



Australian Government  
Productivity Commission

# Victoria's Commercial Land Use Zoning

PRODUCTIVITY REFORM CASE STUDY  
JULY 2020



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The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website ([www.pc.gov.au](http://www.pc.gov.au)).

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# Foreword

This is the first of, potentially, several case studies the Productivity Commission will undertake on productivity reforms across the Australian Federation. The aim of the case studies is to inform and diffuse knowledge and practices across all jurisdictions, and to identify reform opportunities. The Commission does not intend for them to be accountability mechanisms or benchmarking exercises that judge the performance of jurisdictions, or comprehensive investigations into broad areas of policy.

The Commission will select topics for case studies — informed by discussions with states and territories — that relate to a widely acknowledged and common issue among multiple jurisdictions and contribute to new or adapted policies.

This case study is about realising the productive potential of urban land. In *Shifting the Dial: 5-year productivity review*, the Commission indicated that three areas remain priorities across jurisdictions:

1. reducing the number and complexity of restrictions on land use created by prescriptive zoning systems
2. better planning and provision for growth
3. the need to continue moves towards a risk-based approach to assessing development proposals.

This case study focuses on the first priority area, zoning systems. In particular, it examines Victoria's system of commercial and industrial zoning, which provides relatively simple, standardised zone classifications with a broad range of permitted and 'as-of-right' uses. The aim of the case study is to give jurisdictions a better sense of some of the potential advantages and trade-offs of more flexible zoning.



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## Key points

- Land use zoning can be an effective tool for pursuing urban planning objectives, such as separating industrial activities from residential areas or reserving open or green space.
- But overly prescriptive zoning imposes costs and reduces land use flexibility and adaptability.
- While important, zoning is just one of many factors shaping land use in a jurisdiction like Victoria, including population growth and a shift from manufacturing to knowledge- and service-based industries.
- Victoria has sought to simplify and standardise its commercial zones over the past 20 years.
  - Business zones were standardised in the late 1990s to provide greater consistency across newly merged local government areas.
  - The broad Commercial 1 and 2 zones were introduced in 2013 following the merging of the previous five business zones. (This change was accompanied by amendments to the industrial zones to provide more flexibility for office and some retail uses.)
  - The Commercial 3 Zone is a mixed use employment zone introduced in October 2018.
- The effect of these reforms over time has been to broaden the extent of allowable and as-of-right uses (that is, uses allowed without a permit) on commercially zoned land across the state.
- The move to broader commercial zones aimed to increase business investment and encourage more productive land use by making the zoning rules simpler and less prescriptive, but generated concerns about unintended adverse consequences.
- Business investments and qualitative feedback suggest that these measures are having their intended effects.
  - The changes have increased the availability of suitable sites and reduced set-up costs for small-scale supermarkets and large format retailers. Consumers now have greater access to these type of retailers.
- The significant negative impacts predicted to result from the 2013 reforms do not appear to have come about, although some maintain that the more market-driven approach has detracted from urban amenity or unfairly affected some businesses. Some of these arguments are questionable on empirical and/or conceptual grounds.
- The new Commercial 3 Zone aims to facilitate the establishment and growth of creative industries, small-scale manufacturers and start-up businesses.
  - The Commercial 3 Zone has the potential to increase the productivity of land use by allowing limited retail and residential uses, while maintaining the option value of preserving land for employment-related activity (rather than full-scale residential development).
  - Its merits as a form of industry assistance are more questionable.
- This case study highlights that:
  - although it is widely accepted that enhancing the amenity and productivity of land use requires a combination of regulation and markets, there is inevitable debate about the right balance
  - a key benefit of flexible zoning arrangements is that they allow land use to adapt to changing economic circumstances (such as unanticipated shifts in the nature of office work)
  - Victoria's experience suggests it is possible to introduce greater flexibility into zoning arrangements with positive outcomes.

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# Victoria's commercial zoning reforms: a case study

## Introduction

Large cities account for the overwhelming majority of Australia's population, jobs and output. Our big cities are part of our comparative advantage, and Melbourne in particular has been growing fast. This growth has presented its own challenges, especially surrounding congestion and housing affordability.

Efficient and thriving cities are critical to productivity and wellbeing. As the Commission noted in *Shifting the Dial: 5-year productivity review*:

From a productivity perspective, many aspects of cities that affect how they function overlap with those that also matter for people to be healthy, for labour markets to provide long-term opportunities for all workers, for markets to work efficiently, and for services to be delivered where needed and of the required quality (p. 125).

Policies affecting the availability and use of space, and the organisation of activity, have a particular impact on city productivity and liveability. Outdated, complex and prescriptive regulations can stifle diversification and competition among businesses, increase the cost of development, and reduce business investment.

A growing number of economic research organisations, including the Commission (box 1), have highlighted the value of more flexible and responsive land use regulation for businesses, consumers and households (Kendall and Tulip 2018; NSW PC 2019; OECD 2017). However, many in the planning profession (and the public more broadly) view such arguments with scepticism. This may reflect a reluctance among some economists to engage with the practical details that matter to planners, or a tendency to focus on the costs of regulating land use while underselling its benefits (such as its contribution to liveability and the efficient functioning of our cities' transport networks).

To improve understanding of issues associated with implementing more flexible zoning arrangements, the Commission decided to conduct a case study on a jurisdiction generally thought to have simpler and more flexible arrangements — Victoria. This case study is a

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‘deep dive’ into Victoria’s experience in introducing greater flexibility to its commercial land use zones, which comprise:

- the broad Commercial 1 and 2 zones, which were created in 2013 (by merging the previous five business zones) to provide greater flexibility and growth opportunities for commercial and business centres
- the Commercial 3 Zone (C3Z), which is a mixed use employment zone introduced in October 2018 to facilitate the establishment and growth of creative industries, small-scale manufacturers and start-up businesses. (No local government has yet implemented C3Z in their planning scheme.)

The case study also touches on Victoria’s industrial zones, which were amended in 2013 to provide more flexibility for office and some retail uses. It does not directly examine other zones where commercial activity may take place (such as the Capital City Zone in the central business district of Melbourne).

The objective of the case study is to explore the implementation and impacts of changes to Victoria’s commercial zones to identify generalisable lessons for other jurisdictions. The analysis draws on desktop research and meetings with businesses, planners, lawyers, and local and state government (appendix A).

- Sections 1 and 2 provide background on zoning and its effects, and on other factors affecting commercial and industrial land use patterns in Victoria.
- Sections 3 and 4 examine the implementation and impacts of the commercial zones currently operating in Victoria, and of the C3Z.
- Section 5 concludes with lessons for policymakers.



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**Box 1****Previous Commission reports on zoning, and recent developments in other jurisdictions**

Over the past decade or more, the Productivity Commission has undertaken a number of studies that have examined zoning arrangements (PC 2011a, 2011b, 2014, 2017b). Most recently, the Commission examined zoning as part of *Shifting the Dial: 5-year productivity review* (PC 2017b, 2017a). In that review, the Commission identified three areas that remain priorities across jurisdictions, including reducing the number and complexity of restrictions on land use created by prescriptive zoning.

State, Territory and Local Governments should move to fewer and more broadly-stated land use zones to allow greater diversity of land uses. Such a move is likely to make it easier for new firms to enter local markets and for existing firms to expand, reduce administrative and compliance costs, and enable planning systems to more flexibly respond to changing land use activities.

Governments should apply competition policy principles to land use regulation and policies, which oblige consideration of the impacts of policies from the perspective of communities as a whole.

Regulation that explicitly or implicitly favours particular operators and sets proximity restrictions is unjustifiable. (PC 2017a, p. 16)

In examining progress in specific jurisdictions, the Commission observed that:

- Victoria stood apart from other jurisdictions by having fewer business zones (two), with more broadly-stated allowable uses, as a result of zoning reforms in 2013
- New South Wales had eight business zones, with different types of developments permitted
- Western Australia had 20 zone categories, including five zones for commercial uses
- Tasmania and the ACT had five to six different commercial zones, and each had 23 types of zone in total
- Queensland had introduced greater consistency between local planning schemes by identifying mandatory elements (such as definitions, zone names and zone purposes).

Since the release of *Shifting the Dial*, most states and territories have either implemented or signalled changes to their planning systems (particularly development assessment processes); in some cases, this has involved changes to zoning. For example:

- Western Australia announced the Planning Reform Action Plan in 2019 to simplify planning and improve planning consistency and efficiency. Initiatives include introducing a standard suite of zones and streamlining development assessment processes (WA DPLH 2019)
- Tasmania is progressively implementing the new Tasmanian Planning Scheme, which will replace 30 interim planning schemes with a single state-wide scheme. This will introduce a standard set of 23 zones, which are intended to increase land use flexibility. Although the *Land Use Planning and Approvals Amendment (Tasmanian Planning Scheme Act 2015)* pre-dates *Shifting the Dial*, these changes are ongoing (TAS DJ 2017)
- South Australia is implementing a single state-wide planning rule book, the Planning and Design Code, to replace 72 highly complex and variable 'development plans' (which had more than 2500 zone combinations in 2014) (SA Government 2019).

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# 1 Primer on zoning and its effects

## What is zoning?

Zoning is a way of regulating land use whereby governments divide land into zones (typically using categories such as ‘industrial’, ‘commercial’, ‘residential’ and ‘mixed’) and set rules on how that land may be used. For example, a block of land may be zoned for commercial use, allowing supermarkets and retailers to set up there but prohibiting factories. Governments also use ‘built form’ regulation (that is, rules governing matters such as the construction, height, shape and location of buildings) to shape cities. This is conceptually distinct from land use zoning but, in practice, often forms part of the same set of regulations.

In most Australian jurisdictions, local governments are responsible for applying zones to land (subject to ministerial approval), but they operate in accordance with the legislative frameworks and land use plans established by State and Territory governments. Box 2 includes a brief outline of Victoria’s general framework for planning and land use regulation.

### Box 2 Planning and land use regulation in Victoria

The Victorian Government is responsible for Victoria’s land use and development policy and legislative framework.

The primary legislation covering land use in Victoria is the *Planning and Environment Act 1987* (Vic), which came into effect in 1987 with the purpose of establishing:

... a framework for planning the use, development and protection of land in Victoria in the present and long-term interests of all Victorians.

State land use policy is set out in *Plan Melbourne 2017–2050* and eight regional growth plans, which, together, provide broad direction for land use and development across Victoria.

Each local government has a planning scheme. Planning schemes are legal documents that set out the objectives, policies and planning controls that apply to the use and development of land in the local area and incorporate State planning policy. Generally, the local government prepares the local planning scheme and the Minister for Planning approves it.

The Victoria Planning Provisions (which are enabled by the Planning and Environment Act) outline the planning controls that planning schemes may include. The planning controls comprise zones and overlays.

- **Zones** — The rules for each zone set out ‘as-of-right’ uses of land that are allowed without a permit, discretionary uses that require the local government to grant a permit, and prohibited uses that cannot be undertaken in the zone. Conditions (for example, maximum floor area) may apply to particular uses. While the zones are mostly standardised, local governments can vary some rules to suit local circumstances through schedules attached to the zones in their planning schemes. There are about 30 different zones.
- **Overlays** — Overlays are an additional layer of planning control. They set rules on matters such as the design and form of buildings, the protection of heritage buildings, the protection of vegetation and maintaining appropriate drainage. There are about 25 different overlays.

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## The motivations for zoning

Originally, the main motivation for zoning was to separate incompatible uses. For example, when the state government first introduced limited zoning in Victoria in 1921, it was to allow local governments to exclude commercial and industrial activities from residential areas (Metropolitan Town Planning Commission 1929, p. 155).

Over time, additional motivations for zoning have emerged. These include:

- limiting urban sprawl
- controlling the density of urban development
- channelling commercial activity into identified activity centres<sup>1</sup>
- reserving land for open or green space
- reserving land for industrial activity
- protecting the interests of local businesses and residents.

## The costs and benefits of zoning

Zoning can help to mitigate the negative effects of competing land uses on each other and make cities more livable and sustainable. For example, the potential benefits of zoning for households include reduced air, noise and visual pollution from commercial and industrial activities; proximity to employment, shopping, community centres and public transport; and access to open or green space for recreation (McDonald and McMillen 2012).

