

Inner Melbourne Action Plan

Briefing Paper

Proposed Affordable Housing Overlay (Inclusionary Zoning)

Purpose

1. To endorse broad principles (see below) and authorise the preparation of a strategy for briefing and consulting with the State Government and an appropriate vehicle for further investigation in partnership with IMAP Councils that will lead to State support for the proposed Affordable Housing Overlay.

Background

2. On 25 May 2007 the IMAP Committee sought further investigation of the proposed Overlay involving:
 - Independent consultant assessment of the modelling in the SGS reports (2004, 2007) including demand analysis,
 - The potential merits of broadening income range targets in the context of the heightened housing affordability problem, including the needs of low income wage earners, and
 - The market impact of proposed contributions.
3. In December 2007 a Brief was adopted (see Attachment Two). Following a competitive quotation process, Biruu Australia Pty. Ltd. was engaged in February 2008.
4. In February 2008 the Inner Melbourne Affordable Housing Needs Website was established and now provides a useful tool for informing the identification of housing needs and targets. This now needs to be supplemented by the preparation of a Local Housing Plan incorporating local needs priorities provided by each of the four IMAP Councils, housing associations and the Office of Housing. This will identify priority locations, target groups and housing types to guide contribution allocations.
5. In May 2008 Biruu has provided a draft report which is summarised in Attachment One. In short, Biruu found that:
 - SGS's modelling involving development projections and resultant cash-in-lieu rates was in part varied, with averages adopted by Biruu as appropriate.
 - The lowest income groups have been significantly more affected by the housing market and should be targeted by the Overlay.
 - The Overlay should target rental housing.
 - The Overlay is one of many policies/programs necessary to address the issue of housing affordability. Others will target different income groups and tenures.
 - The financial impact on developers of the Overlay for a range of reasonable cash-in-lieu rates was found to have no material impact on development cost/viability.
 - Registered Housing Associations are the appropriate vehicles for receiving the Overlay contributions/delivering housing outcomes.
6. This has led to the recommendation of the following principles by the combined IMAP working group.

Principles

7. That the proposed Overlay is premised on **this mechanism being recognised as an environmental standard**, not as a redistributive intervention, with the environmental value sought being an adequate social mix to maintain social cohesion, cultural vibrancy and an efficient labor market (where lower income wage earners can be sourced locally).
8. That **this environmental value needs to be permanently embedded in successive developments** or the surrounding region in the same way as car parking requirements, heritage controls, solar access and stormwater retention requirements through the planning permit system.

9. That **new residential development is changing the conditions of the inner region** and currently focuses on the high end market. Without intervention, the proportion of affordable housing stock in the region will continue to diminish, given the level of projected housing growth. Therefore, **the development sector, in part, has responsibility to contribute to maintaining housing affordability.**
10. That to be equitable and address housing need the Overlay must be one of a number of policy settings or program interventions that target various segments of the broader housing affordability problem and that **shares the responsibility for social mix between the development community, the State and Commonwealth Government, each of which has vital part to play in addressing the broadening housing affordability problem.** Related programs in this context include home ownership grants, social housing capital expenditure, the proposed National Rental Affordability Scheme (Commonwealth) and the proposed Shared Equity Scheme (Victoria), all of which will complement the proposed Overlay. In addition, local government should investigate suitable incentives to developers to encourage affordable housing.
11. That the Overlay be **broad based** by targeting all residential developments (greater than one dwelling) and all private, commercial development (retail, office, industrial) but exclude demolition activity not linked with development across the region.
12. That the proposed Overlay be **transparent and predictable** with little scope for planning discretion so as to provide developers and local government with certainty while also being flexible in the form of contributions (largely cash-in-lieu or equivalent units set aside in development).
13. That contributions be set at a rate that seeks **to maintain or increase existing proportions of social housing** both within and above public housing income limits, **without materially inhibiting private investment or reducing housing affordability.**
14. That the Overlay **targets lower income, renter households** who have been the most affected by decreasing housing affordability.
15. That the **delivery mechanism** for contributions be **registered housing associations** under the Housing Act that have purposes to house lower income renters in perpetuity that have incomes well above public housing income limits with rents of up to 75% of market rents including low income wage earners unable to participate in the local labour market.
16. That a **regional collection and allocation system** for contributions be developed that is based on regional need priorities informed by IMAP Councils, housing associations and the Office of Housing.

