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Affordable Rental Housing SEPP

Guidelines for Retention of Existing Affordable Rental Housing

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Introduction

State Environmental Planning Policy(Affordable Rental Housing) 2009 encourages the development of new affordable rental housing and assists the retention of existing affordable rental housing. The provisions for developing new affordable housing are in Part 2 of the Policy. These guidelines relate to the provisions in Part 3 of the Policy for retaining existing affordable housing and mitigating its loss when redevelopments occur.

The provisions of Part 3 reflect those of the former *State Environmental Planning Policy No10 – Retention of Low Cost Rental Accommodation* (SEPP10). Although SEPP10 has been repealed by the Affordable Rental Housing SEPP, many of the principles and practices developed over the 25 year operation of SEPP10 remain relevant and are reflected in these guidelines, together with some significant improvements drawn from that experience.

Part 3 applies to existing affordable housing in the form of boarding houses and low-rental residential flat buildings. It requires development consent to be obtained when these forms of housing are proposed to be developed and sets out criteria that must be considered to gauge the impact of the development on the availability of affordable housing in the area.

To ensure consistency of process and fairness of decisions, the Policy requires that the assessment of these criteria must be in accordance with these guidelines.

One of the methods of mitigating the loss of affordable housing resulting from these developments is the payment of a contribution to fund the provision of new affordable housing on another site. Part 3 provides the statutory framework to enable conditions of consent requiring such contributions, and provides a standard formula for calculating the contribution amount. These guidelines explain the circumstances in which contributions can be imposed and how they should be calculated in order to ensure fairness and consistency across council areas.

These guidelines address the following topics which are presented generally in the order that an applicant for a development or a council officer assessing a development application (DA) would proceed:

- Does Part 3 apply to this development?
  - Areas where Part 3 applies
  - Buildings to which Part 3 applies
  - Identifying a boarding house
  - Identifying a residential flat building containing a low-rental dwelling
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- Help and advice

Does Part 3 apply?

There are three main factors which determine whether Part 3 applies to a particular development:

- is the site in an area where Part 3 applies?
- is the building one to which Part 3 applies? (that is, is it a 'low rental residential building' within the meaning of the Policy?)
- is the proposed development one to which Part 3 applies?

Areas where Part 3 applies

Part 3 applies to the following 45 local government areas which are the 43 areas making up the Sydney Region, together with Wollongong and Newcastle:

Ashfield, Auburn, Bankstown, Baulkham Hills, Blacktown, Blue Mountains, Botany, Burwood, Canada Bay, Camden, Campbelltown, Canterbury, Fairfield, Gosford, Hawkesbury, Holroyd, Hornsby, Hunters Hill, Hurstville, Kogarah, Ku-ring-gai, Lane Cove, Leichhardt, Liverpool, Manly, Marrickville, Mosman, Newcastle, North Sydney, Parramatta, Penrith, Pittwater, Randwick, Rockdale, Ryde, Strathfield, Sutherland, Sydney, Warringah, Waverley, Willoughby, Wollondilly, Woollahra, Wollongong and Wyong.

The Sydney Region corresponds to the Sydney Statistical Division (SSD) as defined by the Australian Bureau of Statistics (ABS). This assists in obtaining comparative data when assessing DAs.

The previous SEPP10 policy applied to the whole Greater Metropolitan Region. Most of the development applications assessed under that Policy came from inner metropolitan areas and very few from outside the Sydney Region, Newcastle and Wollongong.

Buildings to which Part 3 applies

Part 3 applies to "low-rental residential buildings" which means:

- a boarding-house, or
- a residential flat building containing a low-rental dwelling.

Part 3 applies:

- to buildings lawfully used for these purposes, irrespective of the original purpose for which the building was erected or whether or not consent was granted;
- whether or not the building previously operated lawfully as a low rental residential building but is now vacant or is being unlawfully used for another purpose.

SEPP 10 applied to hostels as well as boarding houses and residential flats. Few applications relating to hostels were received and these were generally from non-profit or government agencies seeking to modernise facilities or reorganise their property holdings – applications which did not benefit from assessment under the policy.

Identifying a boarding house

Part 3 applies to all boarding houses irrespective of their tariff level (though the tariff level will be a relevant merit factor in assessing the DA).

The SEPP adopts the following definition of "boarding house" in the Standard Instrument:

boarding house means a building:

(a) that is wholly or partly let in lodgings, and

(b) that provides lodgers with a principal place of residence for 3 months or more, and

(c) that may have shared facilities, such as a communal living room, bathroom, kitchen or laundry, and

(d) that has rooms, some or all of which may have private kitchen and bathroom facilities, that accommodate one or more lodgers,

but does not include backpackers' accommodation, a group home, a serviced apartment, seniors housing or hotel or motel accommodation.