However, overly prescriptive zoning can impose costs, including:

- reduced flexibility — zoning can shut out high value or beneficial uses of land. For example, restrictive zoning rules might prohibit or delay a small café or convenience store from opening in a suburban residential neighbourhood even though local residents would welcome it. Such restrictions can contribute to the development of ‘silos’ of activity and reduce neighbourhood vibrancy
- reduced adaptability — zoning can prevent land uses from changing in response to economic and social changes. For example, a local government may zone a piece of land exclusively for manufacturing, only for external factors to make manufacturing economically unviable there. The restrictive zoning would leave the land to sit idle or underutilised
- regulatory costs — zoning imposes regulatory costs such as the fees, delays and uncertainty involved in seeking permits for land uses that require them in particular zones, or seeking a rezoning to accommodate a new use. These add to the costs and uncertainty of overly prescriptive zoning.

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<sup>1</sup> Activity centres are areas identified in planning policy that provide a focus for services, employment, housing, transport or social interaction.

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Researchers have attempted to quantify the costs of zoning. For example, in a 2013 report commissioned by the New South Wales Government, the Centre for International Economics estimated that the economic value inhibited by land use restrictions for Sydney could be in the order of \$8 billion to \$16 billion (CIE 2013, p. 101). Separately, Kendall and Tulip estimated that, in 2016, zoning raised detached house prices in Melbourne 69 per cent above marginal costs (2018).

And it is clear that land values can be very sensitive to zoning. For example, when land in Melbourne's Fishermans Bend was controversially rezoned in 2012 to allow greater residential development, average land values in its Montague precinct rose by 60 per cent in one year — from \$2500 to \$4000 per square metre (Knight Frank 2013).

But generating quantitative estimates of the aggregate economic benefits of land use regulation has proved to be more of a challenge (Coates, Daley and Wiltshire 2018, p. 57; Kendall and Tulip 2018, p. 22). At the local level, planners and local governments often rely on expert testimony, local knowledge and a degree of subjective judgment to help inform these trade-offs.

## **Balancing the roles of regulation and markets**

There is broad agreement that some level of land use regulation is necessary to enhance the amenity and productivity of cities, particularly in addressing market failures (such as negative and positive spill-overs). Similarly, most accept that there is a significant role for the market in determining land use. However, there is considerable debate about how prescriptive regulations need to be to achieve optimal land use outcomes.

Some land use issues appear more amenable to regulatory intervention than others. For example, relatively restrictive regulation may be warranted in cases where there is a risk that leaving the allocation of land to the market would entrench poor land use outcomes. Land, once developed for a particular use, can be costly, difficult and slow to redevelop for other uses. This can entrench poor outcomes and negative spill-overs arising from genuinely incompatible uses (for example, allowing residential housing to be built next to an airport could limit the airport's future expansion, while industrial activity can contaminate land and render it unsuitable for future residential or commercial use). It can also lead to missed opportunities to provide for future growth and promote positive spill-overs (for example, by failing to secure open or green space, or areas for public infrastructure). In such cases, poor land use outcomes can be difficult or costly to reverse and so a proportionate regulatory intervention may be the most efficient approach.

In other cases, it is arguable that less prescriptive regulation and greater reliance on market forces to allocate land will lead to better outcomes. For example, it is questionable whether government is well placed to prescribe with a high level of specificity where particular commercial activities may or may not take place (for example, whether a local café is

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replaced by an accountant's office or a gym, or what forms of retailing occur where). The market generally performs this task more efficiently and flexibly.

This approach aligns with the position taken by the Commission, and supported by various principles of good regulatory practice: that governments should establish a clear policy case for intervention before introducing more regulation (box 3).

### **Box 3 Principles of good regulatory practice and design**

Various economic organisations in Australia and overseas have formulated principles for good regulatory practice and design. Although these principles differ in their detail and emphasis — reflecting the particular contexts in which they are applied — there are reoccurring themes that are relevant to all forms of regulation. These include the need to:

- clearly establish the nature of the policy problem
  - Articulating and agreeing upon the policy problem helps to identify and design policy measures to target the problem and to establish the basis for assessing their effectiveness (which, in turn, promotes transparency and accountability).
  - Economists often approach this task by identifying so-called market or regulatory 'failures' that governments may be able to 'correct', enhancing the broader community interest.
- consider a range of feasible policy options to address the issue
  - Good practice principles emphasise comparing a range of regulatory and non-regulatory measures to address the policy issue.
  - In the context of land use, such options may go beyond regulatory controls (to include tax policies affecting demand for land, perhaps, or direct government investment).
- adopt the option that generates the greatest net benefit for the community
  - All markets have some imperfections. However, government interventions to address such imperfections involve costs (design, administrative and compliance costs) and can potentially have perverse outcomes. Government action should therefore be effective and proportionate to the issue it is seeking to address.
  - Good practice principles emphasise the need to consider the potential impacts of regulation on competition, and put the onus on proponents of regulation to demonstrate that the benefits of the restrictions to the community as a whole outweigh the costs.
- ensure that regulation remains relevant and effective over time
  - As with any new regulation, the case for existing regulations should be periodically reviewed in light of changing circumstances and new information.
- consult effectively with affected key stakeholders at all stages of the regulatory cycle.

*Sources:* COAG (2007); Commissioner for Better Regulation (nd); Government of NSW (2019); Government of South Australia (2011); Government of Western Australia (2020); OECD (2012).

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## 2 Other factors affecting commercial land use patterns

Although zoning sets rules about *where* businesses may locate and *what* they may do on that land, a range of other factors influence the composition and geographic distribution of Victoria's commercial and industrial businesses. As noted above, often the aim of planning policy is to channel market forces rather than attempting to reverse or resist them altogether.

### Land preferences exhibited by different types of businesses

Businesses in similar industries often have similar preferences as to the location and type of land that they seek, reflecting their shared economic characteristics. The geographic distribution of different types of businesses in Melbourne (figure 1) can be seen as a 'spatial equilibrium' arising from the competition between these different businesses for available land.

- Knowledge-based<sup>2</sup> firms are densely clustered around the inner city because this allows them to access a large pool of specialised labour and provides them with greater opportunities for business-to-business interaction. This, in turn, has attracted many workers in knowledge-based industries to live close to the centre of Melbourne.
- Industrial<sup>3</sup> firms are generally clustered in industrial precincts outside inner Melbourne, with the significant exceptions of Port Melbourne and West Melbourne. These firms generally favour large premises on affordable land more than having a central location. It is also important for these firms to have good access to their supply chains, so they prefer locations that are well connected to transport infrastructure (port, rail and road).
- Population-serving<sup>4</sup> firms are more dispersed throughout Melbourne. These firms locate near residential areas, as local residential populations are both their customer base and much of their labour force.

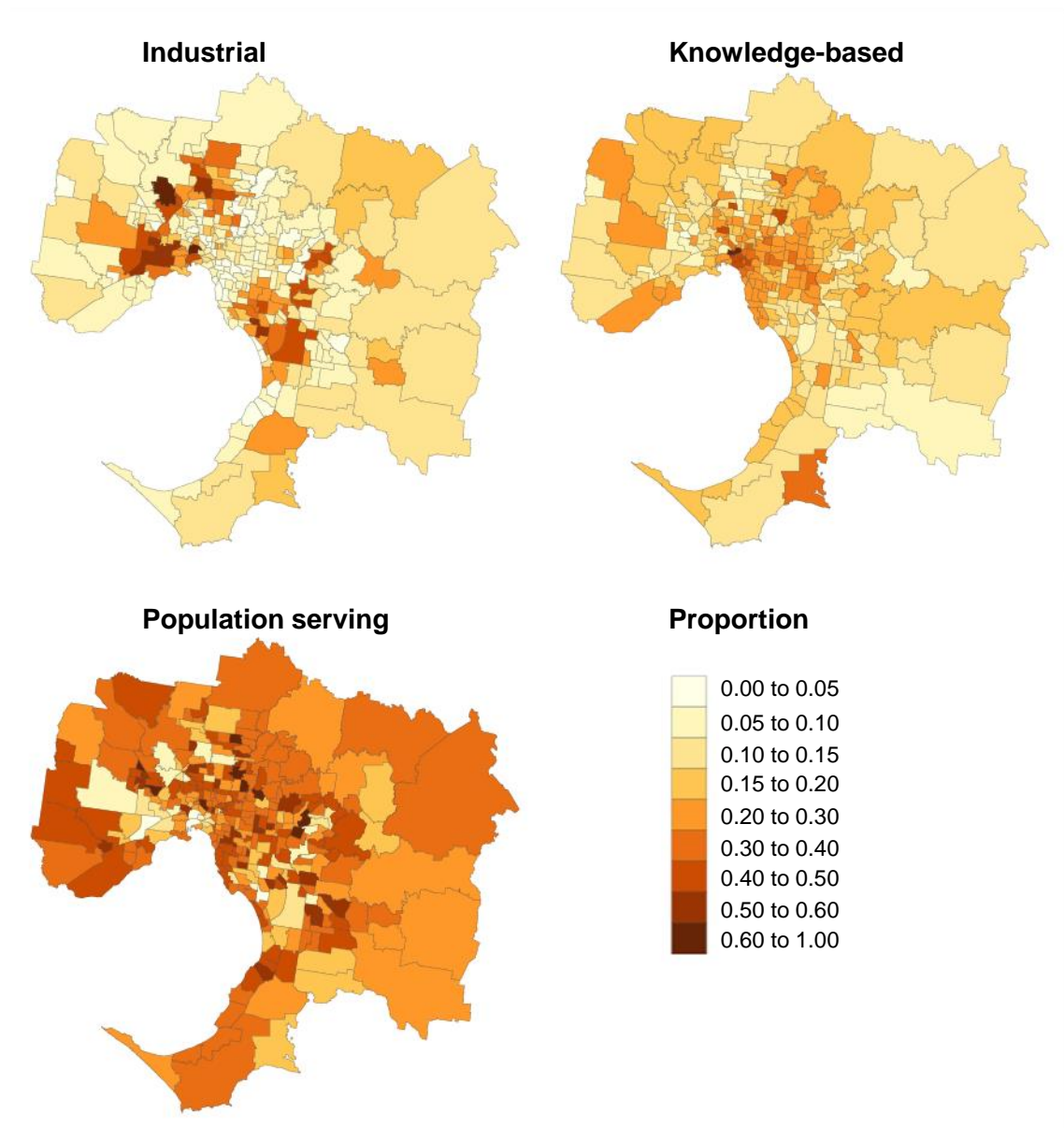
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<sup>2</sup> 'Knowledge-based' industries include: administrative and support services; financial and insurance services; information media and telecommunications; professional, scientific and technical services; public administration and safety; and rental, hiring and real estate services.

<sup>3</sup> 'Industrial' industries include: electricity, gas, water and waste services; manufacturing; transport, postal and warehousing; and wholesale trade.

<sup>4</sup> 'Population-serving' industries include: health care and social assistance; education and training; and accommodation and food services.

**Figure 1 Current patterns of commercial and industrial activity<sup>a</sup>**  
 Proportion of workers in industry sector, by Statistical Area 2 (place of work)



<sup>a</sup> Industry sectors correspond to 'knowledge-based' industries, 'population-serving' industries and 'industrial' industries as defined in this report.

Source: ABS (Census of Population and Housing, Australia, 2016, Cat no. 2901.0, TableBuilder).

## Broader trends affecting commercial and industrial land use

The composition and geographic distribution of Victoria's commercial and industrial businesses are also influenced by broader trends in the economy. These include the shift

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from manufacturing to knowledge- and service-based industries, the increasing importance of freight and logistics, growth in population, and changes to work practices and consumer preferences.

### Shift from manufacturing to knowledge-based industries

Over recent decades, manufacturing's relative importance to Melbourne's economy has declined significantly in favour of knowledge-based industries (DELWP 2020a, pp. 5–6), as it has in the broader Victorian and Australian economies. Manufacturing went from employing about 19 per cent of greater Melbourne's workforce in 1991 to employing about 8 per cent in 2018. Meanwhile, employment in knowledge-based industries increased from 24 per cent to 27 per cent over the same period (figure 2). As a result, manufacturing has faced increasing competition for land from knowledge- and service-based industries.

This is reflected in patterns of land use in inner Melbourne. In 1954, the *Melbourne Metropolitan Planning Scheme* report observed that the 'dominant' feature of the industrial pattern in Melbourne was its 'great concentration' in inner Melbourne (MMBW 1954, p. 46). Since then, growing competition for land and the increasing availability of cars following World War Two (which facilitated Melbourne's outward expansion) have both contributed to industrial activity moving out of inner Melbourne to the middle and outer suburbs.

Now, only two per cent of Melbourne's occupied industrial land is in the inner metropolitan region (DELWP 2020a, p. 22) — and the number of industrial businesses in inner Melbourne continues to decline, with former industrial land gradually being repurposed for residential and commercial use (SGS 2019, p. 23). However, significant concentrations of industrial activity remain in the inner locations of Port Melbourne and West Melbourne.

