Impact of New Infrastructure charges in Townsville

Colin Dwyer

DS Economics

November 2009

Table of Contents

1. Principal Findings

While most of the community accepts the need for infrastructure contributions; there is concern about the timing of the latest increases and their magnitude, in particular on retail and industrial projects. According to a recent report for LGAQ, Townsville has the highest retail infrastructure charges, and the fourth highest residential and industrial charges of any high growth council in Queensland. According to many developers, a significant infrastructure charge would stop or delay the construction of some new commercial facilities. This will deprive the region of jobs, economic activity and reduce the quality of life of some residents.

Townsville Economic Performance

The Northern and North West region, which is based on Townsville, remains in a vulnerable economic position. A combination of data confirms this via significant and recent employment loss, increased underemployment, increasing unemployment, significant recent private sector investment decline, insufficient additional public sector recurrent and capital spending, decline in exports and declines in specific imports.

Early 2010 is likely to be a challenging time for Townsville's economy as pressure mounts to raise interest rates, thousands of school leavers will join the workforce and the finance sector remains cautious, affecting construction employment and business investment. Unemployment is likely to rise further.

Given the economic conditions and the challenges faced over the coming year, the timing of these infrastructure charges may hinder balanced economic progress and reduce community convenience.

Residential Development

New residential property construction, a driver of Townsville's recent prosperity, has slowed and jobs have gone. In the three months to August 2009 residential building approvals dropped 23.4% compared to the same three months last year. As interest rates continue to rise and a higher Australian dollar stifles exports and tourism, the residential construction sector in Townsville will face additional challenges.

The Northern Beaches region of Townsville is likely to be a major residential growth zone over the next five to ten years. Residential infrastructure charges in this zone are some of the highest in Queensland. Despite this, many developers expect that new home buyers will absorb increased residential infrastructure charges by reducing the size of their new home or reducing the size and quality of a component of their new home.

Non Residential Development

A recent report commissioned by LGAQ found that Townsville had the highest retail infrastructure charges of any high growth council in Queensland. Retail and industrial property development in Townsville has eased in the previous year. In the three months to August 2009 the value of commercial building approvals dropped 63.8% compared to the same three months last year. The cost increase associated with the development of some retail land projects will stall the delivery of proposed developments, especially retail developments.

A survey of retail developers identified $260m worth of retail projects planned in Townsville that will be affected by proposed infrastructure charges. If these projects stall due to higher infrastructure costs it would deprive the community of between 759 and 964 Equivalent Full Time (EFT) jobs and over $42 million in wages. The regional economy would be deprived of $160million worth of economic activity and local, State and Federal governments would be deprived of over $24.7million worth of taxes. These are jobs and economic activity that would strengthen the local economy.

Development Finance

Combine challenging economic conditions with uncertain medium term (only 12 months), residential policy, and non residential charges being some of the highest in Queensland, is likely to contribute to financiers remaining cautious when considering project funding.

All business's need to be confident that their plans are not going to be compromised by additional charges and fees that will impact their cost structures in the medium term (3 to 5 years).

If the residential discount is cancelled after 12 months, there is concern that profits and project viability will be compromised. Very few financiers will provide project funding under uncertain conditions.

Given information from surveys and case studies, and considering current economic conditions and economic impacts of new fees, non residential discounts require further consideration for inclusion in the discount strategy.

Action elsewhere

Other centres have experienced similar challenges and responded accordingly. Brisbane City Council recently announced an extension of its 35% discount. Pine Rivers' response was to revert to pre-existing charges and they have since applied a CPI increase while reserving their right to apply the higher charges in the future.

Recommendations:

1. A clearer picture of the full impact will emerge over a longer time period; monitoring market performance is essential.

2. Given information from surveys and case studies, and considering current economic conditions and economic impacts of new fees, non residential discounts require further consideration for inclusion in a discount strategy.

3. The introduction of an infrastructure discount over 3 to 5 years for all development, with regular reassessment that provides certainty to industry and financiers is recommended.

2. Introduction

As Townsville considers solutions to its unique economic, social and environmental challenges, our community needs to scrutinize the affects of infrastructure costs on residential, retail and industrial users and suppliers and the impacts on our wider community.

