

CHAPTER 5

DEVELOPMENT OF DEFENCE PROPERTIES

Introduction

5.1 In this chapter, the Committee examines the appropriateness of Defence's development of surplus properties prior to their divestment in order to 'optimise' the return to the Defence and Commonwealth budgets.

Defence as a developer

5.2 During the inquiry, the Committee took evidence on the work undertaken by DEO when preparing land for disposal. In many instances, this evidence indicated that DEO undertook a degree of development work during the disposal process.

5.3 DEO reiterated that it does not consider itself a developer. In particular, Mr Corey stated:

We are not land developers and we do not intend to be land developers but, by the same token, we intend to take whatever action is necessary to maximise the revenue to Defence and to government before we dispose of properties. We have passed on from where we used to just put a 'for sale' sign on a property and hand over substantial revenue gains to the private sector. We actually maximise them for Defence and the government.¹

5.4 DEO's view of itself as not a developer was not one shared by those outside the Department. Mr Stephen Bartos, General Manager of the Department of Finance and Administration's Budget Group, expressed the view that DEO was involved in development activity:

At the moment it is getting into some land development activities and the problem with that is that it is not a land developer.²

5.5 Mr Blackley, Director of the DEO Sydney Disposal Unit, described the public works that were being proposed for the Ermington site and which have been submitted to the Parliamentary Public Works Committee for scrutiny:

When I talk about infrastructure I am referring to dividing up a large site like Ermington, which you will remember is 20 hectares along the Parramatta River. We then put in main roads. Underneath those roads we

1 Mr Rod Corey, Head, Defence Estate, Department of Defence, *Committee Hansard*, 16 March 2001, p. 675

2 Mr Stephen Bartos, Department of Finance and Administration, *Committee Hansard*, 26 February 2001, p. 487

put in water, power and sewerage. We then sell parts of that site—we often call them super lots—to builders and all they need to do is connect to the services. They then build houses, or whatever the subdivision allows them to build.³

5.6 Mr Blackley then told the Committee what Defence does not do:

Defence does not sub-divide the site into super lots and then build the houses itself. It is not in the business of building houses and selling them to Mums and Dads. It does not do that.⁴

5.7 Mr Blackley also laid out the steps Defence take to improve the return to the Commonwealth on a property disposal:

- a) The first objective is to have an approved land use. This is something that Defence considers is tradeable.
- b) The next step Defence seeks is to achieve is either a development consent for the subdivision of a site or a development consent for a particular building. In the later case, Defence would actually design the building.
- c) The final step in the process is to actually construct the infrastructure required for the approved sub-division.⁵

5.8 It is clear that DEO is acting as a developer. It is playing with semantics to assert otherwise. Although DEO may not develop a site to quite the extent of a commercial developer, it does not mean that DEO is not a developer. The fact that DEO develops a site beyond clearance indicates that DEO is developing that site to some extent. It can therefore be regarded as a developer. In the case of the Ermington proposal it is apparent that Defence are considering development activities similar to that of a number of commercial land developers.

Should Defence be a developer?

5.9 The question was raised during the inquiry whether or not DEO should be involved in development activities.

5.10 Mr Stephen Bartos, General Manager of the Department of Finance and Administration's Budget Group, expressed the view that Defence should not be involved in development activities:

3 Mr Bernard Blackley, Director, Property Disposal Unit, Department of Defence, *Committee Hansard*, 16 March 2001, p. 561

4 Mr Bernard Blackley, Director, Property Disposal Unit, Department of Defence, *Committee Hansard*, 16 March 2001, p. 563

5 Mr Bernard Blackley, Director, Property Disposal Unit, Department of Defence, *Committee Hansard*, 16 March 2001, pp. 559–62

Our view is that Defence should not be a land developer. In relation to the idea that Defence will be a better land developer when the Defence objective is the prevention or defeat of armed force against Australia, the idea that it will be a better land developer than a lame developer just seems to us to not make sense.⁶

5.11 Mr Bartos explained why the Commonwealth was not well placed to undertake property development:

In terms of land development, one of the key differences between the Commonwealth department and a commercial land developer is the treatment of risks. There are big risks associated with land development that land developers adopt. There are also returns. They make returns to their shareholders and they pay dividends, or if they are a private company they make good returns to their owners. In the case of Defence, we do not see the Commonwealth as owner receiving dividend cheques from Defence. It is a very different situation. The idea that a Commonwealth department is best set up to be a land developer we think is not actually the case.⁷