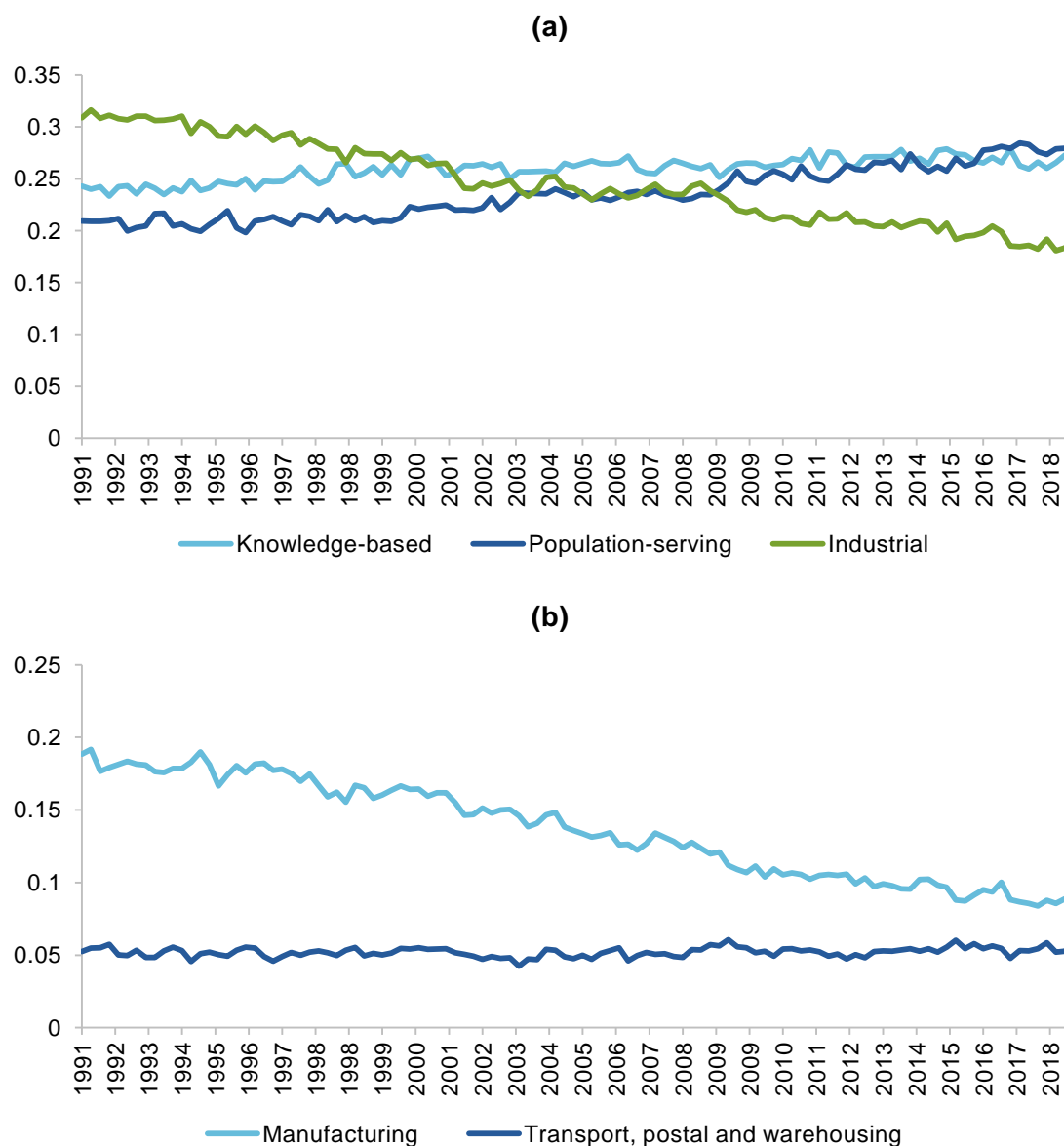
The increase in knowledge-based jobs relative to industrial jobs has contributed to greater employment density in inner Melbourne, as present-day industrial workplaces typically have fewer jobs per square metre of floor space than do knowledge-based industry workplaces (see, for example, SGS 2018b, p. 46).

### Increasing importance of freight and logistics

While manufacturing employment in greater Melbourne has declined significantly (both nominally and as a share of the total workforce), employment in the transport, postal and warehousing sector has nearly doubled in absolute terms and has slightly increased as a share of the greater Melbourne workforce between 1991 and 2018 (from about 5.5 to 5.75 per cent) (figure 2). This has influenced the pattern of industrial land use, with the transport, postal and warehousing sector often requiring very large parcels of land close to major transport infrastructure, rather than smaller sites in the inner city. (This shift is particularly important in light of changing consumer preferences, as discussed below).



**Figure 2 The composition of employment in Melbourne has changed<sup>a</sup>**  
Proportion of Greater Melbourne workforce in different sectors of employment



<sup>a</sup> Industry sectors in graph (a) correspond to 'knowledge-based' industries, 'population-serving' industries and 'industrial' industries as defined in this report.

Source: ABS (*Labour Force, Australia, Detailed, Quarterly*, Nov 2018, Cat. no. 6291.0.55.003).

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## Population growth is increasing demand for employment and residential land

Melbourne's population has grown significantly, from 1.5 million in 1954 to about 5 million in 2018, and the Victorian Government has projected that it will continue to grow to approximately 6.3 million in 2031 (ABS 1954, 2020; DELWP 2020a, p. 15).

This presents significant opportunities for businesses, in the form of increasing local demand for goods and services and access to a growing pool of workers. In 2016, there were about 2.3 million jobs in Melbourne. The Victorian Government is planning for close to 3.1 million jobs in 2031, projecting that many of these jobs will be in the population-serving and knowledge-based sectors and that there will be little change to overall job numbers in manufacturing (DELWP 2020a, p. 15).

However, a growing population also presents challenges. It increases competition for land, particularly in sought-after locations close to the city centre, which can result in higher rents or land costs for businesses. More broadly, it requires using available land more intensively. The Victorian Government estimates that about 10 million square metres of commercial floor space will need to be added between 2016 and 2031, with almost 40 per cent of that additional floor space in the inner metropolitan region (DELWP 2020a, p. 29).

Increasing competition for land has also raised concerns from stakeholders about the potentially irreversible loss of industrial land in strategic locations in inner Melbourne, particularly for residential use. Residential use is often considered the 'highest and best' use of land (that is, the use that results in the highest land value while being physically, legally and financially feasible) where zoning allows for it, although commercial use can be competitive depending on the location and on market conditions (box 4). Section 3 includes further discussion of this concern.

## Changing work practices and consumer preferences are also affecting land use

Commercial land use in Melbourne is evolving in response to changing work practices, technologies, environmental regulations and cost pressures. Rising land costs in the central business district (CBD) and other commercial centres have led to the more intensive use of commercial land through the construction of tall office buildings. Workplaces have adopted practices such as open plan offices and flexible work. Advances in technology have allowed workplaces to save space — for example, on storage for hard copy files and books. Environmental regulations increase pressure on workplaces to reduce their total footprint. Together, these factors have contributed to commercial employment density increasing over time (see, for example, SGS 2018b, p. 36).

Consumer preferences have also affected commercial and industrial land use. Consumers are increasingly turning to online shopping and expecting quick delivery (such as same or next day delivery). This is leading to the creation of more large distribution centres and warehousing close to key road infrastructure, as well as 'last mile' facilities close to where people live (Colliers 2020; Property Council of Australia 2019). Australia Post predicts that e-commerce penetration will continue to grow strongly and will reach 12 per cent of retail spending by 2021 (Australia Post 2019, p. 4).

Many of the trends discussed so far have been evident in the City of Yarra (box 5).

#### Box 4 Is residential the highest and best use of land?

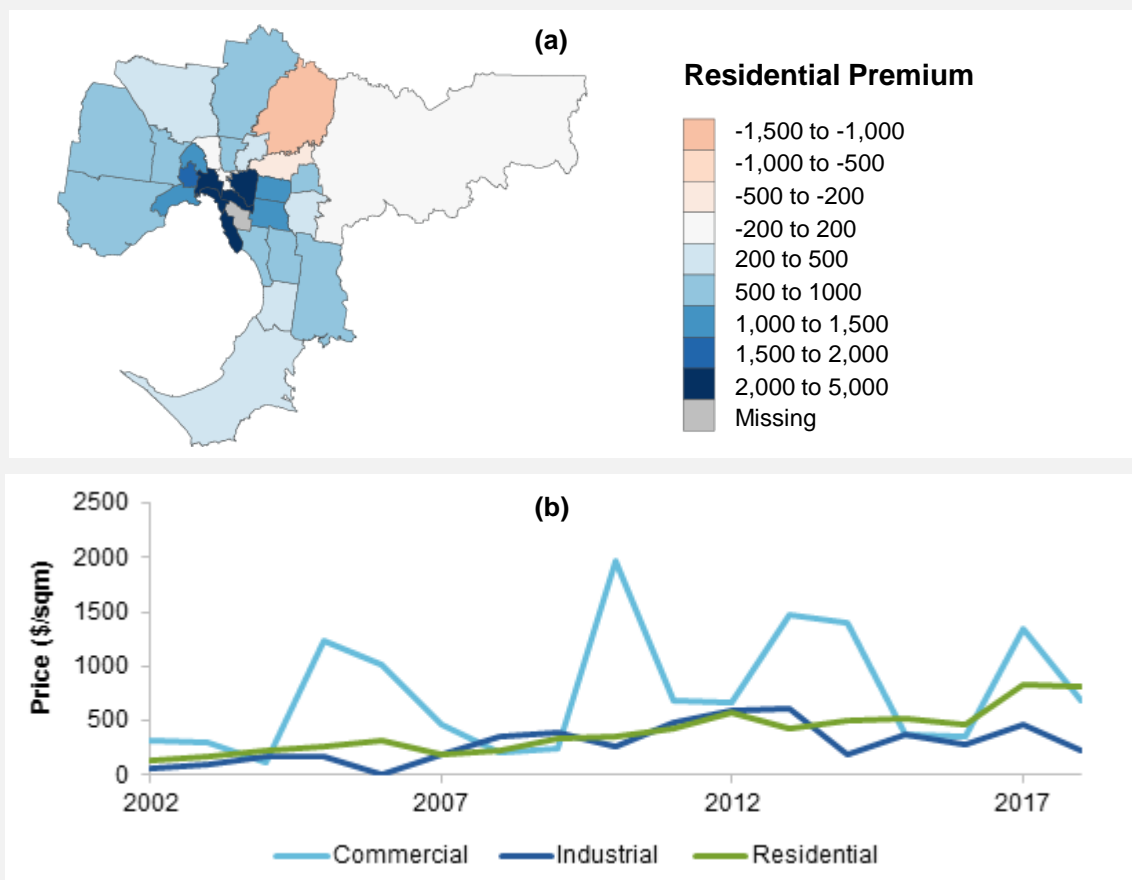
Determining the highest and best use of land involves considering many factors, and no single metric is decisive. These factors include technical financial measures (such as the residual land value, development profit, internal rate of return and net present value) as well as the physical and legal feasibility of different kinds of development.

As a rough proxy for highest and best use, the Commission considered the price per square metre of different land uses from Valuer-General Victoria sales price data. The data indicate that:

- in 2018, the mean price per square metre for residential floor space was significantly higher than for industrial floor space across most local government areas in Melbourne (figure (a))<sup>5</sup>
- a significant gap has emerged between the median prices per square metre of vacant residential land and vacant industrial land over the past decade (figure (b))<sup>6</sup>
- the median price per square metre for vacant commercial land has fluctuated far more than for vacant residential and industrial land, perhaps in response to the business cycle (figure (b)).<sup>7</sup>

Overall, while caution should be used in interpreting these data, they are consistent with anecdotal evidence from stakeholders that:

- residential and commercial land uses are generally higher value than industrial land use
- the comparison between residential and commercial land use is more complicated, and depends on the location being considered and on market conditions.



Source: Valuer-General Victoria (various).

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## Box 5      **Changing land use in the City of Yarra**

The City of Yarra is a municipality located in inner Melbourne which includes the suburbs of Cremorne, Richmond, Collingwood, Fitzroy and Abbotsford, among others. It was formed in 1994 from the amalgamation of several former local government areas.

