SHOPPING CENTRE
COUNCIL OF AUSTRALIA

SUBMISSION TO IPART – 14 OCTOBER 2016:

REVIEW OF THE LOCAL GOVERNMENT RATING SYSTEM: DRAFT REPORT

SUMMARY

The Shopping Centre Council of Australia (SCCA) represents Australia's major owners, managers and developers of shopping centres (refer to www.scca.org.au).

This submission on the *Local Government Rating System* Draft Report (the Draft Report) summarises the SCCA's major concerns with IPART's draft recommendations. Our concerns stem from IPART's failure to appropriately consider the adverse impact the draft recommendations will have on highly improved non-residential property, such as shopping centres.

The Draft Report is about a rating system as it would apply to residential property, not to all property types.

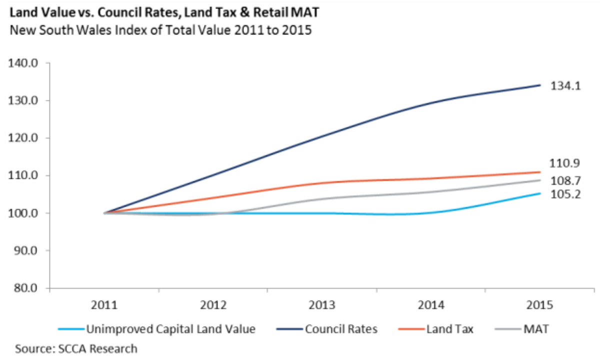
Although it is a simple measure, we note that the term 'shopping centre' is only mentioned twice in the Draft Report - **once** in the body of the Draft Report and **once** in a table in Attachment B. In comparison, the term 'residential' is used well over **150 times** in the body of the Draft Report alone.

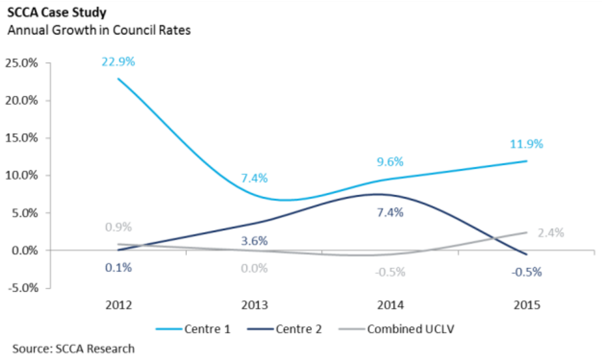
This cannot be considered a balanced approach to analysing the impact of what would be a significant structural change to the local government rating system in NSW.

Our concerns are compounded by IPART's poor understanding of valuation terminology, practice and application – with regard to shopping centre valuation in particular – which is revealed in the Draft Report.

IPART's recommendations over-simplify what is a complex, critical and highly specialised area which has a material impact on the management and profitability of shopping centres and their tenants.

The Draft Report also reveals that no consideration has been given to the perverse outcomes **the current rating system** as applied by council (as opposed to the underlying valuation base, which seems to be IPART's pre-occupation) delivers for shopping centres, including extreme volatility and considerable growth, as illustrated below:





In this regard, IPART also fails to contemplate safeguards that would be necessary in the proposed 'new' rating system to ensure that councils do not progressively 'gouge' highly valued shopping centres.

It remains our view, informed by experiences in other jurisdictions, that without appropriate safeguards, the rate burden across local councils in NSW will shift to highly improved non-residential property, particularly to shopping centres and their tenants.

We appreciated the opportunity to meet with IPART officials during the Draft Report's consultation period, and also the opportunity to attend the Public Hearing held on 19 September. Following the receipt of this submission, we would appreciate the opportunity to, again, meet with IPART officials to discuss our concerns and associated recommendations.

The SCCA's valuation advisor, Urbis, has undertaken modelling to inform this submission. Urbis have also acted independently on behalf of a number of SCCA members. The issues raised within and between these submissions are consistent.

We would welcome the opportunity collectively discuss our concerns with IPART.