Boarding houses most commonly do have some shared facilities, though this is not essential to meet the above definition. Some or all of the boarding rooms may be self-contained with a food preparation area (kitchenette) and en-suite facilities (toilet, shower and wash basin) for the exclusive use of the lodgers of that room.

Distinguishing between a residential flat building and a boarding house which has only self-contained rooms can be difficult. Consideration should be given to:

- Council records of the originally approved building/use and any subsequently approved alterations or change of use;
- Council boarding house register or old licensing records;
- Council notices and orders for "place of shared accommodation";
- Whether the premises are receiving (or have received) an exemption from land tax as a boarding house providing accommodation for low income earners;
- Whether the occupants are "tenants" within the meaning of the *Residential Tenancies Act 1987* or are "lodgers".

"Tenant" is defined in the *Residential Tenancies Act 1987 as* "…the person who has the right to occupy residential premises under a residential tenancy agreement, and includes the person's heirs, executors, administrators and assigns."

The main difference between a tenant and a lodger is that a tenant normally has certain rights against the landlord relating to privacy and quiet enjoyment of the property. For example, the landlord must generally give the tenant 7 days notice of an intention to inspect the dwelling and the number of inspections is limited. The landlord retains 'mastery' of the premises occupied by a lodger and can generally inspect their lodgings at any time. Residential tenancy agreements are not required for a lodger to occupy a boarding room but are required for a tenant to occupy a

unit in a residential flat building. Residential tenancy agreements are therefore an indicator (but not a conclusive one) of a residential flat building.

Identifying a residential flat building containing a low-rental dwelling

A "low rental dwelling" is one rented at or below the median level for that type of unit in that LGA at any time in the 24-month period preceding lodgement of the DA. Median rent levels for the current and previous 12-month periods are published in the "Table of Low Rental Dwellings" on the HousingNSW website.

Buildings excluded from Part 3

Part 3 only applies to boarding houses or residential flat buildings that became low rental dwellings before 28 January 2000. It does not apply to forms of accommodation that are lawfully characterised as an alternative land use. Examples of alternative residential uses defined in the Standard Instrument (Local Environmental Plans) Order 2006 are attached dwellings, backpackers accommodation, bed and breakfast accommodation, dual occupancy, dwelling house, group home, hostel, hotel or motel accommodation, multi dwelling housing, residential care facility, secondary dwelling, semi-detached housing, seniors housing, serviced apartment or shop top housing.

Part 3 also does not apply to a building:

- that has been lawfully approved for strata subdivision; or
- to which *SEPP (Housing for Seniors or People with a Disability) 2004* applies
- is owned by, or under the care, control and management of a *social housing provider* (as defined in the SEPP).

Development applications to which the policy applies

Part 3 applies to any proposal to:

- demolish the building;
- alter or add to the structure or fabric of the inside or outside of the building;
- change the use of the building to another use;
- strata subdivide the building (unless it is a boarding house – for which strata subdivision is prohibited).

Part 3 applies to alterations and additions which result in the structure or fabric being upgraded to a higher standard, such as replacing shared kitchen or bathroom facilities with individual facilities, providing additional on-site carparking, or to comprehensive refurbishment of the building intended to raise the standard of accommodation and enable an increase in rents or tariffs.

Part 3 does not apply to routine maintenance activities needed to prevent the deterioration of the building and/or to ensure the health and safety of residents or maintain a reasonable standard of accommodation. Such work would be consistent with the aim of the SEPP to retain low rental accommodation. Examples of routine maintenance include periodic repairs, painting, renewal of floor coverings, replacement of light fittings, re-wiring or work carried out to comply with a fire safety order.

What if Part 3 does not apply?

If a development application is not subject to Part 3 but there is concern that loss of the accommodation may have adverse impacts on the local housing market, criteria similar to those in Part 3 can be considered when assessing the social and economic impacts of the development under section 79C(1)(b) of the Act.

Conditions requiring contributions for the loss of affordable housing can only be imposed on development applications which are subject to Part 3. It is not possible to impose those conditions on other development applications, even if the existing building meets the definition of "affordable housing" in the SEPP. However, imposition of conditions under section 94F(5) requiring other arrangements for the provision, maintenance or retention of affordable housing can be considered in those cases.

Assessing a development application under Part 3

The criteria for assessing the housing impact of a development are set out in clause 49(2) of the SEPP. A balanced consideration of these criteria is required. A development assessed as having poor outcomes under some of the criteria may nonetheless warrant approval if these are outweighed by positive outcomes under the other criteria – especially if the development can be modified or conditions imposed to overcome or adequately mitigate the poor outcomes.