The area used to be a centre of significant industrial employment, including in the manufacture of textiles, clothing and footwear and in breweries. However, like broader Melbourne, it has undergone a long-term shift away from its traditional manufacturing base. The number of manufacturing jobs in the City of Yarra has declined from about 35 500 in 1971 to about 3400 in 2016 — a decrease of approximately 90 per cent. This is, proportionally, a much larger decline than the approximately 50 per cent decrease in manufacturing jobs across Melbourne over the same period, from about 337 000 to about 163 000.

The largest remaining site of industrial activity in the area is the Carlton & United Brewery in Abbotsford. Other industrial firms in the City of Yarra are typically small-scale manufacturers in food production, textiles, bespoke furniture and printing. One notable local manufacturer, KeepCup, has been making reusable coffee cups since the late 2000s; these have become near-ubiquitous in Australian cafes and are now sold in over 65 countries.

Knowledge-based industry is increasingly important in the City of Yarra, accounting for about 30 per cent of jobs in the area in 2016 (compared to about 26 per cent of jobs across Melbourne). The suburb of Cremorne exemplifies the transition that the City of Yarra has undergone — while Cremorne used to be a largely industrial precinct, it has in recent years become a trendy commercial and mixed use area, home to the head offices of large online businesses such as carsales.com.au and realestate.com.au.

Accompanying the shift towards knowledge-based industry, the City of Yarra has also seen a rise in flexible ways of working: it contains a significant proportion of Melbourne's co-working spaces, and has seen the number of people working from home more than double from about 1000 in 1991 to about 2500 in 2016.

The population of the City of Yarra has grown significantly over the past several decades, from about 64 000 in 1991 to about 101 000 in 2019 (an approximately 58 per cent increase, compared to about 48 per cent for Melbourne over the same period). This, coupled with the growth in commercial activity in the area, has contributed to increasing competition for land and the conversion of former factories and industrial warehouses to residential and commercial use.

Changing land use in the City of Yarra has enabled it to keep pace with the broader structural shift of Australia's economy away from manufacturing and towards knowledge-based industry. Today, the City of Yarra is economically vibrant and prosperous, and this is at least partly due to the system of land use regulation allowing land use in the City to change over time.

*Sources:* ABS (*Census of Population and Housing, Australia, 2016, Cat. no. 2901.0, TableBuilder*); Dingle and O'Hanlon (2009); id consulting (2020); KeepCup (nd); SGS (2018b).

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- <sup>5</sup> The 'detached housing' sub-category was used to represent the broader residential category, given data gaps or anomalies in other sub-categories. All sub-categories with data on mean floor space were used to represent the 'industrial' category, and were weighted by the number of sales.
  - <sup>6</sup> Comparing the 'Vac Res A' category with the 'Vac comm' category between 2002 and 2009 and, subsequently, the commercial 'Dev Site' category.
  - <sup>7</sup> Comparing the 'Vac Res A' category with the 'Vac comm' and 'Vac Ind' categories between 2002 and 2009 and, subsequently, the 'Dev Site' and 'Ind Dev Site' categories.

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In addition, during consultations, stakeholders raised the possible long-term effects of COVID-19 on consumer preferences, work practices and land use. There was speculation about whether the experience of the pandemic would have a lasting effect on the density of workplaces, the adoption of flexible work, and co-working practices. Similarly, there was speculation about whether the pandemic would affect consumers' adoption of online shopping, and about the consequences for traditional retail. It is too early to predict with any degree of certainty how, and to what extent, the pandemic might affect these matters in the long term.

### **3 Victoria's commercial zones: implementation and impacts**

Victoria's current commercial zoning arrangements have evolved over the past 20 years. A significant reform occurred in 2013, when the government created the Commercial 1 and 2 zones (by merging the previous five business zones) and amended the three industrial zones. In 2018, the government introduced a new optional commercial zone, the Commercial 3 Zone; however, no local government has yet implemented the C3Z in their planning scheme. The C3Z is discussed further in section 4 of this report.

The 2013 changes to the zones followed earlier changes to simplify and standardise Victoria's commercial zones. For example:

- between 1997 and 2000, the government introduced the Victoria Planning Provisions. These replaced about 2870 zones (many of which were closely related local variations) with a set of 25 standardised zones, to allow for a wider range of uses and developments with fewer prohibited uses. The changes aimed to make it easier for people to interact with the planning system, but meant that local governments had less scope to tailor their own zones to meet the specific needs of their areas.
  - A new Mixed Use Zone was introduced in 1997 to promote mixed residential, commercial and light industrial uses within the suite of residential zones, and to allow for housing at higher densities.
- in 2012, the government broadened the definition of 'restricted retail' to allow large format retailers<sup>8</sup> (also known as bulky goods retailers) to sell a greater range of goods. The amendments also removed floor space restrictions for these retailers.

Victoria's most recent reforms to commercial and industrial zones in 2013 — hereafter referred to as the 2013 reforms — came with the promise of increased business investment and more diverse retail offerings, but also generated concerns about unintended adverse consequences for urban amenity. The following section takes a closer look at what the changes to Victoria's commercial zones set out to achieve in 2013 and how their implementation has played out in the years since.

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<sup>8</sup> Large format or bulky goods retailers sell large, heavy or bulky items such as household and office furniture, equipment and appliances, sporting goods and automotive parts and accessories. They require large areas for the handling, display and storage of goods.

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## **Victoria's current commercial and industrial zones aim to increase simplicity and flexibility**

As discussed in box 1, Victoria's commercial zoning arrangements are comparatively flexible in that:

- there are relatively few commercial and industrial zones, with a broad range of allowable uses
- the zones are standardised
- many commercial uses are as-of-right (that is, uses allowed without a permit).

The government designed Victoria's commercial zones to promote planning simplicity and flexibility, and to increase business growth opportunities. However, the zones maintain some distinction between different types of commercial activity, as a way of grouping complementary activities and reducing potential land use conflicts (table 1).

The Commercial 1 Zone (C1Z) aims to create mixed use commercial areas for uses such as retail, offices, businesses, entertainment and community activity, while also catering for complementary residential space. The C1Z is applied in diverse areas such as St Kilda Road, Chadstone Shopping Centre, and most high street retail areas.

The Commercial 2 Zone (C2Z) aims to support commercial areas for offices, some manufacturing and industries, certain retail (such as large format), and other business activity. Some examples of C2Z areas include those around South Gippsland Highway in Dandenong South, in Cremorne, around Western Ring Road in Broadmeadows, and on some land adjoining Melbourne Tullamarine Airport.

Similarly, the government designed Victoria's industrial zones to allow a mix of industry, office and limited retail, while maintaining some distinctions regarding the nature of allowable industrial and commercial activity to reduce conflict between different uses. For instance, the Industrial 3 Zone (IN3Z) — intended as a buffer zone<sup>9</sup> — allows for some retail (such as large format retail and small-scale supermarkets), which is restricted or prohibited in the other two industrial zones.

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<sup>9</sup> A buffer zone separates incompatible uses to avoid land use conflicts and protect sensitive uses (such as residential) from adverse impacts.

**Table 1 Victoria's current operational commercial and industrial zones**  
As at June 2020

<i>Zone</i>	<i>Purpose of the zone</i>	<i>Key features</i>
<b>Commercial Zones</b>		
Commercial 1 Zone	<ul style="list-style-type: none"> <li>• Caters for commercial centres including retail, offices, business, entertainment and community uses.</li> <li>• Also allows residential spaces that complement the commercial activity.</li> </ul>	<ul style="list-style-type: none"> <li>• As-of-right uses include residential (as long as ground frontage is less than 2 metres), office, retail, restricted retail, and shops.</li> <li>• Restricted and prohibited uses are largely industrial, warehouse and large recreational facilities.</li> </ul>
Commercial 2 Zone	<ul style="list-style-type: none"> <li>• Caters for offices, some manufacturing and industry, large format retail, and related commercial uses.</li> <li>• Uses should not conflict with nearby uses.</li> </ul>	<ul style="list-style-type: none"> <li>• As-of-right uses include office, restricted retail, small-scale supermarkets and connected shops<sup>a</sup>, and warehouse and industry (with limits on proximity to certain zones and uses).</li> <li>• Uses requiring a permit include retail, agriculture, education centres and hotels.</li> <li>• Residential use is prohibited.</li> </ul>
<b>Industrial Zones</b>		
Industrial 1 Zone	<ul style="list-style-type: none"> <li>• Caters for manufacturing industry, storage and distribution, and related activities.</li> <li>• Must not conflict with nearby uses.</li> </ul>	<ul style="list-style-type: none"> <li>• As-of-right uses include industry and warehouse (with limits on proximity to certain zones and uses), animal production, and railway.</li> <li>• Restricted retail, retail, office, and agriculture require permits.</li> <li>• Shops, supermarkets and residential uses are prohibited.</li> </ul>
Industrial 2 Zone	<ul style="list-style-type: none"> <li>• Caters for manufacturing industry, storage and distribution, and related activities.</li> <li>• Caters for industrial uses that may conflict with uses in other areas.</li> </ul>	<ul style="list-style-type: none"> <li>• Crop raising, grazing animal production, railways, tramways and informal outdoor recreation are allowed as-of-right.</li> <li>• Agriculture, office, retail (other than shops), industry and warehouse require permits.</li> <li>• Residential, hospitals, shops and restricted retail are prohibited.</li> </ul>
Industrial 3 Zone	<ul style="list-style-type: none"> <li>• Designates industry to a particular area to reduce conflict between different industrial uses.</li> <li>• Provides a buffer between the Industrial 1 Zone or Industrial 2 Zone and local communities by allowing uses without adverse impacts, such as noise or dust, near local communities.</li> </ul>	<ul style="list-style-type: none"> <li>• As-of-right uses include service industries, warehouse and service stations (with limits on proximity to certain zones and uses), small-scale supermarkets and connected shops<sup>a</sup>, railways and tramways.</li> <li>• Uses requiring a permit include offices, restricted retail, retail, agriculture, education centres, and industry.</li> <li>• Residential, hospitals, some entertainment and recreation facilities are prohibited.</li> </ul>

<sup>a</sup> Supermarkets of up to 1800 square metres and connected shops of up to 500 square metres are allowed only within the urban growth boundary in metropolitan Melbourne and the City of Greater Geelong. Outside these areas, they are subject to permit requirements. In addition, these small-scale supermarkets must adjoin, or have access to, a road in the Road Zone.

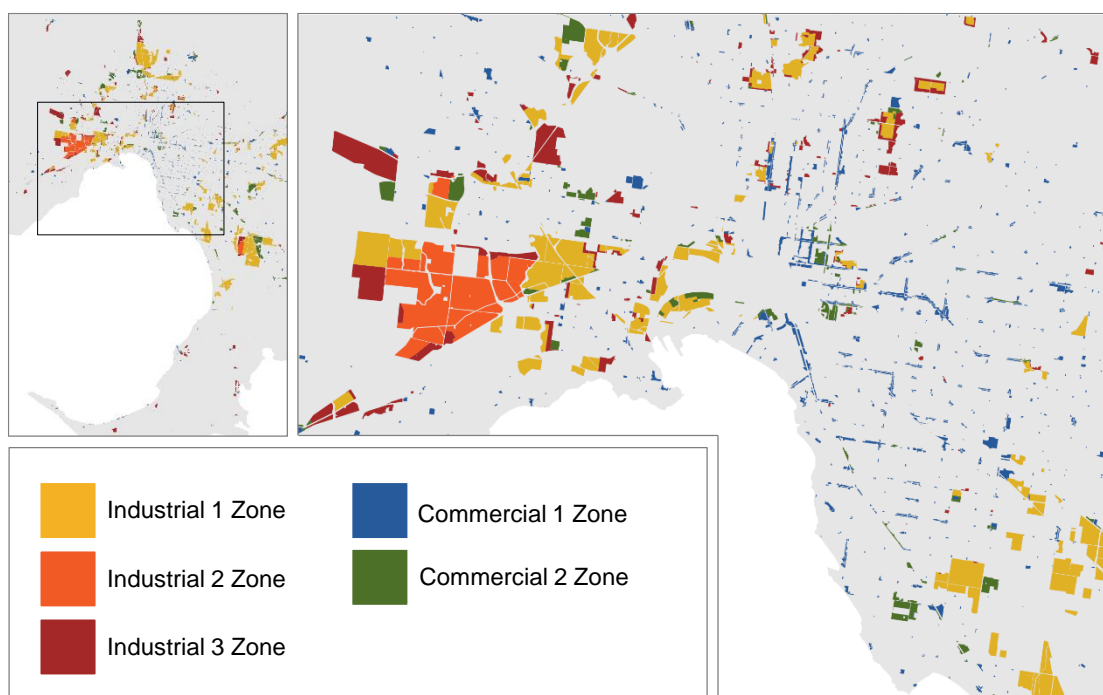
Source: DELWP (2020).