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1

RECOMMENDATIONS

#1 **Acknowledge and address the identified failings of the Draft Report.**

#2 **Acknowledge the considerable shopping centre investment pipeline in NSW and 'do no harm' to the otherwise attractive investment climate in NSW.**

#3 **Recommend appropriate and equivalent safeguards for the application of differential rates to shopping centres; these safeguards should be applied irrespective of the underlying valuation base:**

- **Legislative safeguards to 'cap' rate differentiation**
- **Regulatory oversight of differential rates applied to shopping centres;**
- **Publication of the reasons for applying a relatively higher differential rate, including a demonstration of increased service demands and improvement; and**
- **Prohibiting differential rate sub-categories which have less than 20 impacted properties.**

#4 **Unimproved value should be retained as the basis of the local government rating system**

#5 **Acknowledge that CIV is not a shopping centre's 'market value'.**

#6 **Shopping centre valuation is highly specialised and, for large shopping centres where there are few transactions, should continue to be centralised with the Valuer General as per existing practice.**

#7 **The design of any proposed changes to the rating system should safeguard against a shift of the rate burden to non-residential property by requiring that the rate burden be applied consistently across property types between the current and any future system.**

#8 **Acknowledge that a new CIV rating system would be duplicative, including with the UV base that will still be maintained for Land Tax, and will come at considerable cost to build and maintain.**

#9 **In the event that recommendation 7 (above) is not accepted by IPART, a suitable transitional period will need to be discussed, agreed and implemented to ameliorate the impact on affected ratepayers; a decade or longer implementation period is likely to be required.**

#10 **Abandon recommendations in the Draft Report which are outside the review's Terms of Reference, specifically those with regard to the Emergency Services Property Levy and infrastructure funding.**

2

FAILINGS OF THE DRAFT REPORT

The following provides an overview of **six** (6) fundamental failings the SCCA has identified in the Draft Report. These failings cast doubt on the credibility and robustness of IPART's 34 recommendations:

1) Existing system flaws which impact shopping centres left unaddressed

We are concerned that IPART has not appropriately addressed flaws in the current rating system which, if left unresolved, could potentially compound the adverse impact of IPART's draft recommendations on shopping centres. We addressed a number of these issues in our submission to the Issues Paper, which included the growth and volatility in rates paid by shopping centres and the application of rating sub-categories specific to 'large shopping centres' of which there may only be one or several in a Local Government Area. These issues have not been contemplated in the Draft Report.

2) No modelling is provided

IPART seems to have taken a 'light tough' approach to modelling the impacts of the proposed recommendations with very little detail provided in the Draft Report that would assist stakeholders to understand the basis of IPART's draft recommendations, or give comfort that the draft recommendations are well informed.

Indeed, some conclusions reached throughout the Draft Report appear to be informed, or supported by, the data/analysis provided by one council. There is no subsequent discussion or consideration of the relevance of that example to the balance of the NSW (e.g. with regard to population growth rates, prevailing built form, infrastructure and service requirements etc) (e.g. p.g. 47, analysis provided by Port Stephens Council).

In this regard, we are concerned that IPART has taken an 'academic' approach to the design of a new rating system in response to what is, in our view, a poorly defined problem with regard to residential rating, rather than a practical, applied approach which appropriately considers the impact of its draft recommendations all asset types.

3) Assumptions about so-called 'best practice'

We are surprised that IPART appears to have relied on the existence of different rating and valuation systems in other jurisdictions, including international jurisdictions, as being evidence of these systems being 'best practice' and, therefore, inherently 'better' than the current approach in NSW (p.g. 35).

There appears to have been little consideration given to, or analysis of, 1) the distribution of the rate burden under these various system (including against IPART's own taxation principles, however questionable), 2) shifts in the rate burden overtime in these jurisdictions and whether this impacted investment decisions, 3) the quality and timeliness of infrastructure and services these systems deliver, 4) the strength of investment and growth in these jurisdictions, 5) the consequential financial sustainability of councils, or 6) with particular regard to international jurisdictions, the prevailing taxation and service funding structures which sit alongside/utilise the valuation base.

4) Misunderstanding of the Government's policy of urban renewal

We are of the view that IPART has failed to appropriately contextualise the "*NSW Government's policy of encouraging urban renewal*" which is noted as an issue that IPART was to take account of in the context Terms of Reference. The price signal that would be set by, for example, a shift to a Capital Improved Value basis could potentially discourage investment in 'urban renewal', including large capital investment in the development and redevelopment of shopping centres in the activity centres where Government has a preference for growth and development to occur.