Issues commonly arising in consideration of the criteria are discussed below.

Reduction in affordable housing: clause 50(2)(a)

This is the most fundamental of the criteria and its determination will affect how each of the other criteria are assessed.

Clause 47(2) provides that a very low income household, low income household or moderate income household is taken to include a household that occupies a low rental dwelling or a boarding room in a boarding house. This means that such accommodation is "affordable housing" as defined in the Act and it follows that its loss will reduce the availability of affordable housing for the purposes of s94F(1)(a) of the Act.

The most obvious example of development that reduces low rental accommodation is the demolition of a low rental building to enable its replacement with a non-residential use.

Less obvious are changes that retain the same or a similar amount of accommodation, but result in some or all of the accommodation no longer being available to the low rental market. These may involve changes to the quality, type or tenure of the accommodation, such as:

- alterations to a boarding-house to provide en-suite facilities which result in tariffs being increased beyond the reach of the low income residents. As a rule of thumb, the tariff level required to qualify for land tax exemption[1] is used as a benchmark indicator of boarding house accommodation that is 'low rental'.
- comprehensive internal and external refurbishment of a low rental residential flat building with the potential to enable significantly higher rents to be charged.

[1] Tariff thresholds are published annually in Revenue Rulings issued by the NSW Office of State Revenue. These are available on the OSR website.

- strata subdivision which results in a proportion of residential units becoming owner-occupied and therefore no longer available for low rental.

The proportion of rental units likely to be lost to owner-occupation can be estimated by reference to latest ABS Census figures. The proportion of dwellings being rented and being owned or purchased for a specified suburb is shown in Table B32 – "Tenure type and landlord type by dwelling structure" in the ABS Community Profile for the relevant suburb/s.

It is reasonable to assume that a similar proportion of renters and owners will generally apply to the subject building following strata subdivision – though there may be exceptional circumstances which suggest a higher or lower proportion of renters in a particular building.

In determining applications that reduce low rental accommodation, either by a direct loss of rooms/units or a change in their rental characteristics, care must be taken not to penalise owners wishing to take reasonable measures to maintain the value and income-generating capacity of their asset or to ensure a safe, healthy and hygienic standard of accommodation for the tenants. While potentially increasing rent levels, upgrading may nonetheless be necessary to ensure continued availability of acceptable rental accommodation.

In such cases, alternative developments are sometimes available which achieve a reasonable investment outcome while maintaining or even increasing the amount of low rental accommodation. The *Boarding House Financial Assistance Program* administered by Housing NSW provides grants for fire safety upgrading and extensions to boarding houses. Applicants should explore opportunities to avoid proposed reductions in boarding house accommodation by utilising grants available under the program.

Finally, consideration must be given to any new affordable accommodation being provided on the site which offsets the loss of existing low rental accommodation on the site. This may result in a nil net loss or possibly a gain in low rental accommodation available on the site.

Availability of sufficient comparable accommodation in the locality: clause 50(2)(b)

The Sydney rental vacancy rate published by the Real Estate Institute of NSW is used as the benchmark to assess the availability of comparable accommodation. It is generally accepted that a vacancy rate of 3% represents a reasonable balance between supply and demand of private rental accommodation.

A Sydney vacancy rate of less than 3% is deemed to indicate that insufficient comparable accommodation is available to mitigate the impact of the development on demand for such accommodation. When that is the case, no weight can be given in assessment of this criteria to information purporting to show a sufficiency of comparable accommodation and no further analysis is required to conclude that sufficient comparable accommodation is not available. Preparation of such information unnecessarily adds to the cost and time involved in preparing and assessing the application.

If the Sydney vacancy rate is equal to or exceeds 3% in the preceding quarter, then it is open to the applicant to demonstrate that adequate comparable accommodation is available in the locality.

What accommodation is 'comparable'?

'Comparable accommodation' is that which is similar to the existing building in terms of:

- locality and access to facilities — it is in the same or adjacent suburbs;
- rental level or tariff — the accommodation is rented at not more than 5% above the rent of the existing building;
- number of bedrooms — in the case of residential flat buildings, only units with the same number of bedrooms qualify as comparable accommodation. If the subject building contains bedsitter units, dwellings advertised as 'studio apartments' are considered comparable, as are one-bedroom units at a similar rent level.

Obtaining information on availability of comparable accommodation

Real estate websites provide a quick and inexpensive source of information on comparable accommodation for residential units. The search function generally allows the appropriate locality, rent level and bedroom number to be selected.

For boarding houses, the classified advertisements in local or metropolitan newspapers are a more appropriate information source than websites. Accommodation appearing in 'share accommodation' advertisements is not regarded as comparable, as it generally caters for a different sector of the rental market.