5.12 Mr Bartos went on to say:

Our view is that it should dispose of the land before undertaking any of those sorts of development activities that you have talked about [zoning, infrastructure, facilities]. As you obviously know, and it is worth getting it on the record, the costs of that development are borne by the taxpayers. It seems to us that the price that Defence will get for a piece of land before development will build in the developer's expectations of what they can do with that land, and Defence does not therefore bear the risk of having to undertake that development itself. That will be capitalised into the value of the land, whatever potential future value a developer can see from it. I suppose our view is that Defence is actually likely to get a better return through disposing earlier because the potential developers will have a better idea of what potential they can generate from that land. As I said earlier, Defence is not set up to be a developer.⁸

5.13 The Department of Finance and Administration's view is supported by evidence provided by the Royal Australian Planning Institute:

In truth experience teaches us that the greatest sum of money probably comes with giving the responsibility to private enterprise to develop the

6 Mr Stephen Bartos, Department of Finance and Administration, *Committee Hansard*, 26 February 2001, p. 487

7 Mr Stephen Bartos, Department of Finance and Administration, *Committee Hansard*, 26 February 2001, p. 487

8 Mr Stephen Bartos, Department of Finance and Administration, *Committee Hansard*, 26 February 2001, pp. 487–8

land. In other words, the Commonwealth will net the greatest return by letting a private company take the risks of development.⁹

5.14 Ms Lisa Newell, Randwick City Council, expressed the opinion:

The Department of Defence's major business is not planning and developing new suburbs and planning for new communities. This is a block of land that they are disposing of as an excess asset.¹⁰

5.15 DEO addressed the question of risk with the Committee, stating that it assumed this risk with the express intent of maximising revenue.

Because of the risks that he or she perceives in getting the zoning changed through local council planning controls, the value that he or she is prepared to pay for a site is considerably less than its true worth. So it is all related to trying to remove as much risk from the planning process. What we are really about is adding value by reducing risk.¹¹

We have to optimise that revenue for defence. If we sell a property with that risk still there, the property developer or the purchaser will devalue the property to such an extent that the revenue we get for it is insignificant compared with the revenue we would get if the risk were taken out of the equation.¹²

5.16 DEO also noted that that one of the more significant risks in property development is the political risk:

The political risk is probably one of the more significant risks in Defence land ... Once we have gone through the planning process that Bernard just described the political risk to a purchaser or a future purchaser is basically eliminated.¹³

5.17 DEO replied to DoFA's concern by stating that there were two main reasons for its policy of developing sites before divestment: optimising revenue to Defence and denying developers windfall profits. Defence argued that to dispose of properties without a degree of development would mean discounting the value of the land to such an extent as to provide negligible return to the Defence budget:

We have to optimise that revenue for defence. If we sell a property with that risk still there, the property developer or the purchaser will devalue the

9 Mr John McInerney, Royal Australian Planning Institute, *Committee Hansard*, 5 March 2001, p. 553

10 Ms Lisa Newell, Randwick City Council, *Committee Hansard*, 25 January 2001, p. 331

11 Mr Bernard Blackley, Director, Property Disposal Unit, Department of Defence, *Committee Hansard*, 16 March 2001, p. 558

12 Mr Rod Corey, Head, Defence Estate, Department of Defence, *Committee Hansard*, 16 March 2001, p. 559

13 Mr Rod Corey, Head, Defence Estate, Department of Defence, *Committee Hansard*, 16 March 2001, p. 560

property to such an extent that the revenue we get for it is insignificant compared with the revenue we would get if the risk were taken out of the equation. I refer to the timing that is involved. We have done a business survey on these sorts of properties—and Randwick is a good example—which shows the return to defence, depending on where you sit. If we had sold that property as is, without doing anything, we would have got something less than \$20 million; and here I am plucking a figure out of my head. However, if we eliminate the majority of risks, the return to defence would be in excess of \$200 million.¹⁴

5.18 With regard to windfall gains, DEO argued that, by exiting a property disposal too early in the development process, they were, in effect, handing windfall gains to a developer. DEO illustrated this point by referring to two examples: a Melbourne property and the disposal of the Zetland site in Sydney. With regard to the Melbourne property, Mr Corey said that ‘we could not get a development approval in place. We got an indicative one from the council and the purchaser subsequently got a different one from the council.’¹⁵ Mr Corey drew particular attention to the Zetland site:

In Zetland, a major site in South Sydney, we thought we were fairly innovative in what we did. While we have built in provisions in the contract which give us returns in case of windfall properties—in this case to Landcom—Landcom is sitting there smiling and saying, ‘Thank you very much, Department of Defence.’ We have to balance when we cut off with when we stay in.¹⁶

5.19 However, Mr Corey was unable to say, yet, the level of gains that the purchaser of the site would achieve. Moreover, he also said ‘we have built in provisions in the contract which give us returns in case of windfall [profits]’. The Committee believes that refinement of such contract provisions should be undertaken to safeguard Defence against windfall returns by private companies either in the case of DEO misjudgement or where circumstances are beyond the control of DEO.