Recommendation

17. That the IMAP Implementation Committee endorse the broad Principles underpinning the proposed Affordable Housing Overlay.
18. That a strategy for briefing and consulting with the State Government be developed including the involvement of IMAP CEOs and an appropriate vehicle for further investigation and achievement of State Government support be determined such as the preparation of a State Government Business Case in partnership with IMAP Councils.
19. That in preparation for briefing and consulting with the State government, the proposal be packaged into a consolidated document that sets out remaining tasks for further investigation and undertaking in conjunction with the State government including:
 - a. The development of a Local Housing Plan
 - b. The further development of a draft Affordable Housing Overlay
 - c. The development of delivery mechanisms including collection and allocation arrangements
 - d. Agreement on a target level of social housing by 2033 and the corresponding cash-in-lieu rate per square metre (and equivalent unit contribution alternative) that achieves this.

ATTACHMENT ONE

Executive Summary of the Biruu report, *Inner Region Affordable Housing Overlay* (May 2008)

1. The housing market segment most affected by increased housing cost has been very low income renters (< 50% of Australian median income), in particular between 1996-2001. This income group faces the most serious shortages of affordable rental housing (< \$140/week). This confirms the assessment of housing stress in the SGS report 2004.
2. Biruu provides different estimates of existing and projected stock and development activity, while indicating that there is no precise method for estimating projected activity levels over 25 year periods:
 - Biruu estimates existing commercial and residential stock in 2006 as being 58.1 million m² vs SGS's 55.6 million m²) and averages this at 56.9 million m².
 - Biruu estimates churn (conversion) within existing stock as being 7.0 million m² vs SGS's estimate of 16.0 m² and averages the estimate at 11.5 m²
 - Biruu estimates projected, new housing stock until 2033 as 13.8 million m² vs SGS's estimate of 8.7 million m² and averages this as 11.3 million m²
 - Biruu estimates projected, new non-housing stock at 18.0 million m² vs SGS's estimate of 13.2 million m² and averages this at 38.4 million m².
3. Biruu estimates provide a lower number of existing social housing stock in 2006 of 7,997 units vs 8,818 units from SGS and uses the Biruu figure of 8,818 units. This is due to differing ABS census data categories and differing census years. Thus, its proportion of total housing stock in the region varies: 5.9% (Biruu) vs 5.3% (SGS). In the absence of State projections for social housing growth, this stock is not assumed to increase by 2033 (agrees with SGS on this), meaning that projected new social housing dwellings required to maintain this proportion is 9,259 units (Biruu) vs 4,699 units (SGS) with an average of 7,698 units.
4. Given the different estimates above, identifying a minor double counting error in the SGS modelling and using a different method in estimating social housing as a % of projected rental dwellings affordable to very low income households, Biruu calculates different cash-in-lieu rates/ m² than did SGS for the various social housing level scenarios:

Scenarios- SGS	SGS estimated rates	Biruu scenarios	Biruu estimated rates
<ul style="list-style-type: none"> • Scenario 1- Base case with no IZ (4% social housing) • Scenario 2 (5% social housing) • Scenario 3¹ (maintaining current mix of 6.2% social housing) • Scenario 4 (10% social housing) 	<ul style="list-style-type: none"> • N/a • \$8.17/ m² • \$17.66/ m² • \$47.68 / m² 	<ul style="list-style-type: none"> • Scenario 1- Base case with no IZ (2.8% social housing) • Scenario 2¹ (maintaining current mix of 5.9% social housing) • Scenario 3 (social housing @ 15% of projected affordable housing or 6.4% social housing) • Scenario 4 (social housing @ 20% of projected affordable housing or 8.6% social housing-) 	<ul style="list-style-type: none"> • N/a • \$27.61/ m² • \$34.20/ m² • \$55.79/ m²

¹ Biruu's scenario 2 is the equivalent of SGS's scenario 3 in terms of aiming to maintain the current mix of social housing.