Boarding house owners/managers often rely on unsolicited enquiries to fill vacancies, making it difficult to rely solely on advertised vacancies. Direct enquiries with local boarding houses listed in telephone directories or in council boarding house records are often the best way to gauge the availability of comparable accommodation. Full details of those enquiries need to be submitted with the development application including date of enquiry, address and phone number of property, number of rooms, number of vacancies, facilities provided and rent level.

How much comparable accommodation is 'sufficient'?

If the amount of comparable accommodation available in the locality is less than or similar to the amount of accommodation that would be lost from the site, clearly it is not sufficient.

In other cases, a local vacancy rate can be approximated to provide an indicator of the general supply of rental accommodation in the locality. The stock of rental flats, units and apartments in the suburbs making up the locality can be determined from Table B32 – "Tenure type and landlord type by dwelling structure" in the ABS Community Profile for the relevant suburb/s. The total number of flats, units and apartments available for rent can be determined from rental advertisements. If this number is less than 3% of the stock of rental accommodation, it can be concluded that there is a general undersupply of rental accommodation in the locality and therefore it is likely that the supply of comparable accommodation is not sufficient.

Social and economic effects on the general community: clause 50(2)(c)

Where the vacancy rate for Sydney is less than 3%, it must be concluded that there is not sufficient comparable accommodation in the locality to satisfy the demand for such accommodation. In those circumstances, a development proposing a loss of

such accommodation is likely to cause adverse social and economic effects on the general community.

Potential adverse social and economic impacts on the general community include:

- less housing choice for existing and potential residents contributes to a loss of household diversity (socio-economic, structure, age and ethnicity) and gentrification, increasing the social isolation of remaining low-income residents;
- increased competition for affordable rental housing can lead to an increase in rents, making housing less affordable for the community generally;
- lower income residents may be forced to compromise on their standard of accommodation in order to remain in the area, leading to overcrowding and facilitating the continued provision of substandard or unsafe accommodation;
- low-income residents paying more for housing and having less to spend on food and other essentials can have health and safety risks and costs to the general community;
- the displacement of existing residents who can no longer afford to live in the area causes break down of established social networks, resulting in social dislocation both for displaced residents and the community they are displaced from;
- residents moving out of the community can lead to a fall in demand for services and facilities, which may mean that those services are no longer economically viable and cease to be available to all residents of the community;
- people may become homeless, thereby increasing demand for the limited supply of publicly-funded crisis accommodation and supported accommodation. It may also increase the demand for support and other services provided by the council and other levels of government;
- increased demand on publicly-funded social housing and rental assistance;
- reduced level of opportunity and higher financial burden on low income households forced to move out of areas with good access to services, transport and employment.

Arrangements to assist displaced residents find alternative accommodation: clause 50(2)(d)

Where a development is likely to result in displacement of existing residents, arrangements to assist those residents to find satisfactory alternative accommodation must be identified.

This is a particularly important consideration for residents who may be at a competitive disadvantage in the rental market such as people who are elderly, unemployed, living with disability or on welfare benefits.

The following options should be considered:

- the provision of accommodation in other premises in the same ownership/management or by arrangement with other owners/managers;
- a written agreement with a local estate agent giving displaced residents first option for comparable accommodation that comes onto the market;
- payment of relocation costs or *ex-gratia* disruption payments;
- extension of period of notice to vacate beyond the 60 days generally required under the *Residential Tenancies Act 1987*.

Conditions imposing such requirements should be framed in terms authorised by section 94F(5) of the Act. In such cases, it is important that council notifies residents of the conditions at the time that consent is issued and provides them with details of a council officer and a local tenancy service that residents can contact if they feel the conditions are being breached.

Alternatively, a deferred commencement condition may be appropriate to prevent the consent from operating until satisfactory evidence is provided of the requirements being met or residents being re-housed.

Cumulative loss of low-rental accommodation: clause 50(2)(e)

There has been an incremental, long term decline in low rental accommodation in most areas to which the policy applies (though the rate of decline varies in time and location).

The individual contribution which a particular low rental building makes to the overall supply of low rental accommodation may be small, but the cumulative impact of many such losses is significant. It is therefore important to consider each application in the context of long term cumulative trends.

Trend data on the availability of affordable rental accommodation by local government area is provided in the *Local Government Housing Kit* on the HousingNSW website. Councils should also maintain statistics of applications determined under this Policy (both those involving loss or increase of affordable housing) so that emerging local trends in the supply of low rental accommodation can be identified.