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The commercial and industrial zones operate throughout Victoria, though they are concentrated within a 40 km radius of Melbourne's CBD (figure 3). Other types of zones apply in much of Melbourne's CBD and many suburban activity centres, where a large number of businesses operate.<sup>10</sup>

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**Figure 3 Commercial and industrial zones in Greater Melbourne**  
Commercial and industrial zones as of mid-2020



Source: DELWP Spatial Datamart (2020).

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The C1Z and the C2Z replaced the previous five business zones in 2013 and made more uses as-of-right. The reforms to the commercial and industrial zones were introduced from 15 July 2013 across Victoria (although some provisions do not apply to areas outside of metropolitan Melbourne) and were mandatory. These changes effectively meant that local planners had less control over where to apply the new zones, or where particular types of businesses could open on commercial land.

To understand the impacts of Victoria's current commercial zoning system, it is necessary to understand some of the details of what it replaced.

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<sup>10</sup> Commercial activity is also allowed in various special purpose and residential zones, such as the Special Use Zone, Capital City Zone, Dockland Zone, Activity Centre Zone, Mixed Use Zone, Comprehensive Development Zone, Urban Growth Zone, Port Zone and Residential Growth Zone.



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The Commercial 1 Zone allows greater blending of commercial uses and some residential

The C1Z replaced the previous Business 1, 2 and 5 zones, which distinguished between different commercial uses in far greater detail than the C1Z. For instance, the Business 1 Zone (B1Z) focused on centres for retail stores and complementary commercial, entertainment and community activity, while the Business 2 Zone (B2Z) aimed to cater for offices and related commercial activity. The Business 5 Zone (B5Z) encouraged a mixture of offices and higher-density housing. This allowed planners to use different business zones to create buffers between activities (for example, between office and core retail) and to promote particular land uses.

Compared with the three business zones it replaced, the C1Z opened up some previously restricted uses by:

- removing the requirement to obtain permits for retail activity (such as large format retail and supermarkets) and accommodation. Large format retail required a permit in the previous Business 1 and 2 zones, and was prohibited in the Business 5 zone
- removing floor space limits for shops and offices (except for in regional Victoria, where floor space caps can be specified and existing caps from before the reforms were retained)
- removing the requirement to obtain permits for residential and office uses. Previously, residential development was allowed as-of-right (that is, without a permit) in the Business 1 and 5 zones — with some restrictions on ground frontage and shared office use — and was a restricted use (that is, allowed with a permit) in the Business 2 Zone.

The Commercial 2 Zone opened office areas to new retail formats

The Commercial 2 Zone collapsed the previous Business 3 and 4 zones. The Business 3 Zone aimed to create areas of integrated offices, manufacturing industries and other related commercial and industrial activity. The Business 4 Zone aimed to create areas for a mix of large format retail and manufacturing industry, along with related business services.

The C2Z increased allowable uses by:

- removing permit requirements for large format retail. Large format retail was a restricted use in the Business 3 Zone and was allowed as-of-right in the Business 4 Zone
- removing permit requirements and the 500 square metre floor space cap on offices in the Business 4 Zone (except for in regional Victoria, where existing floor space caps were retained). Offices were allowed as-of-right in the Business 3 Zone
- allowing as-of-right small-format supermarkets (up to 1800 square metres) and connected shops (up to 500 square metres), which were prohibited in the previous Business zones.

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- However, this change did not apply in regional Victoria (specifically, in areas outside the City of Greater Geelong and the urban growth boundary in metropolitan Melbourne), where supermarkets of all sizes and connected shops were subject to permit requirements instead. The Victorian Government made this exception to protect established centres in these areas (DELWP 2013).

Residential use continued to be prohibited in the C2Z, in line with the rules in the business zones it replaced.

## Reforms to the industrial zones allowed for greater commercial and retail use

The Victorian Government amended the three industrial zones in 2013 with the intention of catering for a greater mix of uses in the industrial zones, such as offices and some retail, to encourage business investment and to promote flexibility.

Key changes to the industrial zones as part of the 2013 reform were:

- the removal of office floor space limits in all three industrial zones — though local governments can still specify their own caps
- permitting small supermarkets (up to 1800 square metres), connected shops (up to 500 square metres), and convenience shops in the Industrial 3 Zone (IN3Z); these uses were previously prohibited.
  - As with the C2Z, this change did not apply in regional Victoria (that is, in areas outside City of Greater Geelong and the urban growth boundary in metropolitan Melbourne), where supermarkets of all sizes and connected shops continue to be prohibited in the IN3Z to protect established centres in regional towns.

## The current commercial zones have led to reduced set-up costs and greater investment

To test whether the current commercial zones achieved their intended outcomes, the Commission met with representatives of key stakeholders affected by the reforms to get their views on the reforms and obtain data to quantify the impacts.

Most business groups agreed that the more flexible zoning had reduced regulatory burden and made it easier to find appropriate sites for establishing new businesses, with some noting that standardised zones across the state provide certainty for business investment decisions. A report undertaken for the Large Format Retail Association (LFRA) noted that a lack of suitable sites can affect investment in various ways — including by causing businesses to adopt less efficient business models, establish themselves on less desirable sites, or open fewer stores (Fels and Cousins 2015). It argued that these impacts on investment can, in turn, have the flow-on effects of reducing competition and consumer choice.

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Quantifying the impacts of the 2013 reforms is inherently difficult, due to the range of other factors affecting land use decisions (section 2). Econometric analysis or modelling would suffer from a degree of subjectivity when defining an appropriate counterfactual against which to measure the impacts of the reforms.

The most direct links between the observed changes in commercial land use and the 2013 reforms were instances where businesses established new stores in areas where they were previously restricted.

- For instance, since 2013, Aldi has established 53 new stores in Victoria. Fourteen of these stores are on sites where supermarkets were restricted under the previous zones. Of these 14 stores, 12 are on sites that previously prohibited supermarkets (B3Z, B4Z and all INZs), while 2 are on sites that previously allowed supermarkets with a permit (B2Z).
- Similarly, 317 new large format retail stores have opened in Victoria since 2013. 164 of these stores (or about 52 per cent) were established on sites where they were restricted under the previous zones (C1Z and C2Z).

Businesses benefited where, under the new zone rules, they were no longer required to apply for a planning permit. In Victoria, the application fee for a change in land use permit is about \$1300 (DELWP 2020b). Cost savings as a result of more as-of-right uses could be material for many businesses, particularly small to medium sized enterprises, in cases where development also needs to occur.<sup>11</sup>

Several stakeholders noted that the 2013 reforms have reduced the need for businesses to apply for a 'spot rezoning' (that is, rezoning of specific parcels of land to facilitate a proposed development) to address a shortage of suitable sites for new stores. They noted that spot rezoning was a significant disincentive to business investment (far more so than the need to obtain a permit) due to the added costs, delays and uncertainties involved. For instance, some rezoning applications can take as much as two years or more; this makes site acquisition difficult for businesses, as land owners are unable to reserve sites for that long.

There is some, albeit limited, evidence to support these claims. For instance, five of the stores Aldi opened before the 2013 reforms required spot rezoning. In contrast, only three of the stores Aldi has opened since the 2013 reforms required spot rezoning. This is likely to have meant lower regulatory costs overall. Although the downward trend (over the past decade) in the number of approved planning scheme amendments in Victoria would be consistent with the 2013 reforms reducing the need for spot rezoning, a number of other factors are likely to be at play.

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<sup>11</sup> In practice, there are additional costs associated with obtaining a planning permit where a development needs to occur. These costs vary depending on the size of the development, and on whether or not it relates to certain types of residential uses. For instance, fees for most developments that cost less than \$10 000 or greater than \$50 million are about \$1150 or \$57 700 respectively. In some cases, these fees can be lower if an application qualifies for an expedited process through VicSmart — or they can be greater if land or buildings need to be subdivided, or if an application needs to be amended or subjected to Ministerial or authority approval.

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## Consumers have likely benefited from a more flexible system

The opening of new stores on sites where they were previously prohibited suggests that the move to broader commercial zone classifications has given consumers greater choice in retail offerings, and perhaps lower prices. However, it is difficult to draw firm conclusions on the extent of this effect, given the uncertainty about the counterfactual (that is, the number of stores that would have opened in the absence of the reforms). For example, Aldi store openings in Victoria followed a similar trend before and after 2013, suggesting that businesses may simply have found a way to expand in the absence of the 2013 reforms (figure 4).<sup>12</sup> That said, establishing these additional stores in the absence of the reforms would likely have meant businesses incurring higher regulatory costs (in locations where they were required to obtain permits under the previous zones) or accepting less desirable locations. To the extent that stores are part of national chains, the compliance costs might have been passed on to all consumers, rather than those in specific areas where zoning imposed a higher cost for setting up a retail store.

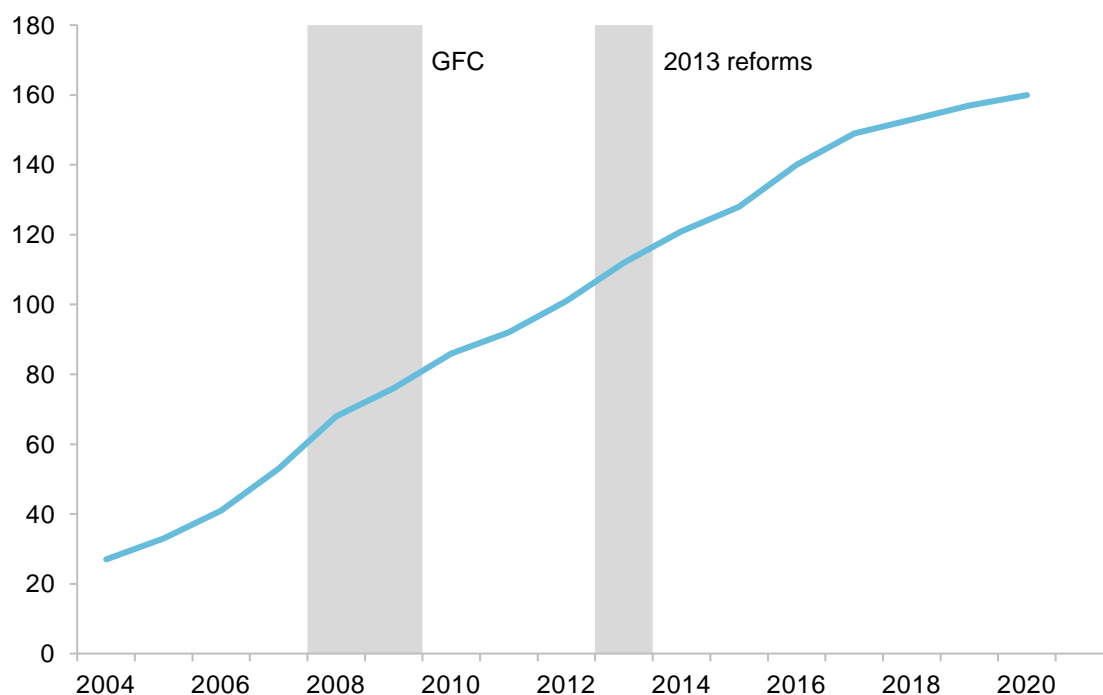
Moreover, good regulatory practice principles suggest that the imposition of a regulatory burden needs to be supported by a strong policy rationale for the restriction (box 2). Arguments for restricting retail locations (for instance, by restricting development outside activity centres) are controversial, and the merits of doing so are often debated. (Further details on out-of-centre developments are discussed in the section below.)

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<sup>12</sup> Several factors affect the number of retail store openings per year; these include population, customer base, and locational costs (including those resulting from zoning). Over time, store openings can taper off after a critical mass is achieved, or as a result of limited opportunities in areas where zoning, pricing, and other uses make securing new sites more difficult (such as in areas within a 10 km radius of the Melbourne CBD).

**Figure 4 The number of Aldi stores continued to grow similarly after the 2013 reforms**

Aldi Victoria, cumulative sum of store openings by year, 2003-2020



Source: Aldi Victoria unpublished estimates (2020).

Further evidence of benefits from the amendments is consumers' improved access to retailers as a result of more store openings. More Melburnians today can access a large format retailer within a 5-10 minute drive than in 2014 and 2011 (table 2). Further, a past study by Aldi suggested that lower-income households are likely to benefit from increased access to low-cost retail stores (Urbis 2012).