The idea of charging new developments for upstream infrastructure charges is not new. Headworks charges for water and sewerage have been around since the early 1980s, and were developed to help fund the external infrastructure to projects (i.e. treatment plants, reservoirs, etc).

In 2009, Townsville City Council introduced discounted infrastructure charges for residential developments, and full fee charges for non residential projects.

New residential and commercial construction is a fundamental component of the Townsville economy, injecting significant investment into the economy and supporting a significant amount of direct, indirect and induced jobs.

This study examines the impact of additional infrastructure charges on new development including residential, retail and industrial.

Data and Method

The method used to describe the impacts of infrastructure charges is practical case studies.

All case study data has been provided by local developers who have given their time freely and we thank them for their input. UDIA Townsville supplied information on infrastructure charges and a report commissioned by LGAQ comparing infrastructure fees was included.

An in-house economic model was developed to identify the effects of infrastructure charges on economic activity, jobs, wages and taxation revenue.

In order to identify and quantify the economic impact of residential, retail and industrial infrastructure charges, a brief telephone and face to face survey of developers was completed.

Several local banks provided their opinion on financial security and infrastructure fees.

3. Residential, Commercial and Industrial Developer's decisions

This section describes three relevant Townsville case studies: a residential example; a retail development; and an industrial example. It finds that Townsville has some of the highest infrastructure charges in Queensland, residential developers and buyers will more than likely find ways of absorbing the discount fee, retail projects will be lost due the infrastructure charges, and owner builder industrial projects will find it more difficult to obtain finance and projects will stall.

Residential Development Case Study

The residential property market is facing challenges. Dwelling approvals are lower than last year, and significant job losses in the wider region have contributed to poor new residential construction performance. Residential vacancy rates are higher than last year and the financial sector remains cautious; restricting access to funding. New home buyers will more than likely have to pay the additional cost associated with infrastructure fees, but many developers are innovative and can see ways of accommodating the added cost.

This affordable residential model supplied by Maidment Developments, highlights the impact of infrastructure costs on an affordable residential project.

Considering the recently introduced discounted infrastructure fees, this example shows that

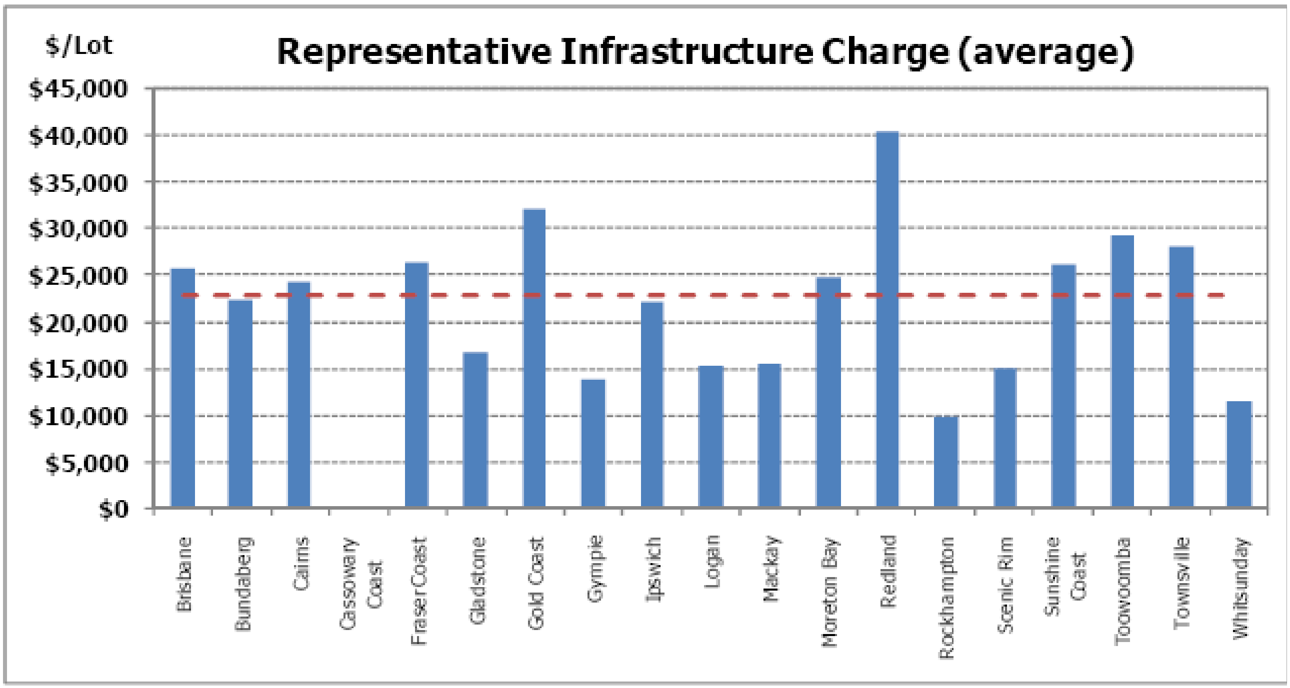
- The cost of a block of land in this example will increase by $12,251;
- Statutory and infrastructure charges are almost $30,000 for this affordable development;
- The increase in infrastructure fees including holding costs and contingency fees is $12,251;
- Developer's margin has dropped to 12.77%, affecting finance approval;
- Projected internal rate of return has almost halved;
- Breakeven date has been extended by 2 months;
- After discussions with several large and medium sized land developers, buyers will more than likely absorb the additional costs in full or will either reduce the size of their new home, or reduce the size and quality of components of their home;
- To obtain finance it is important that developers obtain certainty from all levels of government policy.