Cost of structural and fire safety upgrading: clause 50(2)(f)

It is vitally important that acceptable levels of health, amenity and safety be maintained in low rental housing. In some cases, a building may be currently providing low rental accommodation only because it is in sub-standard condition. The cost of undertaking work necessary to achieve acceptable housing standards needs to be considered in assessing an application for alteration or demolition of such a building.

To substantiate a claim that the cost of the work required is prohibitive, work schedules should be prepared and assessed by a suitably accredited building industry professional such as an architect, licensed builder, quantity surveyor or building surveyor.

Mitigation of impacts through an affordable housing condition: clause 50(2)(g)

This criteria requires that the consent authority consider "…whether the imposition of an affordable housing condition would adequately mitigate the loss of low-rental accommodation resulting from the development."

A balanced assessment of the other criteria of clause 50(2) will commonly find that the development satisfies some criteria and not others, with varying degrees of acceptable and adverse impacts. Where it is clear that the overall impact is major and adverse and cannot be adequately mitigated, serious consideration should be given to refusal – or at least negotiating a modification of the proposal to make its impact acceptable.

In other cases, the imposition of an affordable housing condition may be an appropriate way to enable the development to proceed while mitigating its impact.

Statutory issues to be addressed when considering the imposition of a condition requiring an affordable housing contribution are set out in Appendix 1 of these Guidelines.

A fundamental pre-condition for such a condition is the requirement of Section 94F(1)(a) of the Act that the development will or is likely to reduce the availability of affordable housing within the area. This is determined by the assessment made under clause 50(2)(a) of the SEPP, which is whether the development results in a reduction in affordable housing on the land to which the application relates.

This is clearly the case when the amount of affordable housing in the area is in decline. It can also be the case when the amount of affordable housing is increasing, because the amount of affordable accommodation that would be available in the area following approval of the development is inevitably less than that which would have been available in the area if the development did not proceed.

There may be instances where new affordable accommodation is provided on another site to offset the loss of existing low rental accommodation on the subject site. To enable this new affordable housing to be offset against the loss on the subject site, there must be a real increase in affordable housing on the other site (not merely a change of ownership of existing affordable housing), and there must be a legally enforceable mechanism to ensure that the new accommodation is provided and maintained as affordable housing.

Affordable housing contributions were a common outcome under the former SEPP10 for DAs involving strata subdivision of low rental residential flat buildings. This recognised the relatively large number of residential flats available for rental and the fact that a proportion of the flats (typically 40%) stay in rental tenure following strata subdivision. But this outcome will be less appropriate where the number of available comparable units is very low.

Contributions were a less common outcome for boarding houses assessed under SEPP10. This was because a significant proportion of those DAs were for alterations and additions that did not result in a loss of boarding rooms – in which case no contribution would be appropriate.

Where boarding house DAs that would result in loss of accommodation were approved, this was generally on the grounds that the boarding house was not financially viable. In the absence of a legislated contributions scheme, considerations of fairness and equity made it difficult to determine an appropriate basis for calculating a contribution for a non-viable boarding house.

This has now been addressed in the contributions scheme set out in the SEPP. The scheme provides a sliding scale formula which reduces the contribution payable as financial viability reduces. This is based on the principle that the operation of a financially non-viable boarding house would have involved some degree of financial subsidy by the owner and the reduced contribution is a notional recognition of that subsidy.

In cases where an affordable housing contribution is considered appropriate, the contribution must be determined and paid in accordance with the scheme set out in the SEPP. The scheme includes a standard formula for calculating the contribution amount. This formula is based on 5% of the notional cost of providing replacement affordable housing in the area.

The Minister for Planning has issued a direction under section 94G of the Act requiring the consent authority, upon receiving the contribution from the applicant,

to transfer it to the Chief Executive, Housing NSW, Department of Human Services. The contributions are used to fund an expansion of the *Boarding House Financial Assistance Program* (BHFAP).

The BHFAP provides grants for fire safety measures to both new and existing boarding houses, which provides a highly cost effective use of the limited contribution funds. It also ensures that contributions are used for the purpose of greatest community benefit, by assisting the retention of a valuable but threatened form of housing which accommodates those with the most critical housing need.

Boarding house financial viability: clause 50(2)(h)

The assessment of financial viability is only required for boarding house DAs and is a crucial part of the assessment of those applications. The underlying principle is that it would be unfair and counterproductive to seek the continued operation of a boarding house where that operation could not provide a reasonable return on investment. The continued operation of a non-viable boarding house can have adverse consequences such as inadequate expenditure on maintenance leading to reduced amenity, health and safety for lodgers and neighbours.

The method used to evaluate financial viability is based on rental yield. Clause 50(4) provides that a boarding house is viable if the rental yield determined under clause 51(5) is greater than 6%.