**Table 2 More Melburnians are able to access large format retailers within a 5-10 minute drive**

Proportion of population within drive time of a large format retailer (per cent)

	<i>Auto (5 mins)</i>	<i>Bedding (10 mins)</i>	<i>Hardware (10 mins)</i>	<i>Outdoor (10 mins)</i>	<i>Pets (5 mins)</i>
May 2020	55	76	86	71	43
October 2014	55	72	81	67	32
June 2011	-	-	78	-	18

Source: Unpublished estimates from Deep End Services (2020).

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## Predicted significant downside impacts have not been realised

When the government implemented the 2013 reforms, some stakeholders expressed concerns that the reforms would have adverse impacts on some businesses and be detrimental to urban amenity (City of Port Phillip 2012; PIA Victoria 2013). Specific concerns included that the reformed zones would:

- increase 'out-of-activity-centre' growth. Stakeholders were concerned that retailers such as small-scale supermarkets and large format retail would establish in areas outside activity centres (box 6) and away from public transport (that is, in the Commercial 2 and Industrial 3 zones),<sup>13</sup> with adverse impacts on:
  - businesses in activity centres
  - consumers, who would incur higher travel costs when making multiple car trips for their shopping, or who would be less able to access shops if they were unable to rely on car transport
  - the general public, from increased congestion and less efficient use of public transport infrastructure
  - the availability of industrial land for industrial activity.
- blur the distinctions between and within the zones, resulting in detrimental effects on urban amenity and the loss of 'employment land' (Buxton, Goodman and Moloney 2016; City of Port Phillip 2012; PIA Victoria 2013).

These concerns raise two questions: whether these impacts have occurred and, if so, what role government regulation and intervention might have in addressing the impacts.

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<sup>13</sup> While the changes to the IN3Z did not directly affect large format retail, which continues to be a restricted use in the zone, stakeholders were concerned about the cumulative impact of allowing small format supermarkets and connected shops to establish in conjunction with large format retail in the IN3Z.

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## Box 6      **Activity centres in Victoria**

### **What are activity centres?**

Activity centres are community areas that combine retail, employment, leisure, entertainment and often housing. Activity centres range from small community shopping strips to large centres that can contain shopping centres, entertainment venues and institutions such as universities.

Urban planners typically advocate in favour of activity centres. One potential benefit of activity centres suggested by planners is that they facilitate clusters of mixed use activity that are well-connected to public transport networks. This may reduce car use (and, consequently, congestion and pollution) and improve social equity for people who do not drive. Another potential benefit of activity centres is that they may mitigate urban sprawl by increasing housing density more ‘sustainably’ within the activity centres themselves. Planners have also suggested that activity centres may foster community engagement and social activity for residents.

### **How are activity centres incorporated into planning in Victoria?**

State planning policy documents, such as *Plan Melbourne 2017–2050*, identify activity centres — but it is up to local governments to use planning controls to facilitate and preserve those centres.

One tool available to local governments is the Activity Centre Zone, which is designed to facilitate activity centres within an identified boundary. Local governments can tailor the zone to determine uses that are allowed with and without a permit, and prohibited uses, with the aim of encouraging a mix of retail, office, community, residential, government and transport activity. In practice, however, many of Melbourne’s activity centres use commercial zones (especially the C1Z) rather than the Activity Centre Zone.

In *Plan Melbourne 2017–2050*, activity centres in the metro Melbourne area are classified into three categories:

- Metropolitan Activity Centres: centres that offer a variety of employment, activity and housing, that serve the wider region, and that are well-connected to public transport networks
- Major Activity Centres: centres for services, employment, housing, public transport and social activity that serve local suburbs
- Neighbourhood Activity Centres: local centres of activity that provide local products, services and job opportunities to meet the needs of the local community. They include small neighbourhood shopping, food and entertainment strips.

*Plan Melbourne 2017–2050* and its predecessor, *Melbourne 2030*, identified that activity centres have a role in supporting population growth by introducing higher-density housing and improving public transport access.

## **The adverse impacts of out-of-centre development are likely small**

The broadening of commercial zones in Victoria enabled commercial activity that some stakeholders characterise as ‘out-of-centre developments’: that is, significant business activity (often retail) occurring away from traditional activity centres. For example, since 2013, nine new Aldi Victorian stores and 89 new large format retail stores have been opened in the C2Z, and four new Aldi stores and 24 new large format retail stores have been

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established in the IN3Z. (Large format retailers were allowed in the IN3Z even before the reforms.) These make up about 20 per cent and 35 per cent, respectively, of the total number of their category of store opened since 2013.

Views on out-of-centre development differ vastly among stakeholders. Those critical of out-of-centre developments argue that:

- activity centres provide agglomeration benefits by co-locating various complementary uses, reducing the need for multiple trips and so lowering travel time and road congestion
- activity centres also reduce car reliance due to their proximity to public transport, and therefore lead to more efficient use of public transport infrastructure
- out-of-centre developments take foot traffic away from activity centres, decreasing their vibrancy, and thus have adverse impacts on businesses in activity centres
- businesses involved in out-of-centre developments are able to secure cheaper land in industrial areas, which gives them an unfair advantage over retailers in activity centres
- out-of-centre developments can have an adverse impact on the availability of industrial land.

These concerns warrant close scrutiny at an empirical and a conceptual level. Ultimately, regulation and government intervention to restrict land use (and thereby suppress the potential economic value of particular sites) has a direct cost; it should therefore only be imposed when the overall benefits to the community outweigh these costs (box 2).

Businesses that have set up outside centres argue that such locations are needed due to a shortage of suitable land in activity centres that meets their specific operational requirements — for instance, ample ground level car parking space for customers, and access to major arterial roads to allow trucks to dock and unload heavy goods. While large format retailers previously had their own zone (the Business 4 Zone) that recognised their unique nature, the availability of suitable land has been an issue for some LFRA members (as discussed previously) and potentially other businesses.

To some extent, the nature of some (but by no means all) goods sold by large format retailers also makes it impractical to carry them on public transport. Together with structural changes in retail and consumer behaviour, such as the relative decline in the department store model and the rise of online shopping and ‘click and collect’, this could militate in favour of large warehouse-type stores for storage and distribution.

There is an argument that the emergence of ‘homemaker centres’ (where large format retailers co-locate outside activity centres) also provide agglomeration benefits. They can be seen as creating activity centres in their own right: places where complementary activity is concentrated (figure 5). In many instances, uses such as gyms and health centres, medical centres, child care and small offices co-locate with supermarkets and large format retailers, in much the same way as small businesses locate near anchor tenants in shopping centres. Increased car use becomes less of an issue if consumers are able to shop for



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complementary goods in a single trip and, with the use of longer store opening hours, congestion can be minimised.

In regional areas, the emergence of out-of-centre developments (both in Australia and overseas) often raises concerns about detrimental impacts on the viability of the traditional activity centre (such as the main street of a small town), with negative flow-on effects for communities. Given this sensitivity, it is notable that the 2013 changes to allow small-scale supermarkets and connected shops in the C2Z and IN3Z did not apply in regional Victoria to protect the established centres there.

As the Commission has previously argued, declines in activity centres often reflect changing consumer preferences, and so are not always a direct consequence of the out-of-centre development (PC 2011a). Equally, locational competition can bring community benefits. Several reports on competition (such as the *Competition Policy Review* (2015)) have found that, among other things, the impacts on competition between individual businesses, and proposed developments on the viability of existing businesses should be irrelevant for planning matters (Harper et al. 2015; PC 2011a). This is because planning and zoning laws can create barriers to business entry and/or restrict competition, leading to a lower variety or quality of goods and services. Adverse impacts from competition should only be considered when future planning is conducted, not when a development proposal is being considered (PC 2011a).

A related concern is the availability of industrial land. In Melbourne, State Significant Industrial Precincts (SSIPs)<sup>14</sup> are zoned IN3Z and IN2Z, where only limited retail activity is allowed. These sites are not a natural fit for core retail activity. There is a case for large format retail in industrial areas to the extent that it is established on vacant or underutilised industrial land (which generally meets the requirements for large format retail use), particularly in the industrial areas outside the SSIPs. In response to concerns about the availability of industrial land, the Victorian Department of Environment, Land, Water and Planning (DELWP) has indicated that it will review the range of uses permitted within industrial zones, especially non-industrial uses (DELWP 2020a).

Overall, it is difficult to find clear evidence that out-of-centre developments have had adverse impacts that warrant regulatory restriction.

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<sup>14</sup> State Significant Industrial Precincts have been identified by *Plan Melbourne 2017-2050* (DELWP 2017) and the Victoria Planning Provisions as areas that provide strategically located land for major industrial development linked to freight and transport networks.

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**Figure 5      Large format retailers often co-locate**

Large format retailers in Preston (as at July 2020). [View a historical Google street view of this location.](#)



Sources: Google (2020); Productivity Commission (2020).

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### Fewer zones with more allowable uses lead to more ambiguous zone types

As discussed previously, prescriptive zoning can allow local governments and planners to specify what types of activity can occur in a given area and where (section 1). Moving to a more flexible zoning system that permits a wider range of uses and/or uses not subject to permit requirements can blur the distinctions within and between zone types. For instance, allowing small-scale supermarkets in IN3Z makes the distinction between industrial and commercial zones less clear.

In practice, depending on the design, the same can be said for the distinction between commercial and residential zones. Collapsing Victoria's five business zones into two has meant allowing uses that were previously restricted to coincide with other uses. For example, the B5Z allowed as-of-right residential use and prohibited retail activity, while the B2Z allowed as-of-right offices and required permits for residential and retail use. Under the C1Z that replaced these zones, all office, residential and retail activity is allowed without the need for a permit, thereby obscuring the differences between the zones.

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***There is evidence of medium rise developments in traditional retail strips, but other regulatory tools can be effective in managing adverse effects on amenity***

Stakeholders expressed concerns that having fewer zones with wider ranges of permissible uses (particularly uses that no longer require permits) would lead to a proliferation of medium rise, mixed use developments that detract from the urban amenity and heritage value of traditional retail strips (Buxton, Goodman and Moloney 2016). This view is often shared by planners and local communities.

To gain insights into these effects, the Commission examined aggregate data on changes in land use, as well as pictorial evidence from before and after 2013 for selected developments suggested by participants and identified through desktop research.

Examining current and historical images of urban streetscapes in current C1Z areas reveals that some have changed dramatically, including through the increased prevalence of medium and high rise residential developments (figure 6). For example, the reforms enabled the 2017 construction of Whitehorse Towers in Box Hill — the tallest building in Victoria outside Melbourne’s CBD — in the C1Z.

However, it is difficult to ascertain the extent to which the reforms have contributed to the proliferation of high density developments in strip retail areas since 2013. This is because residential developments were allowed in the former business zones that the C1Z replaced (residential use was allowed as-of-right in the Business 1 and 5 zones, and with a permit in the Business 2 Zone). Google Maps street view shows that the emergence of medium rise residential developments in commercial zones pre-dates the reforms. So, while someone looking at the changing streetscape in, say, Lygon Street in Carlton might associate it with the 2013 reforms, some of the changes might still have occurred in the absence of the 2013 reforms. On the other hand, some of the areas thought to be under pressure for increased development have not changed as much.

Quantitative evidence from the Department of Environment, Land, Water and Planning (DELWP) show the prevalence of high density residential in commercial areas (including the C1Z, where core retailing occurs) before the reforms. Between 2005 and 2016, development projects that combined a mix of commercial and residential uses in the Capital City Zone and C1Z were usually at high densities, yielded a significant number of new dwellings (greater than 10 dwellings per project) and were often near transport and services (DELWP 2018b).

While high density residential can be seen by some as detrimental to the amenity of an area, it plays an important role in balancing providing for a growing population and managing the scarcity of land. These developments increase housing supply to provide more affordable housing and reduce urban sprawl, congestion and environmental impacts.

Stakeholders have previously suggested implementing built form restrictions (such as maximum building heights) in the C1Z schedule to address the impacts on urban amenity and heritage. However, regulations specifically designed to manage built form can be

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effective in addressing any adverse effects on amenity. Indeed, several participants in this case study, echoed by the *Managing Residential Development Advisory Committee Report* in 2016 (p. 134), said that the use of overlays such as heritage and design and development overlays in conjunction with the zones has worked well. The report also found that there is no need for more such restrictions in the C1Z schedule (DELWP 2016).

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## Figure 6      **The changing face of commercial zones in Melbourne**

Street view of selected areas today (as at July 2020)

Whitehorse Towers, Box Hill. [View a historical Google street view of this location.](#)



High Street, Northcote. [View a historical Google street view of this location.](#)



Sources: Google (2020); Productivity Commission (2020).