5. Biruu averages the differing rates to achieve social housing proportions by 2033 at:
 - Scenario 1- base case: N/a
 - Scenario 2- maintaining current mix of 5.9% social housing: \$25.16/ m²

- Scenario 3- 6.6% social housing: \$31.04/ m²
 - Scenario 4- 8.9% social, housing: \$51.39/ m²
6. The market impact of three rates (\$10, \$20 and \$30/ m²) was assessed using 3 case studies:
- 5000 m² commercial office development on cleared site: no significant or detectable impact.
 - Demolition of a 2000 m² building requireing a permit: a material impact with significant cost increases. Not to be recommended (noting that this was never advocated by SGS).
 - Demolition of 1000 m² building and construction of 15 new 2 bed apartments: No material impact, representing less than 1% of the value of units and likely to be swamped by other, unrelated cost factors.
7. That housing associations are the appropriate vehicle for targeting contributions as:
- Social mix as an environmental standard can't be addressed by home ownership as this does not create permanent affordability due to windfall gain by the first purchasers who also will improve their incomes over time, thus eroding the objective of social mix as an environmental standard and, thus, the planning basis of the Overlay.
 - Maintaining permanently affordable home ownership is difficult if not impossible without complex and unwildy arrangements that would have high administrative, monotoring and enforcement costs and public relations issues (eg. disputes with owners).
 - Moderate income households who cannot afford home ownership are still able to rent in the private market.
 - Other programs do or should target the broader housing affordability problem.
8. Recommends the way to achieve buy-in from State Government is to establish a Project Control Group with IMAP and State Government representation and to assess the work undertaken and reach conclusions through the undertaking of a State Government Business Case with IMAP involvement.

ATTACHMENT TWO

Consultancy Brief:

Inner Region Affordable Housing Overlay – Scope and Market Impact

Background

In March 2004, SGS Economics & Planning Pty Ltd (SGS) was commissioned by the City of Yarra on behalf of the Inner Urban Region councils (Melbourne, Yarra, Port Phillip and Stonnington) to investigate housing affordability trends in the Region and advise on the policy directions required to address these issues.

The SGS report, entitled '*Affordable Housing in Melbourne's Inner Urban Region; A Strategic Framework*' was completed in June 2004. Amongst other things, it made the following findings:

- 1 *Affordable housing in inner Melbourne is evaporating*
 - The stock of private rental units available at rents equal to or less than 25% of the (national) 40th percentile household income halved between 1996 and 2001, falling from 14,328 to 7,336 dwellings. If this rate of decline continues, affordable private rental housing will be virtually non-existent in the Region by 2030.
 - Over 60% of low income households in private rental in the Region are suffering housing stress.
- 2 *Traditional policy responses are not likely to solve the problem*
 - The mainstream policy responses to housing stress are the provision of public housing (supplemented by small quantities of community managed / government owned housing), and the provision of income top-ups to households through Commonwealth Rent Assistance (CRA).
 - Funds available for public housing under the Commonwealth – State Housing Agreement (CSHA) have declined over the past decade. The Office of Housing is struggling to maintain its existing dwellings let alone add to the stock. These forces are all the more intense in the Inner Urban Region.
 - CRA is capped and is not regionally differentiated. In the vast majority of cases, receipt of CRA, whilst welcome, is unlikely to mean the difference between affordable housing and persistent housing stress.
- 3 *There is a broad range of opportunities for funding the affordability gap, but no easy options.*
 - The funds required to bridge the gap between affordable rents and commercial returns to private investors (or simply to invest directly into affordable housing stock acquisition) can be sourced from:
 - The introduction of **explicit new taxes**. Models here include local government rate surcharges for affordable housing, extension of Land Tax to provide cash flows for affordable housing and betterment taxes.
 - The **hypothecation of existing cash flows** to affordable housing or the **foregoing of cash flows** as part of an affordable housing program; examples here include:
 - dedication of all or part of the VicUrban dividend to affordable housing initiatives; and

- dedication of the proceeds of government land sales to affordable housing (or the provision of such sites at less than market value for affordable housing projects).
- **Regulatory measures** requiring the creation of affordable housing as part of the development process. These include:
 - *Impact mitigation conditions* in development approvals, whereby proponents would be required to replace affordable housing stock directly destroyed or withdrawn from an affordable rental band as a result of the development in question.
 - *Inclusionary zoning*, whereby all residential, commercial, industrial and other development within a district or region would be required to incorporate a given proportion of affordable housing, or pay the cash equivalent to a designated affordable housing provider in the area (see below).
 - *Bonus systems*, whereby proponents are offered greater development intensity on their sites in return for contributions towards affordable housing.
 - *Negotiated or voluntary contributions* for affordable housing.
 - Enforcement of affordable housing contributions as '*infrastructure charges*', whereby affordable housing is deemed to be in the same category as roads, drains and parks and rendered subject to standard DCP principles and practice.
- **Philanthropy and ethical investment**, which also includes harnessing volunteer effort.