We strongly urge IPART to reflect on this broader policy of the Government and consider the potential unintended consequences of its draft recommendations in this regard.

5) Dated information sources, lack of contemporary analysis

We are also concerned about the selective approach to the information sources that appear to have been relied upon by IPART in forming its recommendations. In particular, we can find no reference in the draft Report to the 2013 inquiry into the *Land Valuation System* by the Joint Standing Committee on the Office of the Valuer General chaired by the current Parliamentary Secretary for Treasury, Matt Kean. This inquiry found *"…that land value is the appropriate basis for valuation for rating and taxing purposes".*

Why hasn't this inquiry, or the existing governance which sits around the function of the Valuer General, including regular appearances before a Parliamentary Committee, been contemplated in the Draft Report?

IPART's failure to acknowledge this comprehensive and contemporary NSW Parliamentary inquiry seems incongruous to, for example, its reliance on international academic literature from 1972 – **findings from 44 years ago** – to give context to IPART's view regarding "willingness to pay' (p.g. 29).

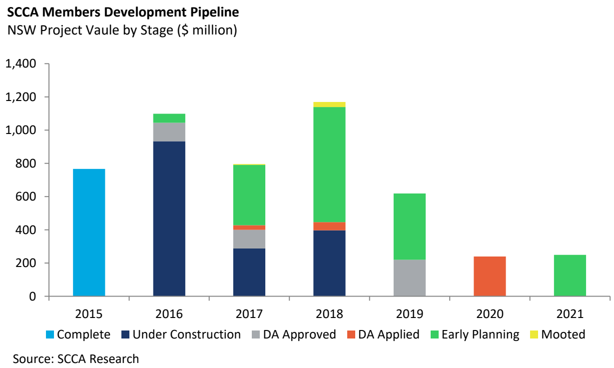
Consistent reference to dated international academic literature throughout the Draft Report gives us little confidence that IPART's Draft Report is based on current and relevant data and research, and reinforces our view that an 'academic' approach has been taken to this review.

6) Recommendations beyond the Terms of Reference

We also observe that IPART has gone beyond the remit of the review's Terms of Reference by making recommendations relevant to taxation and funding mechanisms outside of the local government rating system. By making recommendations regarding the Emergency Services Property Levy (ESPL) (recommendation 33) and jointly funded infrastructure (recommendation 4), IPART has inappropriately waded into other areas of Government policy which are not contemplated in the Terms of Reference. Although we will address these issues beyond the Terms of Reference in this submission, it is our general view they should be disregarded by IPART and not included in its Final Report to Government.

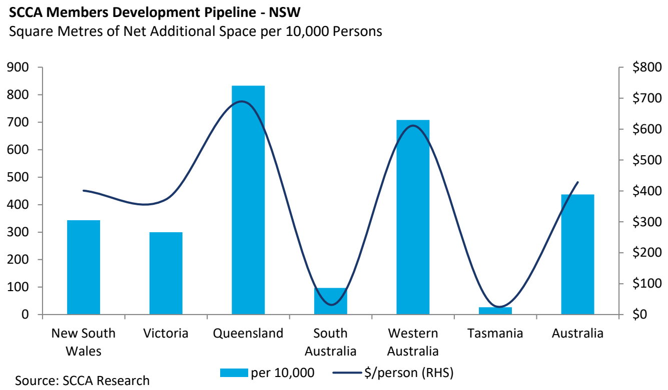
3 INVESTMENT CONTEXT

SCCA's members have $4.2 billion pipeline in NSW, including $3.065 billion over the next three years:



This investment will be delivered across metropolitan and regional NSW and will respond to emerging consumer trends in retail, including increasing and improving the food and beverage offer, re-mixing the retail offer (including delivering new market entrants and some international retailers) and increasing the proportion of non-retail floorspace.

Despite this investment pipeline in '$ terms', on a per capita basis, NSW underperforms other jurisdictions:



The SCCA has serious concerns about the potential impact the draft recommendations in the Draft Report – which are principally focussed on residential property - may have shopping centre investment across NSW.

