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IPART review of the Local Government Rating System

Submission from the Property Council of Australia

14 October 2016

Introduction

Revenue generated by rates is generally the greatest source of income for local councils and supports vital services and infrastructure for residents.

The Property Council supports a fair and transparent system whereby rates are raised equitably from all four categories of land use as laid out in the *Local Government Act 1993.* Our view is that the current system is working well and that with some minor changes it could deliver an even more sustainable income stream to local councils without excessive burden to rate payers.

We are concerned however that a significant structural change to the rating system is being recommended by IPART to ensure a 'fair contribution' from multi-residential units. In this submission we suggest alternative ways of addressing this issue that will not have the same severe negative impacts.

Our recommendations also extend to the potential impacts of introducing CIV as a base for the rating system, growth outside the rates peg and policy around exemptions.

More generally, we would make the following observations on the process to date:

- [redacted]ly on the [redacted] in many local government areas, non-residential categories bear in excess of 50 per cent of the rates burden. More consideration is needed for the impacts of a rates change on these non-residential categories.

- We would recommend that research be conducted into the flow-on effects of that the recommendations of the draft report may have on tenants and business associated with commercial property owners. It is likely to be substantial and should be a key consideration of the IPART report.

- The Property Council deems the comments made by IPART on the Emergency Services Property Levy (ESPL) well outside the scope of the review. The tax is levied by a different level of government and has been finalised in its current form. It should not be the subject of any recommendations from IPART as part of the current review.

About the Property Council of Australia

The Property Council of Australia is the nation's peak representative of the property and construction industry.

Our 2,000 member firms and 55,000 active individuals span the entire property and construction industry, which includes all:

- dimensions of property activity — financing, funds management, development, ownership, asset management, transaction and leasing.
- major property types — offices, shopping centres, residential development, industrial, tourism, leisure, retirement and infrastructure.
- major regions of Australia and international markets.
- four quadrants of investment — public, private, equity and debt.

Our relationship with local government is a critical one. We provide a major source of revenue through the provision of property related services, contributing to the billions collected by [redacted] charges. [redacted]

In particular, our members contribute to local government infrastructure through significant development levies. In 2014-15, councils collected $601 million via these levies – with over $1.3 billion in levies sitting unspent in council accounts across Sydney's 39 councils.[1]

We are also a major user of local government services. Our members rely on councils to progress development applications so they can do business. In 2014-15 (the most recent public data), councils approved 90,183 development applications, worth $34.10 billion.

The property and construction industry also underpins the health and prosperity of the NSW economy. The industry:

- generates over 311,000 jobs - one in ten workers
- provides $20.3 billion in wages to workers and their families
- pays $9.8 billion in State taxes to the NSW Government – the State's single largest tax payer
- is levied an additional $7.2 billion in local council rates and charges annually
- contributes $54.5 billion directly to Gross State Product – 11.1 per cent of total GSP, and
- creates $88.3 billion in flow on activity.

[1] Property Council of Australia – Regular Audit 2014-15

The current status

In April 2013 the NSW Treasury Corporation released a report on the *Financial Sustainability of the New South Wales Local Government Sector*. The report found that the majority of councils report operating deficits, an unsustainable trend. The cumulative operating deficits for all councils over the 2009 to 2012 review period in NSW totalled $1 billion.

The report found that the sustainability position over the short term for nearly 50 per cent of all councils was expected to deteriorate, with 70 of the 152 councils in NSW (46 per cent) expected to be rated as weak or lower within three years.

As at 2012 the infrastructure backlog for councils was $7.4 billion. It is clear that the status quo needs to change.