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### ***Residential development has increased on ‘employment land’***

When commercial zones allow residential activity (and particularly when that activity is as-of-right), a significant concern for stakeholders is the increased risk of residential encroachment on commercial land. Once commercial land is developed for residential use, it can be difficult to redevelop it for other uses, leading to a reduction in ‘employment land’ (City of Port Phillip 2012; PIA Victoria 2013).

As discussed in section 2, high population growth has increased demand for residential land. This high demand is also reflected in the commercial areas that allow residential use — particularly since 2013, with areas that previously restricted residential uses now allowing them without requiring a permit. Data from DELWP show that 30 per cent of all residential development in 2005–2010 occurred in commercial and Mixed Use zones, increasing to nearly 50 per cent of all residential development in 2011–2016, with a third of the growth in the latter years occurring in the C1Z (DELWP 2016).

However, residential development in commercial areas can be complementary with, rather than crowding out, commercial uses. Some submissions to DELWP’s advisory committee report have argued that residential use contributes to the vitality and viability of activity centres and meets government policy objectives in co-locating residential use with transport and employment-generating uses (DELWP 2016).

Concerning fears about residential encroachment on commercial land, the advisory committee agreed that market dynamics have led to more residential investment rather than commercial investment in some activity centres. This is likely a result of residential being the ‘highest and best use’ of land, particularly in inner-city local government areas (box 4). The committee recommended that, as the C1Z is applied more extensively and is the predominant zone in activity centres, residential development should require a permit instead of being an as-of-right use in the zone.

To date, the advisory committee’s recommendations have not been implemented. However, DELWP has indicated that it will review the commercial and industrial zones, with particular regard to the role and function of dwellings in the C1Z (DELWP 2020a).

### ***Other impacts on urban amenity***

In addition to the concerns discussed above, stakeholders were worried about other possible detrimental impacts of the 2013 reforms. For instance, one stated concern was that the amendments, by allowing education uses, offices without a customer service component, and residential development in activity areas, would fail to ensure that ‘active’ parts (such as reception areas) would be located on the ground floor (PIA Victoria 2013). It was said that this could lead to activity gaps and detract from the local vibrancy of the area. However, it is difficult to identify particular cases where this has occurred specifically as a result of changes to the zoning rules. Some stakeholders also noted that other instruments operate to protect urban amenity (as discussed previously).

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While many of the impacts described above are difficult to measure, several stakeholders agreed that their worst fears about the reforms have not been realised.

## 4 The Commercial 3 Zone

### What is the C3Z trying to achieve?

Since the release of *Shifting the Dial* in 2017, the Victorian Government has introduced a third commercial zone — the C3Z. The purpose of the C3Z is to promote areas of mixed employment activity, including industrial, commercial, office and other mixed use activity. Its introduction coincided with the release of the Victorian Government's *Unlocking Enterprise in a Changing Economy* (DELWP 2018c), which identified a need to support emerging types of business (including creative industry, small-scale manufacturing and start-ups, among others) to promote innovation, productivity and employment. The Victorian Government noted that the C3Z is one of several tools available to support the development of suitable locations for these businesses; other tools include new uses of government land and direct subsidisation.

The C3Z has not yet been implemented — that is, inserted into a local planning scheme — by any local government. Stakeholders noted that this partly reflects the time lags for local governments in identifying whether there is a need for the C3Z in particular sites before including it in their planning schemes. Unlike the C1Z and the C2Z, which automatically replaced the existing Business zones, the C3Z is an optional (and additional) tool for local governments.

The C3Z is partly premised on the view that existing commercial, industrial and mixed use zones do not adequately cater for new and emerging businesses. In particular, arguments put forward in policy and background documents include that:

- current industrial and commercial zones contain provisions and land use definitions that do not reflect changing business models, and therefore inhibit business set-up (particularly for small- and medium-sized businesses) (SGS 2018a)
  - These include requirements to obtain permits for co-locating activities that have a low risk of conflict with neighbouring uses: for example, small-scale manufacturers that combine manufacturing, design and retail and do not produce significant noise or pollution. Essentially, the C3Z reflects a desire for more flexibility in the types of commercial activity allowed by zoning.
- current commercial and mixed use zones provide insufficient powers to constrain residential encroachment on employment land (SGS 2018a)
  - This argument suggests that while flexibility in commercial activity is desirable, it is also necessary to restrict the flexibility of other uses (such as housing).

Although the C3Z can be applied by local governments anywhere in Victoria, the background documents underpinning the C3Z focus on its potential as a means of repurposing old industrial



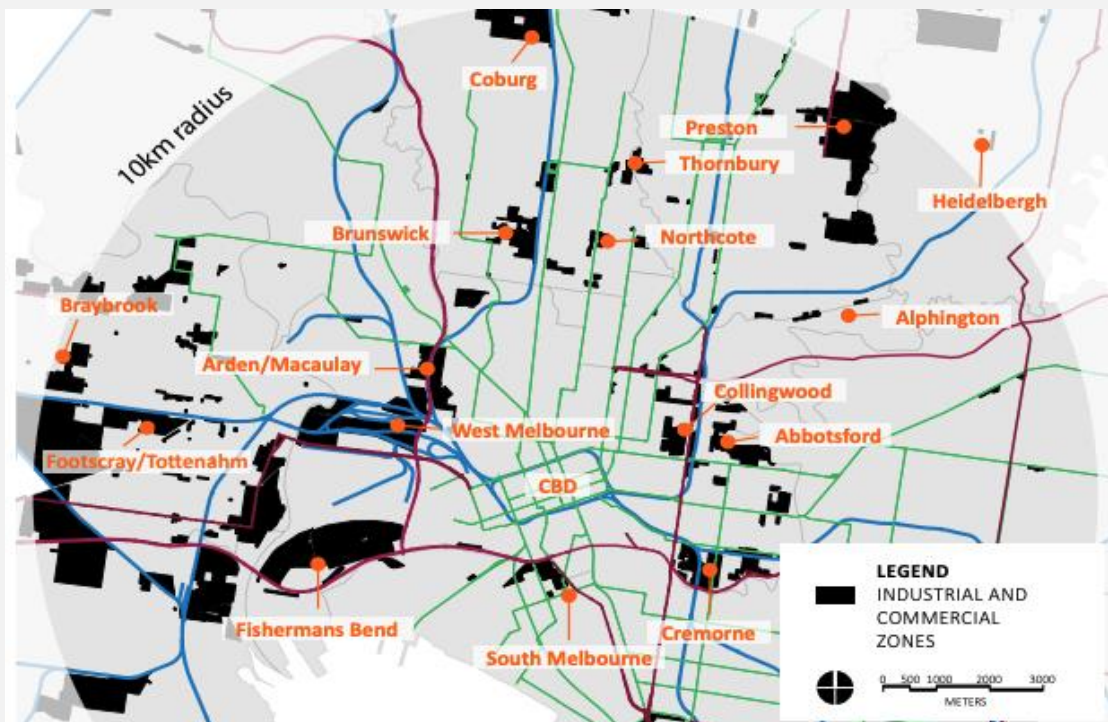
areas of inner Melbourne (box 7). The motivation for the C3Z partly rests on the proposition that supporting certain emerging industries is important because they are expected to have a growing role in total employment, and are required to promote specialisation and comparative advantage (as more traditional forms of manufacturing have comparative advantages overseas) (Echelon 2018). Creative Victoria (2019) estimated that creative industries accounted for 12 per cent of Victorian employment in 2018–2019.

### Box 7 Areas targeted by the Commercial 3 Zone

In developing the C3Z, the Victorian Government commissioned Echelon Planning and SGS Economics & Planning to prepare background reports to help inform the new zone.

Echelon noted that new creative industry, small-scale manufacturing and start-up businesses are often attracted to inner Melbourne's older industrial areas (such as Cremorne and Brunswick). These areas are often unsuitable for modern large-scale manufacturing, and can cater for small 'emerging' businesses by offering large, flexible spaces that are relatively affordable for their inner-city locations (Echelon 2018). Businesses may also benefit from using these sites as they are close to public transport, complementary institutions such as universities and research centres, and a larger pool of specialised labour (Echelon 2018; SGS 2018a).

Both Echelon and SGS noted that a challenge is protecting these older industrial areas from being transformed into residential areas. SGS suggested that residential development tends to yield higher sales prices than other types of development on these sites (SGS 2018a). SGS argued that this results in a loss of employment-generating activity on sites once they are developed for housing, and a corresponding loss in economic activity and taxation revenue (SGS 2018a). The 'loss' of these industrial sites to residential development is then expected to displace creative industry, small-scale manufacturer and start-up businesses from these areas (Echelon 2018).



Source: (Echelon 2018, p. 58).

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## How does the C3Z work?

The C3Z aims to cater for emerging types of businesses by allowing a range of business activity to encourage flexibility, while also allowing only a restricted level of residential and retail space to improve the amenity and vibrancy of the sites. To this end, the C3Z:

- allows a broad range of employment uses without a permit, including offices, art and craft centres, home-based businesses, low-impact industry and manufacturing sales
- allows retail with a permit, and with a maximum of 200 square metres of floor space
- allows residential with a permit, provided that it accounts for no more than 35 per cent of floor space in a building (though local governments can alter this to between 0 and 50 per cent). This is intended to improve the amenity of a site without taking over from commercial activity (DELWP 2018a). Limited residential development also acts as a 'sweetener' to improve the financial attractiveness of mixed use developments for developers (Echelon 2018).

The C3Z offers greater flexibility than the Industrial 3 Zone and Commercial 2 Zone (which also cater for some light industry and commercial activity) in that it allows a mix of light industrial, commercial and limited residential and retail activities that is not possible in those zones. However, the C3Z introduces greater restrictions on retail use than either of those two zones.

## Stakeholders hold a variety of views on the C3Z

Stakeholders presented a variety of views on the C3Z. A number of local governments saw potential in using the C3Z to encourage mixed use employment, but noted that certain drawbacks made it less attractive than other zoning tools. In particular, some local governments saw the 50 per cent cap on residential floor space ratios as being too low to make developments financially viable.

Several businesses and representative bodies in industries targeted by the C3Z supported allowing more uses without a permit as a way to remove unnecessary regulatory burden. However, other groups questioned whether this would have a material impact on the businesses' locational decisions, and suggested that zoning on its own does not provide enough incentive to encourage relocation or establishment. Indeed, other factors (such as access to investor networks) were considered far more important incentives. Other groups indicated that existing tools such as zones and overlays already catered for emerging types of businesses.

Some stakeholders suggested that the C3Z could be counterproductive in assisting small businesses because it allows some residential use. First, there was concern that introducing residential activity into industrial areas (if rezoned to the C3Z) might promote gentrification and increase land values in these areas, pricing out small businesses. Second, housing was considered a sensitive use that might conflict with commercial and industrial activity in the area, thereby deterring new businesses.



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A further objection to the C3Z was that it unfairly restricts certain activity (such as retail sites greater than 200 square metres). Some stakeholders saw the C3Z's focus on providing affordable accommodation for emerging business as 'picking winners', and questioned whether a job in an emerging industry was inherently more valuable than a job in retail.

### **Does the C3Z improve flexibility or 'pick winners'?**

Although no local government has yet implemented the C3Z, some arguments put forward in its favour seem more compelling than others.

One of the arguments for the C3Z is that the wide range of uses allowed without a permit reduces unnecessary compliance costs for small businesses. In this regard, the C3Z is consistent with the longer-run evolution of Victoria's commercial and industrial zones in promoting flexibility, competition and innovation.

However, many of the creative industry, small-scale manufacturer and start-up businesses targeted by the C3Z already exist in Melbourne within existing zones, such as in Cremorne and Brunswick.<sup>15</sup> The existing commercial zones allow various activities without a permit that are also included in the C3Z, such as art and craft centres (C1Z and C2Z), art galleries (C2Z), light industry (C2Z) and warehouses (C2Z), as well as offices and some retail (C1Z and C2Z). The only additional as-of-right uses allowed in the C3Z that are restricted in the existing commercial or industrial zones are manufacturing sales, markets, places of assembly and research centres.

Hence, in reality, the C3Z may lower compliance costs for a limited range of business activity in comparison with existing commercial zones. A broader question is whether manufacturing sales, markets, places of assembly and research centres should require a permit in existing commercial zones (because of the potential conflicts with other uses) or should be as-of-right. It may be simpler to allow additional uses without a permit in the existing commercial zones, though this would also involve some costs in amending the commercial zone schemes.