As property owners are 'price-takers' on statutory-charges (and as are shopping centre tenants), the local government rating regime has the ability to impact the confidence with which our members view the investment climate in NSW.

We do not want to see the rating system subject to clumsy reform which will adversely impact highly improved non-residential property and, potentially, destabilise the otherwise attractive investment climate in NSW.

We have serious concerns that this may be the outcome if IPART's draft recommendations are adopted.

We would be pleased to discuss this investment analysis with IPART upon the receipt of this submission.

4 NECESSARY SAFEGUARDS

It is extremely frustrating that IPART has contemplated necessary safeguards that would need to apply to a new, more 'flexible' residential rating system (e.g. recommendation 8), without making equivalent recommendations for the benefit of shopping centres.

Differential rates via 'Business' rating sub-categories are able to be applied to non-residential property under the **current** local government rating system with none of the legislative protections that IPART is recommending would need to apply to residential rate payers in a new system.

This oversight by IPART is particularly revealing of its predominant focus on residential property in the Draft Report.

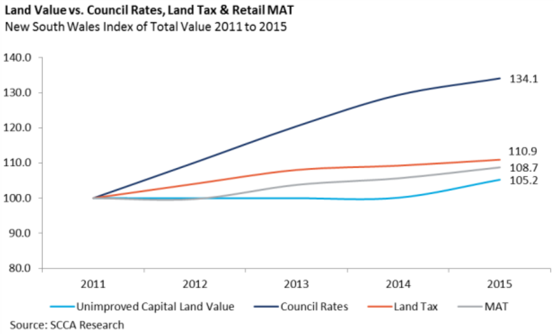
IPART offers the following reflection at page 69 of its Draft Report:

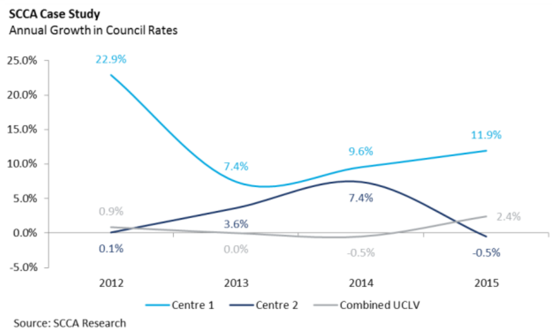
> *If councils are allowed to set different residential rates, there is a risk that some ratepayers may be subject to excessive rates. To mitigate this risk, new protections should be introduced to promote equity and transparency.*

The same can be said of the payment of rates by shopping centre owners. This needs to be considered.

If legislative protections are considered necessary for residential ratepayers, they should be considered similarly necessary for non-residential ratepayers, such as shopping centres owners (and their tenants).

As was demonstrated in our submission to IPART's Issues Paper, shopping centres in NSW have experienced consistent growth in their local government rates (which has far outstripped underlying growth in land value and centre turnover) and also significant rating volatility in recent years.





Modelling of a representative sample of SCCA member centres reveals that the applicable ad valorem rate applicable to these centres is, on average, 5.9 times higher than a council's lowest ad valorem rate.

The existing legislative framework does not require differential rates applied to 'Business' sub-categories (e.g. to 'large shopping centres') to be justified via, for example, a demonstration of increased service demand or improvement. It also doesn't apply limits to the range within which rates can be differentiated (i.e. an ad valorem 'cap' between the highest and lowest applicable rate structures) or impose thresholds for "*regulatory oversight*" (p.g. 69). There is also no requirement for a council to "*publish on its website the reasons for the different rates*" (p.g 70).

This demonstrates the strong need for safeguards in this regard - both in the context of the current rate system, and any reformed future system.

Although we think that the application of a range within which rates can be differentiated is critical, we also note that this approach does not come without concerns.

By way of example, we are aware of a recent instance where a council introduced a new rating sub-category specific to a 'major retail shopping centre', where the rate differential was 48% from the CBD business rate applicable to the centre in the previous financial year (47% from the CBD rate applied in the current year).