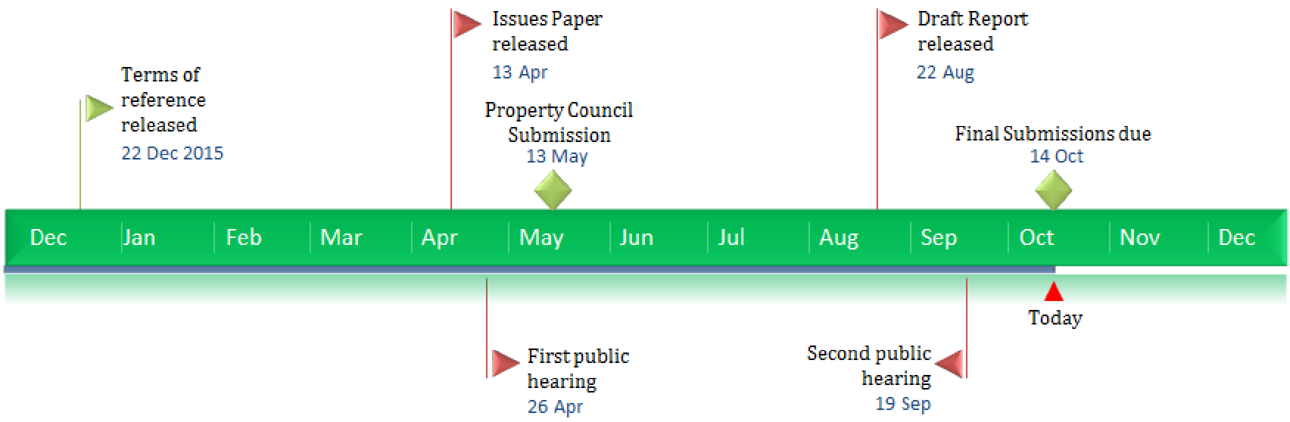
The NSW Government's *A Plan for Growing Sydney* has a vision for Sydney being a strong global city and a great place to live.

By 2031, Sydney's economic output will almost double to $565 billion a year and there will be 689,000 new jobs. In the 20 years to 2031, Sydney's population will grow by 1.6 million people. [redacted] need around 664,000 additio[redacted]xt 20 years, which is an [redacted]e. [redacted]

In December 2015, IPART was requested by the Premier to undertake a review of the local government rating system in NSW. The aims of the review as laid out in the Terms of Reference are as follow:

- Enhance the ability of councils to implement sustainable and equitable fiscal policy; and
- Provide the legislative and regulatory approach to achieve the Government's policy of freezing existing rate paths for four years for newly merged councils.

Timeline snapshot



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Areas addressed by the Property Council's submission

The Property Council welcomes the opportunity to provide a further submission as part of the ongoing review into the rating system currently being undertaken by IPART. Our comments will be relevant to the following recommendations made in the draft report:

- The rating burden across and within communities, including consideration of apartments and other multi-unit dwellings;
- The appropriateness and impact of current rating categories and exemptions, mandatory concessions and rebates;
- The land valuation methodology used as the basis for determining rates in comparison to other jurisdictions;
- The impact of the rating system on residents and businesses of a merged council and the capacity of the council to establish a new equitable system of rating and transition to in a [redacted]y manner. [redacted]

[redacted]ating syste[redacted]
taxation.

Property Council Recommendations

Recommendation 1: Retain a rates system predicated only on unimproved land value.

Recommendation 2: Capture multi-residential apartments based on sub-categories

Recommendation 3: Growth outside the peg should be based on population growth and applied equally within rates categories.

Recommendation 4: More targeted exemptions should be implemented.

Recommendation 5: Differential rates across a local government area should not be implemented.

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Retaining a fair valuation system to underpin council rates

Recommendation 1: Retain a rates system predicated only on unimproved land value.

<u>A tax on jobs</u>

The status quo is that the business community carries a disproportionate amount of the rates burden and we would caution strongly against allowing changes to the policy that will further exacerbate this issue. A tax that increases the burden on businesses will ultimately be reflected by reduced levels of employment.

One of IPART's key recommendations is that the NSW rating base should be modified from the longstanding unimproved valuation (UV) to the capital improved valuation system (CIV). As part of the process of preparing this submission, the Property Council engaged M3 Property to model what the effects of this change will be.