Residential Case Study

Madison Place - 53 lot residential subdivision					
Study showing the effect of Increase in Headworks on residential land development feasibility					
		Option 1 - Based on Infrastructure Charges applicable to development applications reaching decision stage up to 30 June 2009		Option 2 - Based on Infrastructure Charges applicable to development applications reaching decision stage after 30 June 2009	
COSTS & REVENUES		**$AUD Total**	**$AUD Per Lot**	**$AUD Total**	**$AUD Per Lot**
REVENUE					
	Quantity	$AUD		$AUD	
Total Sales Revenue	53	8,374,000	158,000	8,374,000	158,000
Less Selling Costs		(505,123)	9,531	(505,123)	9,531
TOTAL REVENUE (before GST paid)		7,868,877	148,469	7,868,877	148,469
Less GST paid		(636,545)	12,010	(636,545)	12,010
TOTAL REVENUE (after GST paid)		**7,232,332**	**136,459**	**7,232,332**	**136,459**
COSTS					
Land Purchase Cost (Actual)		1,500,000	28,302	1,500,000	28,302
Land Transaction Costs (Stamp Duty & Acquisition)		65,475	1,235	65,475	1,235
Construction (Civil & Electrical Construction)		2,155,545	40,671	2,155,545	40,671
Professional Fees (Survey, Design, Planning + Others)		289,805	5,468	289,805	5,468
Statutory Fees (Council Fees and Infrastructure Charges)		1,007,639	19,012	1,559,933	29,433
Project Contingency (2.5% of Project Costs)		97,066	1,831	110,874	2,092
Land Holding Costs (Rates, Land Tax, Maintenance)		27,000	509	27,000	509
Interest Expense (on 100% finance)		451,762	8,524	534,911	10,093
Landscaping, Irrigation, Footpaths and Fencing		429,660	8,107	429,660	8,107
TOTAL COSTS (before GST reclaimed)		6,023,952	113,659	6,673,203	125,909
Less GST reclaimed		(316,908)	5,979	(316,908)	5,979
TOTAL COSTS (after GST reclaimed)		**5,707,045**	**107,680**	**6,356,295**	**119,930**
PERFORMANCE INDICATORS					
Net Development Profit		**1,525,287**		**876,037**	
Development Margin (or Profit/Risk Margin)		**24.55%**	on development costs	**12.77%**	'on development costs
Residual Land Value (Target Margin)		**1,693,922**	(@ 20% target margin)	**1,161,821**	(@ 20% target margin)
Project Internal Rate of Return (IRR)		**28.67%**	(per ann. nominal)	**15.61%**	(per ann. nominal)
Breakeven Date for Cumulative Cash Flow		**Jan-2011**	**(Month 16)**	**Mar-2011**	**(Month 18)**

Source: Maidment developments

In the practical example above, when we apply the discount infrastructure charge there is unconvincing profit to attract financial institutions. A brief survey of finance providers identified their concern regarding uncertainty of future additional fees. Residential projects will stall if benchmark profit levels are unachievable.