Council will levy **Ordinary Rates** in 2016/17:

Category	Rate in the $ (based on land value)	Minimum Rate	Base Amount $	Base Amount %	% of Total Rate	Yield $	Local Govt Act	Basis of Categorisation or Sub Categorisation	Area Applicable
Residential	0.122090		$519	46%	87.71%	$62,078,098	s516	Dominant use	Hornsby Shire
Farmland	0.121239		$519	29%	0.79%	$559,135	s515	Dominant use	Hornsby Shire
Business	0.446813	$548			6.83%	$4,834,037	s518	Dominant use	Hornsby Shire
Business - Hornsby CBD	0.888277	$548			3.19%	$2,257,644	s529	Centre of Activity	Hornsby CBD
Business - Shopping Centre	1.301390	n/a			1.48%	$1,047,619	s529	Centre of Activity	Hornsby CBD
Total					100%	$70,776,533			

Hornsby Shire Council – Operational Plan 2016/17, 8 June 2016 p.g. 78

Regardless of the rating base and this concern noted above, we would like to discuss this safeguarding option further with IPART as an ad valorem 'cap' is a sensible starting point for discussion.

We also note that there is also no current safeguard against the creation of a business rating sub-category – via the existing 'centre of activity' flexibility inherent in the application of rates on business - which only applies to one or several properties, such as 'major retail shopping centres' (as above).

Put simply, this approach is used by council's under the current rating system to surreptitiously, and without justification, shift a rate burden to a highly 'valued' property on the basis of a council's perceptions of the property owner's 'capacity to pay'.

We recommend prohibiting differential rating sub-categories which have less than 20 impacted properties to ensure that a council cannot gouge large shopping centre owners, or their tenants.

We would be pleased to discuss this issue further with IPART, and the application of this recommended safeguarding measure.

The need for these safeguards is independent of the prevailing discussion in the Draft Report regarding the valuation base of local government rates more generally.

IPART should recommend that these safeguards should apply in the context of the current rating system.

If, against our recommendations, IPART affirms its recommendation regarding CIV in its Final Report, the need for the development and recommendation of safeguards for highly improved shopping centres will be even more critical.

5 ANTICIPATED ADVERSE IMPACT OF SHIFTING TO CAPITAL IMPROVED VALUE

Put simply, the Draft Report fails to acknowledge that council rates are applied within the **political framework** of local government. We are concerned that IPART's proposals will expose shopping centres – which will be among the most highly improved and valued properties in a local government area – to the even greater whim of local political forces.

Fundamentally, shopping centres are at particular risk of a transition to a CIV basis as shopping centre have a proportionally high value of improvements relative to land.

For a typical super-regional shopping centre NSW, the proportion of the capital improvements relative to land could be as high as 20 times (i.e. heavily improved), while the equivalent proportion for improvements for a typical detached house to land is around two times (i.e. lightly improved).

This introduces considerable risk that politically motivated policy makers may be inappropriately influenced by perceptions of capacity to pay as the CIV of a rated shopping centre will be considerably higher than the underlying land value.

Apart from the fact that the recent Parliamentary inquiry found *"…that land value is the appropriate basis for valuation for rating and taxing purposes"* (a finding which has been ignored in IPART's deliberations), *we* have **five** (5) fundamental concerns with IPART's proposed shift to CIV as the basis of the local government rating system:

1) CIV is not a typical valuation base for shopping centres

In the Draft Report, IPART has failed to acknowledge the complexity of valuation, both within and between asset types.

(In fact, we would be interested to understand whether IPART has even sought the advice of a valuation exert in preparing its report.)

While IPART communicates CIV as being a 'straight forward', or intuitive, alternative to unimproved value (UV), this is not the case with shopping centres. This is as a result of the considerable intangible improvements which also exist in a shopping centre context.

This means the CIV of a shopping centre will not be equivalent to the going concern market value of the centre (being the basis upon which shopping centre values are reported for company, financial purposes etc).

Put simply, the 'market value' of a shopping centre is not equivalent to the CIV of a shopping centre.

We stress this point as IPART has dawn this exact equivalence in its Draft Report, at page 3:

> *Councils would be able to choose either the UV method or a CIV method that sets a property's rates based in its **market value** (ie, land value plus capital improvements)* (our emphasis).

IPART's lack of applied understanding with regard to non-residential property, and its reliance on academic literature, is betrayed on pages 143 and 144 of the Draft Report where is it suggested that valuation is as simple as '1 + 2 = 3'.