The concept of CIV is not clearly defined in IPART's documentation to date where it is described as *'a method, which values the property based on the market value, or the value inclusive of all capital improvements'*. This definition is not accurate enough and should be refined to ensure [redacted] further confusion. For the pur[redacted] will consider the [redacted] in t[redacted]

"Capital improved value means the sum which land, if it were held for an estate in fee simple unencumbered by any lease, mortgage or other charge, might be expected to realize at the time of valuation if offered for sale on any reasonable terms and conditions which a genuine seller might in ordinary circumstances be expected to require."

While it is hard to achieve a high level of certitude within the parameters of the review, based on the assumptions listed in the report delivered by M3 Property, the key findings are as follows:

- It is likely the shift away from a UV to CIV rating system would impact the proportion and level of rate charges, particularly so for commercial and rural property owners.
- In Victoria councils have utilised similar changes in rating base to redistribute the rate burden to Business and less to Residential.

By redistributing the rating burden to capture more valuable/highly developed properties, businesses will be disproportionately affected. Ultimately this will have the effect of being either a tax on jobs or a tax on urban renewal, neither of which is a desirable policy outcome.

<u>Cost of establishing and maintaining a CIV register</u>

NSW does not currently have a register of the CIV of properties. Establishing one would be a costly exercise due to the vast amount of data required. The NSW Valuer General, Simon Gilkes, at the public hearing held in May as part of this review noted that the costs involved in transitioning to a capital improved value rating system would be in the 'tens of millions of dollars'. Further, the additional layer of complexity in valuing both the value of the land and its capital improvements would make obtaining the CIV of a property more difficult than just the

UV. It is likely that the greater diversity in capital improvements will preclude the Valuer General from using 'component grouping' to assess changes to the values of multiple properties simultaneously – rather an individual valuation may have to be conducted for each property on a yearly basis. This is another expense that will further increase the cost of maintaining a CIV database for NSW properties.

Due to IPART's recommendation that 'growth outside the peg' should only be calculated using CIV, councils would have to invest in a both a UV and a CIV register regardless of the valuation method chosen as a basis for rates. This is further reinforced by the fact that land tax and the ESPL will continue to be calculated using UV.

Whether these costs are to be passed onto land holders through the rating system or funded through general consolidated revenue, we would suggest it would be an unreasonable and unnecessary financial impost when the current system is continuing to work well in most respects.

<u>A simpler solution</u>

One of the key principles of good taxation outlined by IPART's issues paper is 'simplicity' - that is [redacted] on a group or community can e[redacted]y those who have to [redacted]ting taxes[redacted]d value including – land tax and the ESPL. No taxes in NSW are currently using a system of CIV. Making a change to the system will make it unnecessarily more complex for tax payers to understand. A study published in 2013[2] has established that there is a clear correlation between taxpayers understanding taxes and complying with them. Therefore there is a strong incentive for the rates system to remain predicated on an established and widely understood and accepted valuation system.

[2] The influence of understanding taxes and taxpayer perception to taxpayer compliance (2013) Sari, Diana; Huda, Riri Nurul.

Ensuring an equitable contribution from multi-residential units

Recommendation 2: Capture multi-residential apartments based on sub-categories.

There is a drawback in the current system which IPART identifies as the inability "*to equitability and efficiently raise rates revenue from residential apartments".* The issue with raising sufficient revenue from multi-residential units is at the heart of this review and should be addressed in a measured and equitable fashion without unnecessarily altering the fundamental basis upon which rates are calculated. Essentially, the Property Council warns against a knee-jerk overhaul of the entire rating system – which, aside from this, appears to be working well – to address this flaw.

According to IPART's analysis, under the current system, a significant number of multi-residential apartments are captured by imposing a minimum amount on rates. This is being used as an imperfect tool by local government to create a more equitable distribution of the rates burden between units and standalone dwellings.

Councils could better access a fairer contribution from multi-residential units by applying differential ratings to residential apartments – that is, a different level of *ad valorem* [redacted] unimproved land value. An ex[redacted]ld work is provided in [redacted]rch would[redacted]d the sub-categories. IPART could further investigate this issue as part of this review to inform the bounds of the sub-categories. This would be an effective way of addressing not only inequities in contributions between standalone houses and apartments, but also between individual apartments. Apportionments of the rates could then be split as they are currently through unit entitlements – or potentially through other systems, such as gross market rent.