Source AEC Group

According to a recent report produced for LGAQ, Townsville has the fourth highest residential infrastructure charge of high growth Councils in the State. Although, the example used in the analysis is not representative of the major future residential growth zone. The Northern Beaches are widely recognised as the major residential growth zone and it has higher infrastructure charges than shown in the analysis.

The residential market, more than likely, will be able to absorb the infrastructure charges with a variation in product. But it is important for business to have certainty from government policy in order to obtain finance and remain sustainable.

Retail Case Study

According to a recent report produced for LGAQ, Townsville has the highest retail infrastructure charges in Queensland. This will more than likely influence developers' decisions, developers' access to finance, retail development, the local economy and social convenience in Townsville.

A retail development model supplied by Lancini Constructions highlights the impact of infrastructure costs on a retail project. The Information shows that with new infrastructure charges this 4,000m² retail centre would not proceed.

Retail Case Study

Case Study	Old Charges (Pre-June 2009)	New Charges (Post-June 2009)
Revenue	Item	Item
Gross Rent		
Woolworths	$ 900,000	$ 900,000
Specialty (best 500m2)	$ 325,000	$ 325,000
Specialty (next 500m2)	$ 275,000	$ 275,000
	$ 1,500,000	$ 1,500,000
Less Outgoings	$ 280,000	$ 280,000
Net Sale Proceeds	$ 1,220,000	$ 1,220,000
Capitalised at 7.75%	**$ 15,741,935**	**$ 15,741,935**
Costs (2009 Prices)		
Land		
2 hectares at $200/m2	$ 4,000,000	$ 4,000,000
Construction Costs (2009 Prices)		
4,000m2 @ $2,600/m2	$ 10,400,000	$ 10,400,000
Other costs		
Headwork's, interest, holding costs, incentives	$ 2,000,000	$ 8,000,000
Total Costs	**$ 16,400,000**	**$ 22,400,000**
Profit / Loss	($ 658,065)	($ 6,658,065)

Source: Lancini Constructions

This example shows that

- The cost of a block of land in this example will increase by $6 million;
- Cost increases are too high to be absorbed by the developer;
- Statutory and Infrastructure charges are almost $8m;
- Developer would make a loss if project proceeded;
- Finance would not be available;
- To obtain finance it is important that Retail developers obtain certainty from all levels of government policy.

In this Townsville industry standard model there is no profit for the developer and finance would not be available. Adding significant headworks charges onto this development stalls the project and the associated economic activity and any other revenue that would otherwise have been generated for Council.

3.2.1 Economic impact of higher retail Infrastructure charges

A significant infrastructure charge that persuades a developer to abandon a retail neighbourhood shopping project and influences a financier to stop finance has repercussions throughout the Townsville economy.

Townville Projects adversely affected by Infrastructure charges

Project	Developer	Estimated Cost $m
Fairfield Commercial	Lancini	65
Stockland Plaza	Stockland	150
Bushland Beach	Sunland	13
Deeragun	Honeycombs	32
Total		$ 260m

Source Townsville developers

A brief survey of ten local retail projects revealed four proposed projects (other projects already had pre-infrastructure fee DA approval) will stall, due to higher retail infrastructure charges. If these projects were to collapse due to higher costs it would deprive the community of between 759 and 964 equivalent full-time jobs and more than $42 million in wages. The regional economy would be deprived of $160 million worth of economic activity and local, state and federal governments would be deprived of over $24.7million worth of taxes.