5.20 DEO also argued that it is in a position to conduct development work because of the time frame between the initial decision to declare a property surplus and the final divestment. During this period, environmental remediation activities, relocation of military units and other activities provide the opportunity for DEO to undertake concurrent activity to help optimise revenue to Defence. Mr Corey explained:

While we are going through this process we still have Defence people on the land and we still have to remediate the land. We can do a whole lot of productive activities while we are still holding the land. Even if we took into account holding costs, in commercial terms those costs would be

14 Mr Rod Corey, Head, Defence Estate, Department of Defence, *Committee Hansard*, 16 March 2001, p. 559

15 *Committee Hansard*, 2 April 2001, p. 675

16 Mr Rod Corey, Head, Defence Estate, Department of Defence, *Committee Hansard*, 16 March 2001, p. 562

significantly less than the increased revenue we would get from the property.¹⁷

5.21 There are other factors to be taken into account in DEO's development activities during the disposal process. Unlike most other Commonwealth agencies, Defence may keep revenue from the disposal of properties up to one per cent of its Budget allocation. This is an incentive for Defence to increase revenue from the sale of properties. DEO's Operating Principle 2 ('Disposal strategies will seek to optimise net revenue to Defence'),¹⁸ which drives the developmental approach to disposal of properties to optimise revenue, perhaps explains why DEO has been in disagreement or conflict with stakeholders involved with many Defence properties being divested. The disagreement generally stems from DEO's plans for the properties, which, in accordance with its principles, seek to optimise/maximise revenue but which do not accord with the wishes of one or more stakeholders. The Committee acknowledges that, sometimes, the stakeholders are unrealistic in their demands or politics intrudes into the equation. Nevertheless, there are other times when stakeholders have reasonable grounds for objecting to DEO plans. The prospect of a higher return to Defence appears to make it more difficult for DEO to compromise. The greater the degree of development undertaken by DEO, the greater is the profit and the greater is the opportunity for stakeholders to take issue with DEO on its planned development. Stakeholders may, for example, support early steps taken by DEO to develop a site but then disagree with more detailed plans proposed in later steps in the disposal process.

5.22 As discussed earlier in the report, the Committee is concerned about the DEO's expertise and experience as a developer. It is also concerned about the incentive for DEO to increase revenue at the expense of the community.

Conclusion

5.23 In considering this issue, the Committee noted that pre-sale development of surplus Defence properties is not government policy and did not have the support of the Department of Finance and Administration. It was, however, not inconsistent with government policy. The Committee came to the view that it does not object in principle to DEO adding value to properties and increasing revenue for the Commonwealth and Defence. However, in undertaking development of a property prior to sale, DEO should consider carefully the extent to which it develops a property, the nature of that development and the revenue likely to be obtained from that development. DEO should remember that its function is to sell surplus properties and not to become a community planner. DEO is very dependent on consultants to conduct developmental work and, arguably, does not have the expertise within its own ranks to oversee it, particularly should consultants misjudge the extent or nature of a proposed development. While Mr Corey believed that DEO had sufficient experience

17 Mr Rod Corey, Head, Defence Estate, Department of Defence, *Committee Hansard*, 16 March 2001, p. 559

18 DEO, *Property Disposals Policy Framework*, p. 2

to manage the development work, DEO is also dependent on retention of that experience, particularly at senior levels.

5.24 The Committee's guarded acquiescence to DEO's development of properties before sale is also based on DEO taking greater cognisance of State government, local government and other community views. The Committee does not believe it is in Defence's interests for DEO to try to secure the last dollar out of a sale when, by doing so, it alienates a lot of people and organisations. That is not to say that DEO should capitulate in the face of differences of opinion on its development strategy in each and every case where such criticism occurs. It should, however, try to be more accommodating of stakeholders, when they have particular concerns about specific DEO proposals, than seems to have been the case. Ultimately, it is the local government and the community that have to live with the decisions made about the end use of a divested Defence property.

5.25 Although Sydney Disposal Unit has only 19 properties while the Canberra Unit has 120, Mr Corey said that:

So while the revenue generated is principally out of the properties in Sydney—they are high profile; they soak up a lot of expenditure and a lot of time; and they involve a lot of management effort from Bernard and his team and the consultants—on Liz's side you have some 120 properties scattered throughout the country that are only in the noise in large part but they make a lot of noise when something goes wrong with them.

5.26 As much of DEO revenue is being generated from the disposal of large Sydney properties, DEO has an opportunity to be more magnanimous in respect of smaller properties that, in overall budget terms, are small contributors. This issue will be addressed in more detail in Chapter 6.