Differential rates payable based on sub-categories using UV.

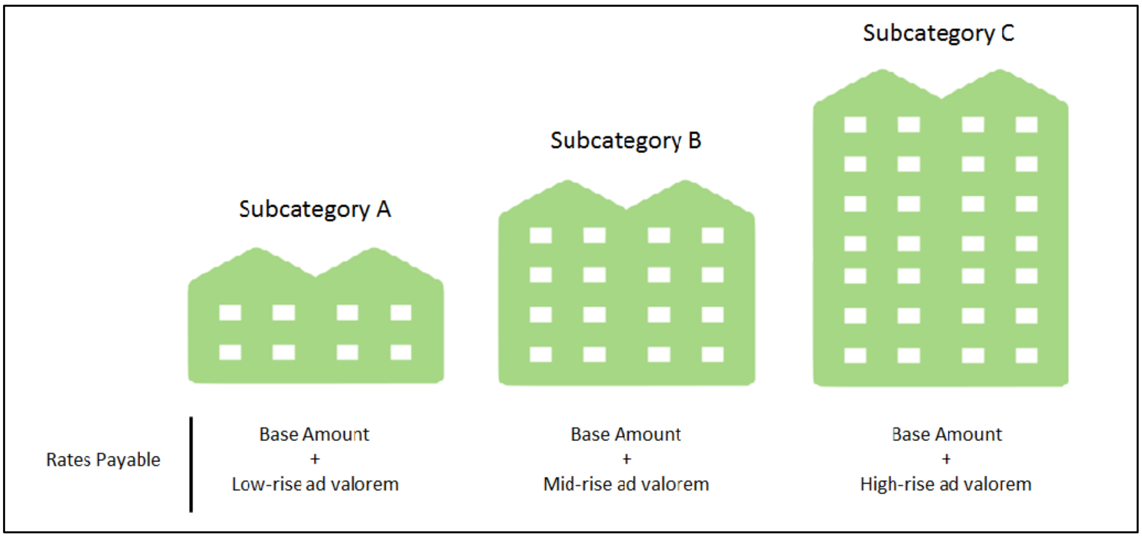

Figure used for indicative purposes only. Further research will be required to establish more precise sub-categories.

<u>Balancing revenue generated from rates and S94 Levies</u>

Section 94 of the Environmental Planning and Assessment Act 1979, enables local councils or other consent authorities to levy contributions for public amenities and services required as a consequence of new developments – in particular for multi-residential units. Any increase in rates for new developments would be added to the existing burden of Section 94 Levies. Ultimately this will have the effect of taxing developers and rate-payers twice for the provision of services and infrastructure. If councils are able to generate higher rates from multi residential buildings, then section 94 contribution plans should be revised to reduce upfront levies applied by councils on new multi-residential developments. IPART should be tasked with monitoring and reporting on such a reduction in levies.

Growing councils' income in a sustainable manner

Recommendation 3: Growth outside the peg should be based on population growth and applied equally within rates categories.

IPART's draft recommendation is that a council should be able to grow their revenue outside the rate peg by multiplying its general income by the proportional increase in CIV from supplementary valuations.

[redacted] to the pr[redacted] peg to address the issue of insufficient rates income, there are more cost effective ways of achieving this without recourse to fundamental changes to the rating system.

One key downfall of the proposed method of increasing a council's revenue in accordance with CIV is the fact that, regardless of whether the rating system is predicated on UV or CIV, the council will have to invest in a CIV register. As discussed above, the establishment and maintenance of a CIV register is a costly endeavour.

The Special Rate Variation (SRV) is already in place and can be used effectively by councils to raise additional income. In 2015-16, there was a 100 per cent approval rate for local council applications for SRVs. If however the uptake of SRVs in not strong enough, growth outside the peg could be linked to population growth (or an associated factor) in a local government area. Population growth would have a direct influence over the requirement for additional services and infrastructure and would therefore be a good indicator for the need for additional revenue.