It is acknowledged that returns on boarding houses vary due to site specific characteristics and property cycle factors. The 6% threshold is based on case studies in the boarding house sector and analysis of the residential property market more generally. This figure attempts to balance the returns from income and capital gain obtained from boarding houses with those from other sectors of the residential property market.

In the private rental market, net yields measured by this method are generally much lower than 6%. Most investors expect, however, that a private rental property will realise greater capital gain than a boarding house when it is sold. A higher yield threshold for boarding houses compensates the investor for lower expectations of capital gain.

A key objective of the assessment method is consistency across the boarding house sector. For this reason, viability is determined with reference to the property rather than the operator - that is, the financial and taxation arrangements of the boarding house operator are not included in the assessment. The capital costs associated with providing a boarding house are, however, included by making allowance for depreciation.

Financial viability assessments submitted by applicants need to be carefully reviewed, especially when the property is initially assessed as not being viable. In general, there are two situations which will prompt a review of the initial assessment. The first is when the initial assessment is close to the 6% threshold. The second is when the rental income and expenses are significantly different to recognised industry benchmark values. There is some scope for negotiation of the values used in the financial viability assessment, particularly with regard to rent levels and upgrading opportunities.

While the method used is relatively simple, discretion will be required when values are estimated in specific cases.

The general formula

The test for financial viability is set out in clause 51(5) in the following formula. The formula calculates the rental yield of the boarding house taking into account depreciation and capital upgrading.

$$\frac{Y - E - d}{V + U} > 6\%$$

where:

Y = rental income

E = expenses

d = annual depreciation

V = current investment value

U = capital upgrading

If the assessment determines that the property has a yield greater than 6%, then the property will be assessed as being financially viable.

If a boarding house is assessed as financially non-viable, the values used for the various elements of the formula should be reviewed to determine whether they reflect normal industry practice. For example, upgrading a boarding house could increase its viability by decreasing maintenance and management costs (expenses), reducing vacancies or increasing rents (but at a level below the land tax exemption threshold).

Determining rental income (Y)

Gross rental income is the cash income produced by the boarding house. Gross rental income can be obtained from the applicant's Profit and Loss Statement. Otherwise it will be estimated by the following formula:

$Y = r \times 52 \times (1 - v)$

where:

r = total rent/week

v = vacancy rate

The level of rental income should be re-evaluated following an initial assessment of financial non-viability having regard to whether:

- whether the rents charged are too low relative to comparable boarding houses;
- whether rents could be increased if the property was well maintained;
- whether better management or upgrading could reduce the vacancy rate.

The vacancy rate for boarding houses is generally low by industry standards due to demand for low rental accommodation substantially exceeding supply in recent years. A vacancy rate of 4% has commonly been applied, representing 2 weeks vacant per year, but this varies with the location, configuration and condition of the building.

Determining expenses (E)

Valid expenses include:

- management fees and costs
- insurance
- utilities
- cleaning
- maintenance and repairs
- council and water rates

Any expenses charged to tenants must be excluded.

Expenses typically equate to 20-30% of income of a boarding house, but this varies with the configuration, age and condition of the building. Heritage status can also increase maintenance costs by requiring the use of particular techniques and materials when undertaking repairs and restoration. Where claimed expenses fall outside the typical range, documentation of actual amounts by receipts and financial records should be provided.

Land tax cannot be claimed as an expense where the property qualifies for exemption under the Office of State Revenue tax ruling – even where the exemption has not actually been claimed.

Determining depreciation (d)

Depreciation represents an estimate of the capital costs associated with providing the boarding house for a single year. In some cases, the applicant will have claimed depreciation for taxation purposes. The amount claimed should be included in the Profit and Loss Statement submitted with the application.

If the amount of depreciation claimed for taxation purposes is not included in the Profit and Loss Statement, then depreciation will be calculated at a rate of 2% of replacement value if the boarding house is less than 50 years old. Depreciation cannot be claimed for a building more than 50 years old.

Determining current investment value (V)

The application must include an independent valuation based on the property continuing as a boarding house. The independent valuation must be done by an accredited land valuer.

The valuation should be based on actual rent and expense figures unless these are clearly not representative of market rates, in which case market rates based on comparison with similar boarding accommodation should be used.

Determining capital upgrading (U)

Capital upgrading is expenditure on the property that enhances rather than preserves the value of the property. The current value of any upgrade expenditure will be calculated as follows.

$U = C \times i - D$

where

C = upgrade cost

i = CPI inflator for Sydney[2]

D = accumulated depreciation (2% p.a.)

[2] ABS Cat. 6401.0 — Table 1

When capital upgrading has taken place in different years, the costs should be separated and inflated according to the CPI inflator for the corresponding year.

