on a sample survey of community housing projects from City of Port Phillip, Port Phillip Housing Association Ltd., Melbourne Affordable Housing Ltd and Yarra Community Housing Ltd.

Table 5 indicates the contributions per square of total new floorspace with varying targeted social housing mix.

Table 5 Estimation of Inclusionary Zoning Cash in Lieu Rate

	2006 Stocks	2031 Stocks	Demolition & Replacement	Total Development Activity 2006 - 2031
Housing Stock (units)	152,290	239,551	5,413	92,674
Housing Stock (floorspace, sqm)	15,229,000	23,955,100	541,300	9,267,400
Non-Housing Development activity (floorspace, sqm)	40,429,556	53,587,887	15,474,198	28,632,529

Variables/inputs	Scenario 1 - Base Case with no Inclusionary Zoning	Scenario 2	Scenario 3 - Maintaining Current Social Housing Mix	Scenario 4
Current Social Housing Mix (2006)	6.2%	6.2%	6.2%	6.2%
Current Social Housing Stock (2006)	9,499	9,499	9,499	9,499
% Social Housing Mix Target / Outcome in 2031	4.0%	5.0%	6.2%	10.0%
% Funding Mix	NA	50%	50%	50%
Equivalence ratio	NA	1	1	1
Housing acquisition cost per unit	NA	\$250,000	\$250,000	\$250,000
Additional Social Housing Units Required to Meet Target	NA	2,479	5,353	14,456
Cost of Additional Social Housing Stock	NA	\$619,637,500	\$1,338,290,500	\$3,614,025,000
Development Activity (sq. m)	37,899,929	37,899,929	37,899,929	37,899,929
Cash in lieu rate per sq. m.	NA	\$8.17	\$17.66	\$47.68

Assuming that 50% of the average \$250,000 social housing unit purchase cost is met from sources other than the Affordable Housing Overlay, and assuming that each square metre of non-residential floorspace is treated the same as each square metre of residential floorspace as far as the Inclusionary Zoning requirement is concerned, the relevant cash in lieu rates would be:

- \$8.17 per square metre of total floor area for a 5% targeted social housing mix in 2031;
- \$17.66 per square metre of total floor area to maintain the current social housing mix in the Region (6.2%) in 2031; and
- \$47.68 per square metre of total floor area to achieve a 10% targeted social housing mix in 2031.

5 Management of Funds and Delivery of Affordable Housing

Inclusionary Zoning provisions such as those set out in the foregoing Section will generate significant stock and or cash flows of between \$300 million and \$1.8 billion over 25 years. The arrangements for the collection and management of these funds must be efficient, responsible transparently fair and open to public scrutiny.

A number of principles can be cited for designing such a system, including:

- Assets dedicated via the Inclusionary Zoning mechanism should be permanently and securely directed towards the provision of bona fide 'affordable housing', that is permanent rental housing which is available to households in the bottom two quintiles of the income distribution;
- Allocation of this affordable housing to particular households should be equitable and subject to transparent eligibility criteria and operating rules;
- Assets dedicated via the Inclusionary Zoning mechanism should be deployed in the most financially advantageous way, within prudent risk limits, so that appropriate equity leveraging can occur to improve housing yields can;
- Assets dedicated via the Inclusionary Zoning mechanism should be used within the municipality from which they were provided, in line with the provisions of the affordable housing plan; and
- Deployment of the assets should be subject to periodic or continuous competitive bids from affordable housing providers, to maximise financial efficiency.

Institutional arrangements to support operation of Inclusionary Zoning within these principles have already been established in Victoria through the 'Housing Associations' legislation (*Housing (Housing Agencies) Act 2004, Act No. 106/2004*). The Act establishes a framework for the regulation and prudential supervision of not for dividend housing providers ('Housing Associations'). Compared to community housing groups which have operated in Victoria for many years, a registered Housing Association under the 2004 Act:

- will be required to meet more stringent regulatory requirements, as it will have higher risk exposure because of its access to private sector borrowings;
- will be required to access private finance;
- will have preferential access to government capital growth funding; and
- will be able to implement flexible rent policies but will have to ensure that all eligible tenants receive their maximum entitlement to Commonwealth Rent Assistance and that tenants' rents are affordable.