The IPART draft report states that:

"Using population to scale changes in rates income would require relatively precise and timely information on population at the LGA level, which would incur additional cost and would not be as useful for other purposes."

Population projection data by local government area in NSW however is readily available[3] and already being used across multiple levels of government. The Department of Planning & Environment has projected increases in population over the coming years taking into account

[3] Estimates based on Australian Bureau of Statistics data and the *2014 NSW population project 2031*.

historical data as well as assumptions based on births, deaths and migration. This information is used for *'assessing future needs for residential and commercial land, housing and public utilities.'* If the projections are being used successfully for planning public transport and utility needs, they could be used to the same effect for setting rates outside the peg. While by their nature, the accuracy of projections decreases over time, the census provides a point of reference on a five-yearly basis thus ensuring a high degree of precision.

In NSW state legislation enables councils to set different rates for particular rates categories and while there is a rate peg across all income there is no mechanism to prevent disproportionate distribution of burden. Ultimately the impact will be determined on an individual council basis however modelling and evidence from councils[4] who have switched to CIV shows an inevitable shift in the rates burden to high value properties. Experience from Victorian councils also shows that councils have utilised the change in rating base to redistribute the burden to business and less to residential[5]. In Victoria the highest differential rate cannot be more than four times the lowest differential rate declared by a council. We submit that while this is a step in the right direction, there is no justification for businesses to be levied excessively to subsidise other rate contributors. Of all the councils using CIV that were surveyed in Victoria, none of them had a lower differential rate for business in comparison to residential. An extreme example of this in NSW is the city of Sydney where businesses pay 8.5 times the rate in the dollar paid by the residential category. This disparity is unacceptable and should be address through a robust [redacted] framework to avoid the majority of the burden being borne by businesses.

[4] NSW Council Rate Modelling Analysis (2016) M3 Property.
[5] NSW Council Rate Modelling and Analysis (2016) M3 Property.

More targeted exemptions and differential rates

Recommendation 4: More targeted exemptions should be implemented.

IPART is recommending a more targeted exemptions framework for council rates. The most significant change is that rate exemptions will no longer be based on the ownership of the land but rather its use.

While the Property Council does support this recommendation in principle, we would caution against any changes that would lead to an increase in administrative burden for organisations that are currently exempt. Currently organisations receive a blanket exemption once they are registered with the Australian Charities and Not-for-profits Commission. If charitable organisations have to make a case-by-case application for every property in which they operate there will be a significant increase in administrative burden. This would be a poor outcome and should not be a consequence of any change that is recommended.

The recommendation by IPART on removing exemptions for land used for commercial or residential purposes regardless of ownership requires further clarification. There are many situations where commercial activities are conducted on land that is also providing a public benefit (e.g. coffee shops, convenience stores located within retirement villages). It would not be equitable to remove exemptions for charitable organisations in these circumstances and rates exemptions should be retained for these 'mixed-use' circumstances.

Recommendation 5: Differential rates across a local government area should not be implemented.

IPART recommends giving metropolitan councils greater flexibility when setting rates within their local area. Under the proposed system which is focused mainly on residential land use, councils would be able to move away from a single ad valorem rate for properties in the same categories. Currently councils may set different rates based on separate 'centres of population'. The IPART report rejects this system as it is a vague term: and is open to interpretation/uncertainty. The report states:

"The meaning of the current requirement for setting differential residential rates by 'centre of population' is not clear. In their submission, several councils indicated they were confused about its application in urban areas."

Instead IPART suggests that councils should be allowed to determine a residential subcategory, and set a residential rate, for an area by:

- a separate town or village, or
- a community of interest.

The term 'community of interest' is as problematic as 'centre of population' - it is open to interpretation and could lead to some very subjective outcomes. Should this policy be implemented, the Property Council would seek more robust foundations for the establishment of different zones within a local council.

Depending on the jurisdiction, state government legislation allows councils to set a different rate for specific properties (such as shopping centres, business high-rise). There is no justification for these provisions and we would strongly suggest that this policy should be modified to prohibit these occurrences.

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