A further argument for the C3Z is that there are economic benefits (such as innovation and increased productivity) that follow from supporting creative industry, small-scale manufacturers and start-ups (SGS 2018a), specifically by restricting some competing uses such as significant retail activity. The logic of such a restriction is to suppress the value of the site (or relevant part thereof) in order to make it more affordable for the intended use. This has the effect of an indirect subsidy for emerging types of business. Designing a bespoke zone for this purpose imposes costs on the community as well as providing benefits to the chosen industry.

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<sup>15</sup> Cremorne was identified in *Analysing Melbourne's Enterprise Precincts* as a significant enterprise precinct with a concentration of professional, scientific and technical services, and contained about 11,900 jobs in 2016 (SGS 2018a, p. 43). Brunswick (especially Brunswick South) was also identified as an enterprise precinct, with a concentration of jobs in design, including manufacturing, and contained about 3,600 jobs in 2016 (SGS 2018a, p. 43).

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From an economic efficiency perspective, special government support for particular industries is only warranted where there are demonstrable additional benefits (also called spill-overs) for the broader community. These benefits may arise through knowledge- and technology-sharing between businesses that locate near one another. In the case of the C3Z, the business categories are broad and can include a wide range of activity — including arts and crafts centres, furniture making, graphic design, tech start-ups and performing arts businesses. Spill-over benefits are difficult to quantify, and these industries likely differ greatly in the types of spill-over benefits they provide.

As the C3Z is intended for small industrial sites, as distinct from large state-significant industrial areas, the benefits of small businesses grouping together in clusters may be constrained. The existence and size of these benefits varies in economic literature — although, anecdotally, they can be important (Greenstone, Hornbeck and Moretti 2008). However, there is very limited evidence of governments successfully implementing policy (especially zoning) to create this effect, as businesses tend to establish in certain locations as part of entrepreneurial decision making (Greenstone, Hornbeck and Moretti 2008; Nathan and Overman 2013).

Even if the clustering of ‘emerging’ types of business is likely to result in significant spill-over benefits, it does not follow that the C3Z would be the most efficient way to encourage such developments. For example, the C3Z’s Planning Practice Note (DELWP 2018a) identified the zone as a way to ensure affordable workspaces for emerging industries by restricting other uses (namely retail and residential) from competing for this floor space. However, there are other options for industry assistance that are more transparent and better targeted.<sup>16</sup> For example, direct subsidisation of accommodation may provide clearer financial incentives than restrictive zoning, and may offset some of the other costs for small businesses of setting up in inner-city areas. Alternatively, government land could be allocated to particular businesses identified through a merit-based application process.

One argument for the C3Z is that it could serve as a transitional zone for older industrial sites. For older inner-Melbourne industrial areas that are no longer viable for their traditional uses, the C3Z may help to introduce a wider range of activity without losing the employment function of the area. Clearly, these older industrial areas could also be rezoned to the C1Z or the C2Z as another way of introducing a greater range of employment uses. However, the C3Z may strike a balance in the amount of residential activity allowed. The C2Z prohibits

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<sup>16</sup> The European Union Commission’s (2016) paper *Smart Guide to Cluster Policy* argued that modern policy to encourage clusters of business activity should aim to help create favourable business conditions for firms, rather than ‘picking winners’. It suggested that the role of government can be to provide appropriate incentives to entrepreneurs and organisations, while ultimately recognising that clusters emerge through market-driven processes. It noted that ‘this market process is subject to market failures and is strongly affected by policy choices’ such as collective action problems (coordination failures), externalities that lead to inadequate investment in innovation, and externalities and path dependency (p. 17). It also recognised that cluster policies should not have a narrow sectoral focus, but rather should take advantage of regional comparative advantages to explore new emerging industries.

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residential uses, which may make these industrial sites less appealing solely for commercial development. On the other hand, the C1Z allows residential development without a permit, and may allow residential development to encroach too far on employment activity.

As the C3Z restricts the amount of residential floor space while allowing a flexible range of commercial and light industrial uses without a permit, it maintains some option value for future uses of the land, given that commercial and industrial land often faces pressure from residential development (DELWP 2020a).<sup>17</sup> Having some flexibility in the land uses permitted on these sites would make them more likely to meet future land use needs, and would allow more higher-value uses on a site.

Given the benefits of flexible and standardised zoning, it is important that arguments for maintaining (or introducing) complex zoning arrangements are subject to close scrutiny. The C3Z is a commendable attempt by the Victorian Government to experiment with commercial zoning. However, good regulatory practice principles applied in other areas of public policy highlight the need to clearly establish the case for regulation, compare the benefits and costs of a range of feasible policy options, and ensure that the benefits to the community as a whole of the restrictions on competition outweigh the costs (box 3).

## 5 Lessons for policymakers

Zoning is a way of guiding urban development to mitigate land use conflicts and promote public benefits. The challenge for policymakers is how to design zoning arrangements to maximise the benefits and minimise the costs — or, put another way, how to determine the respective roles that regulation and markets should play in directing economic activity and land use. In Australia, it is widely accepted that enhancing the amenity and productivity of land use requires some combination of regulation and markets; however, there is inevitable debate over the right balance.

Victoria's commercial zoning arrangements are comparatively flexible and market-driven, in that:

- there are relatively few commercial and industrial zones, with each zone covering a broad range of uses
- the zones are standardised
- the zones allow many commercial uses as-of-right (without a permit).

This flexibility has benefited businesses, and probably also consumers (via greater retail offerings), by reducing impediments to investment. There is limited evidence that the significant negative impacts predicted to result from the 2013 reforms have come about, although some stakeholders maintain that the more market-driven approach has detracted

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<sup>17</sup> The *Melbourne Industrial and Commercial Land Use Plan* (2020a) recognised that residential development is unlikely to be available in the future for commercial uses (p. 31).

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from urban amenity or unfairly affected some businesses (such as those that have lost business due to out-of-centre developments).

Opinion is divided on the merits of C3Z, including among planners. The C3Z is more flexible than the other zones in some ways but more restrictive in others. For some, the C3Z is partly a response to the overly permissive nature of existing commercial zones, and gives planners back some control over development, such as through the restrictions on retail activity and the ability to preference selected 'emerging' industries. Others question its merits. On its face, the C3Z has the potential to increase the productivity of land use while maintaining the option value of preserving employment land in specific locations (that might otherwise be lost due to residential encroachment). As a way of transitioning to higher value use for former industrial sites, the new zone has merit. However, its merits as a form of industry assistance are more questionable.

There are trade-offs to relying more on pricing to allocate land rather than regulation, and vice versa. These trade-offs are often difficult to quantify and necessitate some judgment. Moreover, debates about the benefits and costs of zoning reform often reflect different philosophical views, particularly among economists and planners. As one American academic put it:

Economists and planners are often at loggerheads. Economists see the strengths of markets; planners see their weaknesses. When a market fails in some respect, economists favor pricing solutions, while planners favor regulatory solutions. Economists tend to be pragmatists; planners tend to be idealists. Economists generally respect consumer tastes, while planners often challenge them. Though the philosophical differences between economists and planners are difficult to reconcile, a more productive dialogue between the two groups is possible if each better understands the language and the logic of the other. (Arnott 2011, p. 51)

Some land use issues appear more amenable to regulatory intervention than others. For example, relatively restrictive regulation may be warranted in cases where there is a risk that leaving the allocation of land to the market would entrench poor land use outcomes. Land, once developed for a particular use, can be costly, difficult and slow to redevelop for other uses. This can entrench poor outcomes and negative spill-overs arising from genuinely incompatible uses, and can also lead to missed opportunities to provision for future growth and promote positive spill-overs (for example, by helping secure efficient provision of employment land, public open space, and areas for public infrastructure). In such cases, poor land use outcomes can be difficult or costly to reverse and so a proportionate regulatory intervention may be the most efficient approach. There is also a role for governments (local government, or a suitably constituted independent panel) to apply some restrictions on built form.

However, restrictive regulation is much less likely to be efficient when it seeks to determine the specific mix of economic activity allowable within commercially or industrially zoned sites. The market generally performs this allocative task efficiently and flexibly. This is consistent with the position, as outlined in *Shifting the Dial* and previous reports, that there

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is value in taking a flexible approach to land use zoning. Such flexibility will be particularly valuable given the current uncertainties surrounding future patterns of commercial land use (such as those created by the COVID-19 pandemic).

There is merit in all State and Territory jurisdictions considering ways to make their commercial and industrial zoning arrangements more flexible to support a broader range of uses. Each jurisdiction starts from a different point, with different institutional and policy histories — so it is overly simplistic to say that other states or territories should adopt or replicate the precise parameters of Victoria’s model for commercial and industrial zoning. Victoria, too, could potentially make its system more flexible, such as by expanding as-of-right uses in its commercial zones.

Each jurisdiction could gain from measured reforms in this area. This case study illustrates that greater flexibility can be achieved, generating positive economic outcomes without undermining the appropriate role for land use regulation in managing ‘spill-overs’ and contributing to the public good.

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# Glossary and abbreviations

## Glossary

As-of-right	Land uses that do not require a permit in a zone, under the planning scheme.
Activity centres	Community areas that combine retail, employment, leisure, entertainment and often housing. Activity centres range from small community shopping strips to large centres that can contain shopping centres, entertainment venues and institutions such as universities.
Bulky goods retail	See 'large format retail'.
Creative industry	Includes a range of business activity that use 'creative' processes and/or ideas to create value for customers. Activity may include fields such as arts, screen, design, publishing and advertising.
Emerging businesses	Includes creative industry, small-scale manufacturer and start-up businesses. For example, a business that develops new medical technology.
Employment land	Land that is used for activity that supports ongoing employment. For example, land used for commercial, retail and/or industrial activity that supports jobs.
'Industrial' industries	Includes electricity, gas, water and waste services; manufacturing; transport, postal and warehousing; and wholesale trade.
'Knowledge-based' industries	Includes administrative and support services; financial and insurance services; information media and telecommunications; professional, scientific and technical services; public administration and safety; and rental, hiring and real estate services.
Large format retail	Large format or bulky goods retailers sell large, heavy or bulky items such as household and office furniture, equipment and appliances, sporting goods and automotive parts and accessories. They require large areas for the handling, display and storage of goods. In the Victoria Planning Provisions, these retailers are called 'restricted retail'.

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Mixed Use Zone	A residential land use zone in Victoria. The zone aims to foster a mix of commercial, industrial, higher-density housing and other uses to promote mixed-use areas. As-of-right uses include housing, retail, offices and shops.
Out-of-centre development	Refers to the establishment of retail in core commercial and/or industrial areas, outside of designated activity centres.
‘Population-serving’ industries	Includes health care and social assistance; education and training; and accommodation and food services.
Restricted retail	See ‘large format retail’.
Small-scale manufacturing	Businesses that combine design and production to produce goods to sell, typically in small batches (as opposed to large-scale manufacturing, where goods may be mass-produced).
2013 reforms	Refers to Victoria’s reforms to commercial and industrial land use zones in 2013 (which were part of broader zoning reforms). The changes included merging five business zones into two new commercial zones and amending the three industrial zones.

## Abbreviations

B1Z, B2Z, B3Z	Business 1 Zone, Business 2 Zone, Business 3 Zone
B4Z, B5Z	Business 4 Zone, Business 5 Zone
C1Z, C2Z, C3Z	Commercial 1 Zone, Commercial 2 Zone, Commercial 3 Zone
CBD	Central business district
DELWP	Department of Environment, Land, Water and Planning
INZ	Industrial Zone
IN1Z, IN2Z, IN3Z	Industrial 1 Zone, Industrial 2 Zone, Industrial 3 Zone
LFRA	Large Format Retail Association
MICLUP	Melbourne Industrial and Commercial Land Use Plan
PC	Productivity Commission

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# Appendix A: Meetings

The Commission held meetings with a range of companies, individuals, industry bodies and government agencies (table 3). The Commission is grateful for the input stakeholders provided throughout this study.

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Table 3      **Meetings**

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Aldi Victoria
City of Maribyrnong
City of Yarra
Colliers International Australia
Department of Jobs, Precincts and Regions
Echelon Planning
HWL Ebsworth Lawyers
Large Format Retail Association
LaunchVic
Moreland City Council
Plan2Place Consulting
Planning Institute of Australia
Reserve Bank of Australia
School of Global, Urban and Social Studies, RMIT University
SGS Economics and Planning
Shopping Centre Council of Australia
Space Tank Studio
Urban Development Institute of Australia (Victoria)
Victorian Planning Authority
Whitehorse City Council

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