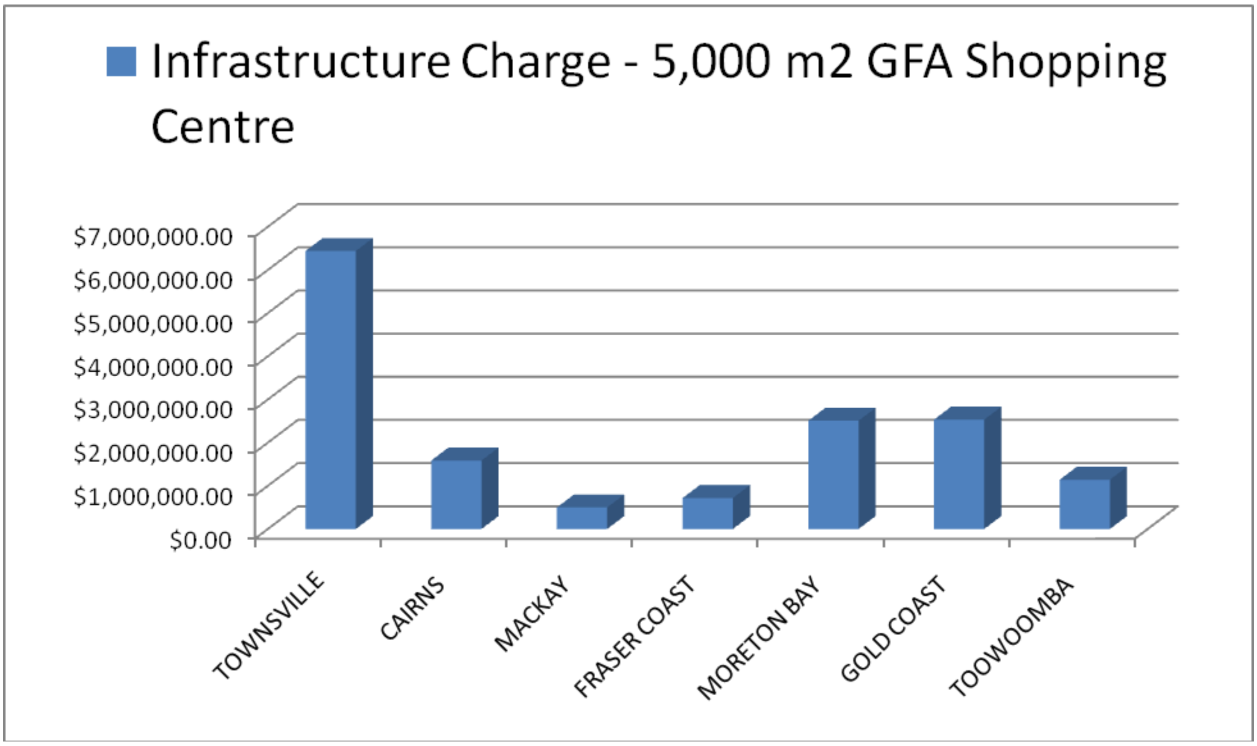
Wages and employment impact of retail construction projects not proceeding

Estimated cost of projects	Wages	Jobs
$ 260,000,000	$ 42,705,000	759 - 964

3.2.2 Providing Retail facilities in Townsville's growth areas.

In 2008, Townsville's seven major population growth zones contained 50% of the city's population and contributed 89% of the population growth. These zones represent the major areas that will require new neighborhood retail centres and medical facilities.

According to many developers, a significant new infrastructure charge would stop or delay the construction of these facilities.



Source UDIA Townsville

In conclusion, Townsville's retail development infrastructure fees are the highest in Queensland and they will:

- Stop some retail projects;
- Lead to reduced convenience for local resident's;
- Deprive the community of over 750(EFT) much needed jobs and over $42m in wages;
- Reduce additional economic activity by $160milliion;
- Deprive governments of $24.7million in taxes.

Industrial Case Study

Industrial lot infrastructure charges have grown substantially in recent years. Townsville has one of the highest industrial infrastructure charges of any high growth council in Queensland. Industrial property market conditions remain subdued, industrial vacancy rates have grown compared to last year and it remains difficult to obtain finance to establish industrial buildings.