Not all expenditure on the building is capital upgrading. The different types of expenditure should be treated as follows:

- expenditure on construction and structure can normally be accepted providing reasonable evidence is provided;
- expenditure on repairs, maintenance and fit-out should not be accepted;
- expenditure that has not been incurred but is agreed to be unavoidable at the time of assessment (due to normal wear and tear or changing standards) can be accepted at its current market value – with the exception of expenditure which is a consequence of inadequate maintenance over an extended period (asset 'harvesting') which should not be accepted. A nominal apportionment of the overall expenditure may be the most practical course in these cases.

Appendix 1 statutory considerations for imposing conditions requiring affordable housing contributions

Overview

The *Environmental Planning & Assessment Act 1979* has specific requirements which must be met before a condition of development consent can be imposed to require payment of a contribution towards affordable housing.

These provisions are contained in Division 6A of Part 4 of the Act. They include the following requirements:

- a State environmental planning policy must identify that there is a need for affordable housing within the area: Section 94F(1);
- the condition is authorised to be imposed by a State environmental planning policy or local environmental plan: Section 94F(3)(b);
- the condition complies with all relevant requirements made by a State environmental planning policy with respect to the imposition of such conditions: Section 94F(3)(a);
- the consent authority is satisfied that the proposed development will or is likely to reduce the availability of affordable housing within the area: Section 94F(1)(a);
- the condition requires a reasonable dedication or contribution, having regard to:
- (i) the extent of the need in the area for affordable housing,
- (ii) the scale of the proposed development,
- (iii) any other dedication or contribution required to be made by the applicant under this section or section 94: Section 94F(3)(c).

These legislative requirements have been addressed in the SEPP and guidelines as follows:

Need for affordable housing in the area:

Clause 51(1) of the SEPP identifies a need for affordable housing within the 45 local government areas to which Part 3 of the Policy applies and thereby satisfies the first of these requirements.

Authorisation by a SEPP or LEP:

The SEPP authorises affordable housing contributions where the development is subject to Part 3 of the SEPP and will result in the loss of existing low rental accommodation.

Compliance with a scheme:

The SEPP requires compliance with the scheme set out in Part 3 of the SEPP.

Compliance with relevant requirements of a SEPP

The relevant requirement of the SEPP is that conditions must comply with the requirements of Part 3.

Development must reduce the availability of affordable housing in the area

This requirement is addressed in the consent authority's assessment of the development proposal under Part 3 of the SEPP.

Clause 47(2) provides that a very low income household, low income household or moderate income household is taken to include a household that occupies a low

rental dwelling or a boarding room in a boarding house. This means that such accommodation is "affordable housing" as defined in the Act and it follows that its loss will reduce the availability of affordable housing for the purposes of s94F(1)(a) of the Act.

To reach this conclusion, the consent authority will firstly need to make a finding under clause 50(2)(a) of the SEPP that the development will result in a reduction of affordable housing on the land to which the application relates.

Any measures proposed to offset this reduction by the provision of new affordable housing (either on the site or on another site in the locality) should then be taken into account to determine if the development reduces the availability of affordable accommodation in the area.

Extent of need for affordable housing in the area

This requirement is also addressed in the consent authority's assessment of the development proposal under Part 3 of the SEPP.

Clause 50(2)(b) of the SEPP requires an assessment of whether there is available sufficient comparable accommodation in the locality to satisfy the demand for such accommodation in that locality. Poor availability of comparable accommodation indicates a high need for that accommodation.

Where the residential vacancy rate for Sydney is below 3%, clause 50(3) provides that there is deemed to be insufficient comparable accommodation. Where the vacancy rate is above 3%, a merit assessment must be made of the sufficiency of available comparable accommodation in accordance with these Guidelines.

Scale of the proposed development

This requirement is addressed in the consent authority's assessment under clause 50(2)(a) of the SEPP as to "..whether there is likely to be a reduction in affordable housing on the land to which the application relates."

Even a development classified as 'small scale' because it involves a numerically minor loss of low rental accommodation may warrant an affordable housing condition if it contributes to a cumulative loss of low-rental residential accommodation in the area. This is assessed under clause 50(2)(e) of the SEPP.

Other contributions for affordable housing or contributions levied under section 94

If an affordable housing contribution has already been paid for loss of the existing low rental accommodation on the site, it would be inappropriate to seek a further contribution for that same loss on a later development applying to that site. However if the previous development involved partial loss of low rental accommodation and the current development involved additional loss, a further contribution for the additional loss could be appropriate.