4 *Inclusionary Zoning should be the preferred regulatory measure to support housing affordability in the Inner Urban Region*

- '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. With its references to '*conservation of special cultural value*' and '*explicit consideration of social and economic effects*' when determining use and development of land, the Planning and Environment Act in Victoria supports the extension of Inclusionary Zoning to affordable housing.
- Inclusionary Zoning has been successfully applied in the Ultimo Pyrmont peninsula and elsewhere in Sydney. All development in Ultimo Pyrmont is required to incorporate affordable housing or pay a cash in lieu rate of around \$30 / m² of floorspace.
- Taking into account the experience in Ultimo Pyrmont and elsewhere, a working assumption can be made that the Inclusionary Zoning provisions may be applied so as to be 'non-distortive'. That is, the cash-in-lieu rate would not deter development activity that would otherwise have occurred in the Region but would instead be largely absorbed in reduced margins for developers and/or lower residual land values and/or higher end user prices..
- Developers would have certainty regarding the affordable housing inclusion requirement and could factor this into land bids, potentially passing some of the burden back to land sellers.

- Relatively small per sq metre cash in lieu payments, spread over a large number of developments would provide a significant cash flow that could be used in conjunction with private finance leveraging schemes to generate sizeable expansion in affordable housing stocks, at least in the medium term.

The findings of SGS's 2004 report were broadly endorsed by the Inner Region Councils and, early in 2006, SGS was again commissioned to provide advice on the specific mechanisms which might be included in the Victoria Planning Provisions (VPP) to implement Inclusionary Zoning in the Region.

The agreed methodology pursued by SGS included facilitation of a 'Chatham House' rules discussion with key developers to define the areas 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 the introduction of Inclusionary Zoning.

For the purposes of SGS's 2006 work, 'affordable housing' was 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.*

This SGS report, entitled '*An Affordable Housing Overlay in the Victoria Planning Provisions: Implementation Model for Melbourne's Inner Urban Region*' (March 2007), found that:

1. Application of Inclusionary Zoning for affordable housing would require a new **Overlay in the VPP**. This should 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.
2. 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.
3. 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 approximately \$18 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.
4. 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.

5. Under the strict supervision of the Registrar appointed under the Housing Agencies Act 2004, the Overlay funds and stock should be deployed as permanent affordable rental housing, allocated according to transparent, fair and prudent tenant management policies.
6. With the prudential supervision of the Registrar, these Housing Associations should be free to leverage their assets to optimise affordable housing yields.
7. 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.
8. 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.
9. Four other factors are vital to the successful introduction of the Overlay;
 - As well as being broadly based with few or no exemptions in terms of scale of project and land use, 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.
10. 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.

CEO’s of the Inner Region councils considered the recommendations of the March 2007 report in August 2007. They identified a need for further study and financial modelling to address the following issues:

- The desirability or otherwise of extending any Inclusionary Zoning or related mechanism beyond households in the target income range for Housing Associations, to include moderate income households (including key workers) on the basis that these groups are also increasingly excluded from the Region by rapidly escalating housing prices and rents. Current income limits for Housing Associations are set at levels above public housing income limits and are as follows:

Target household type	Social (public and community) housing general income limits (Sept 2007)¹	Housing Association income limits (Mar 07)¹
Singles	\$22,308	\$37,940
2 persons	\$37,128	\$63,484
3 persons ²	\$38-896-40,664	\$84,354

¹ Updated 6 monthly in accordance with CPI increases

² 1 or 2 parents with 1 to 2 children

A suggested, extended upper income limit could possibly be an income that equated to the threshold income necessary to afford to purchase a median priced house in the inner region (refer to separate, supporting data from Swinburne Institute for Social Research); and

- Taking into account the preferred income range for targeted households and the preferred total yield of affordable housing units from any Inclusionary Zoning mechanism, the extent of the financial impact of such a requirement on developers and whether this would see a relative diminution of construction activity in the Region.

The CEO’s also required an independent review of the modelling of Inclusionary Zoning contribution rates included in SGS’s March 2007 report.