Using information supplied by Knight Frank research, some industrial developments will find it harder to proceed with new infrastructure charges. This industrial model highlights the impact of infrastructure costs on an owner occupied industrial shed; a typical one built by a small businessman.

An industrial shed 1,000 m2 on a 2,500 square metre site has different costs in different Townsville locations.

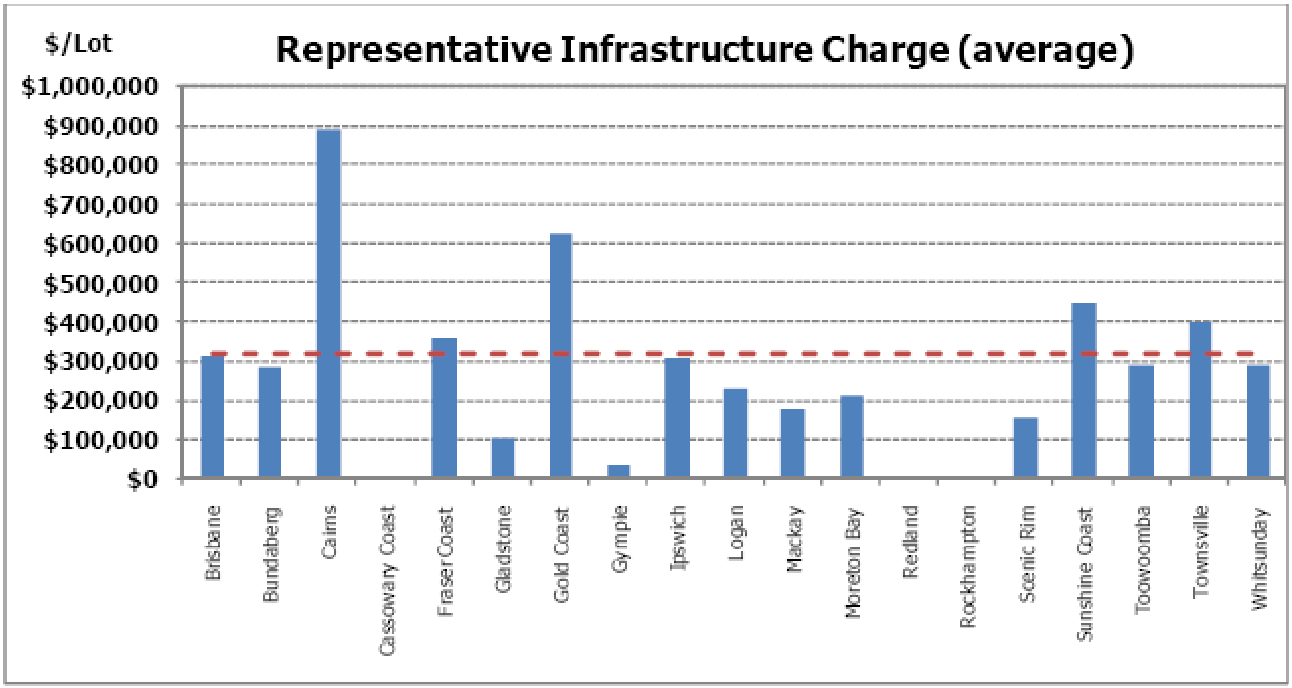
3.3.1 Industrial Shed Case Study

	Sector 10 - Mt Louisa/Bohle		Sector 10a - Shaw Rd	
	Old	**New**	**Old**	**New**
Size (GFA)	1000	1000	1000	1000
Net Rent $/m2	$ 125.00	$ 125.00	$ 125.00	$ 125.00
% Yield (current)	9%	9%	9%	9%
Value	**$ 1,388,888**	**$1,388,888**	**$ 1,388,888**	**$ 1,388,888**
Less Selling Costs				
Commission and Legals (4%)	$ 55,555	$ 55,555	$ 55,555	$ 55,555
BUILDING VALUE	**$1,333,333**	**$1,333,333**	**$ 1,333,333**	**$ 1,333,333**
Less Other Costs				
Land Cost Current @ $160/m2	$ 400,000	$ 411,000	$ 400,000	$ 411,000
Land Acquisition Costs @ 5%	$ 20,000	$ 20,550	$ 20,000	$ 20,550
Headworks Cost for constructor				
Old	$38,586		$ 89,018	
New		$ 121,701		$ 213,551
Construction (incl. design and planning)	$ 925,000	$ 925,000	$ 925,000	$ 925,000
TOTAL OTHER COSTS	**$1,383,586**	**$1,478,251**	**$1,434,018**	**$1,570,101**
Position before holding costs and interest	**($ 50,253)**	**($ 144,918)**	**($ 100,685)**	**($ 236,768)**

