UDIA NSW President's Taskforce on Infrastructure Contributions Reform

Policy Issue Paper

Encourage Councils to Forward Fund Infrastructure, Through Borrowing and Pooling of Funds

Background

The NSW Productivity Commission has recommended that councils be incentivised to borrow, allowing them to forward fund infrastructure. It has also recommended that individual councils pool their contributions collected to provide enabling local infrastructure, removing a barrier where not enough funds are available.

Some councils have historically chosen not to pool their contributions plan revenue, either deliberately or are inadvertently unaware of the opportunity. This creates a barrier for those councils to spend funds on larger local infrastructure projects that enable development.

The Environmental Planning & Assessment Regulation 2000 currently allows contributions collected by councils to be pooled, but only if authorised specifically by a council's contributions plan(s). The Environmental Planning and Assessment (Local Infrastructure Contributions – Pooling of Contributions) Ministerial Direction was introduced in May 2020 as a temporary measure to remove the specific authorisation required by the Regulation in a contributions plan. The Direction provided those councils who did not authorise pooling to access funds in other contributions plans to immediately forward fund local infrastructure.

Challenge

There appears to be 3 main impediments to councils borrowing funds:

- TCorp's debt coverage ratio
- loss of a councils' 'debt-free' status
- insufficient resources for councils to co-ordinate the acquisition of land, designs and construction of infrastructure projects.

Even if councils could pool or borrow funds to forward fund local infrastructure, they may not have the capacity to expedite infrastructure provision. This is also a challenge for State government in delivering regional or SIC infrastructure.

There appears to be an expectation by councils that developers will deliver some of this infrastructure in-kind if the developer is willing, and if the developer complies with the various different council delivery policies, such as VPA and Work-In-Kind policies.

However, in-kind provision by developers only address some of the enabling infrastructure and councils still require resourcing to deliver infrastructure early to support development.

Whilst we understand that the Government will make the provisions of the *Environmental Planning and Assessment (Local Infrastructure Contributions – Pooling of Contributions) Ministerial Direction* permanent through legislation, enabling councils to deliver infrastructure remains a challenge.

Barriers

Borrowing

The Productivity Commission states that TCorp should review its lending criteria to allow grants and contributions to be included in the calculation of a council's 'Debt Coverage Ratio'. If TCorp does not review this ratio, the incentive is largely impeded.

The Debt Coverage Ratio is calculated (the debt serviceability calculation) by dividing a council's operating result less interest and depreciation – EBITDA (the numerator) by its total debt servicing costs (both principal and interest payments). The target for this ratio is >2, meaning that the overall borrowing is limited such that its total EBITDA is at least twice its annual debt service cost.

The problem with this ratio is that the numerator excludes all Section 7.11 related revenue, but the denominator includes all debt servicing costs. Therefore, if a council was to externally borrow for part of the costs for its Section 7.11 program, the ratio would be impacted by the resultant debt servicing costs but not include the corresponding Section 7.11 contributions revenue. This then reduces the amount of external borrowings permitted for other works funds.

Note: EBITDA stands for Earnings Before Interest, Taxes, Depreciation, and Amortisation and is a metric used to evaluate a company's operating performance. It can be seen as a proxy for cash flow from all operations.

As an example, a council may have a borrowing capacity (based on the debt coverage ratio) of around $245 million. Its annual Section 7.11 developer contributions revenue is around $130 million and if that amount is included in the calculation, then its permitted external borrowing amount would increase to around $850 million.

Under the existing debt coverage ratio, any external borrowing at a sufficient level to bring forward the council's Section 7.11 works program would effectively limit any remaining capacity for the council to externally borrow to fund works in other parts of its local government area.

The NSW Government needs to amend how the Debt Coverage Ratio for local government is calculated, so external borrowings to forward fund Section 7.11 infrastructure does not limit other borrowings funded from a council's general funds.

Pooling

The Government has now accepted the Productivity Commission's recommendation to extend the Direction and make it permanent. This should remove a council's reluctance to access funds held in different contributions plans to forward fund infrastructure. However, the implementation and control of this remains with the individual council who may still be reluctant to borrow funds from contributions in one particular contributions plan to forward fund infrastructure in another contributions plan area.

Solutions

Relying solely on councils to pool or borrow to fund infrastructure should not be the only solution (it is still reliant on councils seeking those funds). The Government's Housing Acceleration Fund (HAF) and Accelerated Infrastructure Fund (AIF) programs were recognition that the State should intervene if there are signs of infrastructure deficiencies or shortfalls in funds – these should be continued.

Whilst we understand that the NSW government will make pooling mandatory, the barriers that disincentivise councils to borrow, such as the debt coverage ratio, must be reviewed.

Government should also ensure that councils have the operational resources through rate peg reforms to deliver infrastructure.