In addition, the CEO’s expressed the view that any Inclusionary Zoning mechanism should not apply to single dwelling projects.

Purpose of this Brief

The objectives of this brief are to:

1. Provide advice on the desirable household income range that should be targeted in any Inclusionary Zoning mechanism to be implemented in Melbourne’s Inner Urban Region;

2. Provide advice on the total affordable dwelling yield that should be targeted in any such mechanism;
3. Assess the impact of an Inclusionary Zoning mechanism with these targeting and yield requirements on a range of representative development types in the Inner Urban Region (but excluding single dwelling projects);
4. Provide advice on whether this impact is likely to lead to significant capital diversion from the Region and/or significant deterioration in the overall affordability of housing in the Region; and
5. If such diversion and/or deterioration in general affordability is anticipated, whether the disbenefits associated with these outcomes might be adequately offset by the benefits associated with the Inclusionary Zoning requirement.

Tasks to be Completed

1. Participate in an inception meeting with the client Councils to gain a full appreciation of the background to the Region's Inclusionary Zoning initiative.
2. Assess the conceptual and analytical robustness of SGS's March 2007 report.
3. Replicate, modify or replace the SGS modelling approach as necessary, to test the impact on the Inclusionary Zoning cash-in-lieu rate per sq. metre, of adjustments to the income range of targeted households and/or the total quantum of affordable housing units to be generated from this mechanism over the assessment period in question.
4. Review SGS's March 2004 report in the light of more recent Census and property market information to assess how the character of the affordable housing challenge in the Region might have changed over the past 3 years.
5. Review relevant Government policies, undertake consultations with appropriate officials and key non-government stakeholders, appraise the relevant policy and research literature and undertake demand analysis to arrive at a considered opinion about:
 - the income groups and household types that currently struggle to gain access to housing in the Region or might prospectively do so;
 - the specific band of household incomes and household types that should be factored into any Inclusionary Zoning mechanism for the Region; and
 - the quantum of housing yield that should be targeted for the Inclusionary Zoning mechanism, that is set a justifiable target including unit numbers for affordable housing in the inner region.
6. If it is considered that the households targeted for accommodation under the Inclusionary Zoning mechanism should range beyond the income limits set for public housing and Housing Association managed stock, identify any additional administration, monitoring and enforcement costs that might attach to this broadening of groups eligible for the relevant affordable housing.
7. Using the modelling framework developed via Task 3, assess the implications of varying the targeted range of households and the targeted quantum of affordable housing units in line with the recommendations arising from Task 5, for the cash in lieu rate per sq. metre under an Inclusionary Zoning mechanism, making the same broad assumptions as the SGS report regarding the proportion of capital cost to be funded from sources other than the Inclusionary Zoning mechanism and taking into account any additional administration, monitoring and enforcement costs as identified through Task 6..
8. Identify a range of actual and hypothetical case study projects across the region (excluding single dwelling projects) to test the impact of the cash in lieu rate arrived at via Task 6 on the financial performance of these projects, based on two scenarios:
 - immediate introduction and enforcement of the Inclusionary Zoning provision; and

- immediate introduction of the Inclusionary Zoning provision but enforcement after a two year lag period to permit developers to clear current projects and factor the Inclusionary Zoning provision into their feasibilities for future projects;
9. Based on these case studies, and consultation with developers, assess the impact of the Inclusionary Zoning mechanism on the Inner Urban Region's likely share of development activity across the metro area, Victoria and Australia.
 10. Also based on the case studies and consultation with developers, assess the impact of the Inclusionary Zoning mechanism on prices and the general affordability of housing in the Inner Urban Region.
 11. Assess the extent to which the reduction, if any, in the Inner Urban Region's share of development activity associated with Inclusionary Zoning and/or any reduction in general affordability of housing in the Region occasioned by this measure will be offset by social and economic benefits associated with improved availability of housing to lower and moderate income groups in the Region.
 12. Provide a weekly one page progress report to the client's nominated contact officer.
 13. Prepare a full report addressing the 5 key objectives of this brief and making recommendations about the preferred way of implementing Inclusionary Zoning in the Inner Urban Region.

Output

The consultant is expected to deliver a concise and accessible report targeted at a lay readership.

Timing

The project must be completed within 10 weeks of instructions from the client to proceed.

Budget

A budget of up to \$40,000 inclusive of GST is available for this project