Source: Knight Frank

This example shows that:

- The cost of a block of land will increase by between $83,115 and $124,533;
- Losses higher than $30,000 are unlikely to be absorbed by an owner builder;
- Infrastructure cost increases are too high to be absorbed by the developer;
- Statutory and Infrastructure charges have risen by between $83,000 and $125,000;
- Currently an owner builder needs $300,000 in cash or about 20% equity in order to gain finance. If an owner operator then had to find over $50,000 (to cover his projected loss) plus interest and holding costs, finance would not be available.



Source AEC Group

According to a recent report produced for LGAQ, Townsville has the fourth highest industrial charges of any high growth council in Queensland and they will halt some projects, finance will be more difficult to obtain affecting small business.

4. Conclusion

Townsville is the commercial capital (over 80%) of the Northern and North West Statistical Divisions which remains in a vulnerable economic position. In the previous year employment has fallen by over 8,500, unemployment is rising, construction activity has fallen dramatically in both the residential and non-residential sectors, business confidence remains close to zero, compared to capital cities local property markets remain subdued and exports through Townsville port have fallen by almost 5%. Interest rates are rising from emergency lows and thousands of school leavers will join the workforce soon, adding to concerns of surging unemployment in early 2010. A higher Australian dollar and likely appreciating dollar will stifle exports. These are challenging economic conditions.

New policy needs to provide at least medium term certainty for business and community. Implementing short term certainty, but uncertain medium range local economic regulations, could hinder sustained economic recovery. That is, if the residential discount is withdrawn after 12 months, there is concern that project viability will be compromised.

Combine challenging economic conditions, with uncertain medium term residential policy, and non residential charges being some of the highest in Queensland, financiers are likely to remain cautious when providing project funding, essentially stalling some development and balanced economic progress. The discount policy needs to reflect these risks.

While residential projects will be affected, it is acknowledged by industry that buyers will have flexibility to adjust product and therefore better absorb cost increases in the medium term.

However, this is not the case in the non residential development sector. Townsville has the highest retail charges of any high growth council in Queensland. Developing suburbs without retail facilities, essentially creating dormitory suburbs, reduces resident's convenience and increases the burden on other retail centres and main roads. The comparatively higher infrastructure fee will prevent the delivery of some retail projects in Townsville, affecting economic activity and quality of life of residents in major new residential zones.

Access to finance is crucial to residential and non residential development. If new, short term fees restrict the viability of proposed projects, the finance sector is likely to remain tentative. If the identified commercial projects fail to proceed, the regional economy will be deprived of crucial jobs, wages and spending and local, State and Federal governments will be deprived of vital taxes.

References

Australian Bureau of Statistics

Australian Taxation Office

Michael Matusik presentation to Townsville UDIA May 2009-08-12

Knight Frank Research

Maidment Developments

Lancini Constructions

Benchmarking of Infrastructure Charges Queensland High Growth Councils AEC

Department of Infrastructure and Planning

Townsville City Council

UDIA Cairns

UDIA Townsville

UDIA Toowoomba

Limitation of Liability

No guarantee of accuracy of data and extrapolations is made. To the extent permitted by law, DS Enterprises Pty Ltd will not be responsible in tort, contract or otherwise for any loss or damage, including for any personal injuries or death, or any consequential loss, loss of markets and pure economic loss, suffered by the Customer, whether or not the loss or damage occurs in the course of performance by DS Enterprises Pty Ltd of this contract or in events which are in the contemplation of DS Enterprises Pty Ltd and/or the Customer or in events which are foreseeable by DS Enterprises Pty Ltd and/or the Customer.