The method for calculating affordable housing contributions is set out in the Policy. The purpose of a universal formula is to provide consistency, fairness and predictability in the amount of contribution levied. Therefore no scope is provided for variation of the contribution amount. If the consent authority considers that the combined contributions payable for affordable housing and under section 94 are excessive, consideration should be given to reducing the amount payable under section 94.

Reasonableness of contribution

The formula for determining the contribution amount set out in this schedule is based on 5% of the notional cost of providing replacement affordable housing. This rate of replacement has been applied in North Sydney local government area for many years and upheld in case law.

In North Sydney, a monetary contribution rate per affordable bedspace lost was determined based on 5% of the historical cost to Council of providing replacement affordable housing. This historical cost was indexed annually to determine the current contributions rate.

A simplified contribution formula has been adopted in the SEPP based on 5% of the first quartile sale price for strata properties in the relevant local government area. The following measures have been built into the formula to ensure contributions are reasonable:

- Strata properties in the first quartile (the cheapest 25% of units in the area) are used because these are likely to be comparable in form and value to the replacement affordable housing funded by the scheme.
- Using the first quartile value for the relevant local government area ensures that the contributions reflect the cost of providing replacement affordable housing in that area. It also ensures that contributions in low value areas reflect the lower development return made upon sale of the property.
- A 12-month average of first quartile values is used to level out any short term spikes in local property values (which are sometimes significant).
- The simplified formula results in contributions which are, on average, 1.5% below the contribution that would be obtained by adapting the North Sydney formula to the relevant area.
- The contribution rate is further reduced when applied to boarding houses assessed as being not financially viable. It is reasonable to obtain a contribution towards replacement of lost boarding rooms even if their continued operation is not financially viable, because they still play a valuable role in providing low rental accommodation that will need to be met should they cease operating. But reduction of the contribution rate is reasonable to reflect the implicit subsidy that would have been paid by the owner in operating the non-viable boarding house.

When is a contribution appropriate?

The decision to impose an affordable housing condition is a discretionary one. Advice to assist making this discretionary determination is provided in the preceding guidelines relating to clause 50(2)(g) of the SEPP.

Calculating the contribution amount

Once a decision has been made to impose an affordable housing condition, the amount of the contribution must be determined in accordance with the formulae set out in clause 51 of the Policy.

Examples of contribution calculations

The contribution for any given development can be calculated automatically by inputting figures into the on-line calculator on the Department of Planning website.

Example 1: Strata subdivision of a low rental residential flat building containing 8 units.

- Contribution = Loss (L) x Replacement cost (R) x 0.05
- The building contains 4 one-bedroom units and 4 two-bedroom units.
- The building therefore contains 12 bedrooms (4 in the one-bedroom units and 8 in the two-bedroom units).
- The loss of low rental accommodation (L) resulting from strata subdivision was assessed as being 3 bedrooms based on an owner-occupancy rate of 25% in the suburb (25% x 12 bedrooms).

- The “replacement cost” (R) in the LGA at the time the DA was lodged was $300,000.
- The contribution = 3 x 300,000 x 0.05 = $45,000.
- *Example 2*: Conversion of a boarding house to a single residence
- The building contains 6 boarding rooms.
- The proposed residence will contain no boarding rooms. The development therefore results in a loss of 6 bedrooms.
- The “replacement cost” (R) in the LGA at the time the DA was lodged was $300,000.
- The contribution payable under clause 50(3) would be 6 x 300,000 x 0.05 = $90,000.
- The boarding house has been assessed as financially non-viable, having a rental yield of 4.5%.
- The contribution payable under clause 50(4) is

$$\$90{,}000 \times \frac{(100 \times 0.045) - 3}{3}$$

$$= \$45{,}000.$$

Payment and transfer of contributions

The Minister for Planning has issued a direction under section 94G(3)(b) of the Act requiring consent authorities to pay the monetary contributions levied under the SEPP to the Chief Executive, Housing NSW, Department of Human Services.

The contributions will be used to expand the scope of the *Boarding House Financial Assistance Program* which is administered by Housing NSW and provides financial assistance to support the ongoing viability of existing boarding houses. This ensures that the funds are targeted to improving accommodation for some of the most vulnerable tenants in the private housing sector.

The financial support provided under the program is currently limited to grants for fire safety upgrading works. The expanded program will include grants for upgrading and extending boarding houses. This provides an efficient and effective use of the limited contributions funds pool due to the relatively low cost of upgrading and constructing boarding rooms compared to other forms of affordable housing.

The program requires that tariff levels in boarding houses receiving the grants must be kept within the maximum level at which a boarding house is eligible for a land tax exemption. This ensures that the contributions are used for the purpose of affordable housing, as required by section 94G(4) of the Act.