We are firmly of the view that IPART's approach presents the very real risk that applying a CIV base to shopping centres will result in confusion, the inappropriate consideration of intangible improvements in determining the rateable value of a shopping centre, more valuation objections, delays and frustrations for shopping centre owners and councils alike.

As a result of IPART coming to this review through the prism of residential property, IPART is oversimplifying what is a highly specialised approach to shopping centre valuation. This issue is discussed further below.

2) IPART must acknowledge that shopping centre valuation is highly specialised

We object to IPART's recommendation 34 which would allow councils the flexibility to "*…buy valuation services from private valuers…*" (p.g. 118).

Again, this recommendation betrays the residential lens that IPART has used in forming its recommendations.

As was detailed in our submission to the Issues Paper, the valuation services provided by the NSW Office of the Valuer General should continue to be required to be used by local councils in NSW for shopping centre valuations.

Valuation isn't a simplistic concept or task for shopping centres as a result of the fact that there are relatively few shopping centres across NSW and that they transact infrequently. There is also only a small number of shopping centres in any given area (e.g. any given LGA).

The general or mass valuation approach of residential property that we think IPART has reflected on in forming this recommendation cannot be applied to shopping centres, particularly large shopping centres which have few or no transactions.

Shopping centres are generally treated as a specialised asset class for statutory valuation purposes, which involve additional review processes to ensure that valuations, particularly for larger shopping centres, are consistent and accurate across the state.

Maintaining a centralised approach to valuation is necessary to ensure that the integrity of shopping centre valuations, which largely exists as a function of the engagement of the Office of the Valuer General, is maintained.

We would be pleased to meet with IPART, along with our valuation advisor, to discuss this issue in more detail, including providing a commercial-in-confidence briefing on the approach taken to shopping centre valuations and ongoing collaboration with the Valuer General.

3) The rate burden is likely to shift to highly improved properties, such as shopping centres

Modelling of a representative sample of SCCA member centres has been undertaken to demonstrate the uplift between lightly improved properties and highly improved properties under CIV rating. It is not the intent to reflect the actual likely shift in rates burden but, rather, demonstrate the reapportionment of the burden to highly improved properties under CIV rating.

This modelling applies two general parameters, being 1) the collection of an equivalent proportion of general rates from residential having determined an equivalent ad valorem rate to achieve that result with a CIV base and, 2) applying a 1.5 times (and 2 times) differential in the ad valorem rate relative to the residential rate to the highly improved assets.

METROPOLITAN (City of Sydney)

	1.5 TIMES CAP	2 TIMES CAP	GCMV IMPACT (1.5)*	GCMV IMPACT (2.0)
Example A				
LV of $75M and CIV of $1.5B	137%	216%	($26,605,124)	($41,961,498)
Example B				
LV of $56.25M and CIV of $750M	58%	110%	($7,669,602)	($14,649,772)
Example C				
LV of $25M and CIV of $250M	18%	58%	($915,529)	(2,884,295)
Example D				
LV of $6.25M and CIV of $50M	-5%	26%	$61,688	(303,940)

OUTER METROPOLITAN (Liverpool)

	1.5 TIMES CAP	2 TIMES CAP	GCMV IMPACT (1.5)*	GCMV IMPACT (2.0)
Example A LV of $75M and CIV of $1.5B	128%	205%	($28,405,839)	($45,249,452)
Example B LV of $56.25M and CIV of $750M	52%	103%	($7,883,336)	($15,539,524)
Example C LV of $25M and CIV of $250M	14%	52%	($805,236)	($2,964,673)
Example D LV of $6.25M and CIV of $50M	-9%	22%	$113,849	(287,189)

*GCMV (Going Concern Market Value)

<u>This demonstrates that the proportional rate burden increases considerably as assets increase in CIV.</u>

It also demonstrates that, imposing an ad valorem rate cap – although a critical safeguard - will still see significant adverse impacts imposed on highly improved shopping centres.

This modelling has been undertaken for the SCCA by Urbis and is also contained in a number of submissions lodged by SCCA members. We request an opportunity to collectively discuss this modelling with IPART.