There are currently two registered Housing Associations servicing the Inner Urban Region; Melbourne Affordable Housing Ltd (www.melbourneaffordablehousing.com.au) and Port Phillip Housing Association Ltd (www.ppha.org.au). There is scope for more Associations to be registered over time.

Assets dedicated via Inclusionary Zoning could, by way of conditions on development approvals, be directed to either Melbourne Affordable Housing Ltd (MAH) or Port Phillip Housing Association Ltd (PPHA) by the Council with responsibility for the development approval in question. Sharing of this funding stream between these providers could be the subject of a protocol agreed by all Councils which are applying the Inclusionary Zoning Overlay. This protocol would then be signed off by the Registrar of Housing Associations and placed on the public record.

MAH and PPHA would be obliged to deploy these funds in line with the Affordable Housing Plan which accompanies the relevant Overlay in the VPP. Developers who are providing these funds / stock would be assured of permanent dedication of these resources to affordable housing provision within the subject municipality via the supervision and reporting arrangements administered under the auspices of the Registrar of Housing Associations. In this sense, the dedication of these assets would be effectively the same as the 'gifting' of road, drainage, parkland and other assets to the host Council when a developer undertakes a residential subdivision or similar project.

In time, it may be appropriate to open access to the Inclusionary Zoning funding stream to other providers registered under the Housing Agencies Act. These could include vehicles within which developers themselves might have an interest. The key issue will be that any Inclusionary Zoning funds vested in such vehicles deliver the relevant outcomes in terms of permanency, equity of allocation and efficiency. Opening up the system to more providers would inject a degree of competitive tension to ensure the best possible use of the funding stream on offer.

6 Preconditions for Successful Implementation

As discussed in Section 2, the Inclusionary Zoning model proposed in this paper is premised on environmental protection grounds, as opposed to development taxation or betterment taxation.

Notwithstanding that this measure is defensible and warranted as a planning requirement (much like heritage protection or parking requirements), the development sector will be inclined to interpret such an initiative as a simple cost shift, from the general taxpayer to a 'soft target' in the development industry.

This scenario requires a positive and pragmatic response.

Any move to introduce Inclusionary Zoning should be accompanied by a suite of offsetting benefits for industry including, for example;

- Guaranteed (timely) release of a pipeline of State Government and local government controlled sites for redevelopment;
- Review of planning standards and design guidelines for these sites and for redevelopment in the Region generally to optimise yields within reasonable environmental envelopes;
- Introduction of innovative planning measures to provide more certainty, particularly for residential developers, for example, agreed infill targets for particular areas where the broad parameters of built form will have been resolved by Council at the Planning Scheme amendment phase, so that advertising of subsequent developments would not be necessary; and
- Introduction of further measures to streamline development approvals and reduce uncertainty, for example, application of the Development Assessment Forum (DAF) model under which approvals are given by technical panels operating at arm's length from the Councils in question.

Based on discussions held in the preparation of this report, four other factors are vital to the successful introduction of the Overlay;

- It should be broadly based with few or no exemptions in terms of scale of project and land use, and contributions should be fully 'scheduled' so as to avoid negotiation uncertainty.
- It should provide developers maximum flexibility in terms of whether the Overlay requirements are met on site or via cash in lieu contributions or some mix of both. This should apply regardless of the scale of the development.
- It should be phased in over a sufficiently long period to enable developers to clear their existing pipelines of projects, so that they might have the opportunity to factor the Overlay cost implications into the land price bids they make for new projects.
- Both State Government and local Councils must demonstrate that they are prepared to shoulder some of the cost burden associated with maintaining a healthy social mix in the inner urban region. Amongst other things, this could include Councils making land available at less than market value so that affordable housing can be successfully incorporated.