The SCCA works on rate, tax and valuation issues across every jurisdiction in Australia and it has been our experience that changes to a rate or taxation base, such as that proposed by IPART, leads to considerable additional costs being shifted to highly improved, non-residential properties, like shopping centres, without any justification (beyond an implicit desire to 'protect' residential rate or tax payers) or commensurate improvements in, for example, service delivery or infrastructure accruing to these assets.

We are concerned that IPART's theoretical rating system will similarly result in a shift in the rate burden to highly capitally improved shopping centres.

This concern is exacerbated by the absence of a recommendation from IPART that the relative split of the rate burden between property types should remain the same in the transition between the current system and the proposed new system.

It is **<u>critical</u>** that the design of any proposed changes to the rating system should be guided by a primary safeguard against a shift of the rate burden to non-residential property, such as highly improved shopping centres. This should be achieved by IPART making an explicit recommendation that the proportional rate burden at the local government level be applied consistently across property types between the current and the new system.

For example, in the table provided in section 4 above, the proportion of rates raised from residential is 87.71% and 'Business - shopping centre' is 1.48%. It is critical that these proportions be maintained in a transition to any new system.

4) Additional costs will be imposed on ratepayers to build and maintain the CIV database

IPART has, inappropriately, positioned itself as an expert in the establishment and maintenance of a valuation database, claiming that its "*suggested approach…will ensure that costs are contained*", without specifying what those costs could be and without any reference to the Valuer General's general advice to a public hearing in April that it could cost in the "*…many tens of millions…*".

The SCCA trusts the advice of the Valuer General, not IPART, on this matter.

We anticipate that the cost of introducing a new valuation base would be considerable and compounded by the fact that a new system would (in the absence of a recommendation to the contrary), in fact, be a dual system along with UV which will otherwise continue to be determined for the purpose of the NSW Government raising Land Tax.

There is no indication in the Draft Report that IPART contemplated this issue (which, in any event, would be well beyond the Terms of Reference of the review).

In this regard, IPART also do not seem to have considered the potential cost of running a dual valuation (CIV and LV) and dual objection (CIV and LV) process at the local government level or how this would work in a decentralised system. This comment assumes that IPART maintains its recommendation that councils should have the choice of whether to apply CIV or LV at the "*rating category level*".

IPART also seems to have selectively ignored that the costs that will continue to be carried by taxpayers as a result of the Value General continuing to maintain a UV database, and associated objection processes, for the purposed of the state Government raising land tax.

5) A lengthy implementation period will be necessary, which will create considerable uncertainty

Considering the huge structural changes that IPART is proposing to the local government rating system, it is surprising that IPART has not made any recommendations about the transition and implementation task that will be necessary to see its proposed changes introduced.

This task needs to be considered in two ways, 1) the transition and implementation period necessary from an administrative perspective (e.g. structures and governance to shift away from centralised valuation, including agreements between the Valuer General and councils, time to tender, build and test a new valuation database, establishing a new approach to valuation objections etc), and 2) necessary phasing of anticipated resultant rate increases on shopping centres.

The most recent significant reforms to a valuation base occurred in Queensland and this was met with a 12-year transitional period. Using this as a baseline, we expect that a transition period of a decade or longer will be necessary to ameliorate the impact on affected ratepayers.

6 RECOMMENDATIONS MADE OUTSIDE THE TERMS OF REFERENCE

IPART's report makes a number of recommendations which are, fundamentally, outside of the scope of the review's Terms of Reference.

Considering the lack of appropriate focus on non-residential property in the Draft Report, it is disappointing that IPART has seen fit to dedicate time to making recommendations on issues they weren't asked to.

We have identified two (2) recommendations of particular significance to shopping centre landlords which are outside the review's Terms of Reference. These recommendations should be abandoned and not included in IPART's Final Report to Government.

1) The basis of the ESPL should remain UV, as committed to by the NSW Government

The Terms of Reference did not ask IPART to contemplate the Emergency Services Property Levy (ESPL). IPART is being extremely presumptions in making this recommendation.

IPART's recommendation that the ESPL and council rate valuation base should be aligned (recommendation 33) should be abandoned.

The ESPL has no relevance to the local government rating system except to the extent that local government will be the collection 'agent' acting on behalf of the NSW Government.

The commentary and analysis in the Draft Report wilfully ignores the considerable consultation and inter-jurisdiction evidence about the impact of moving the funding of emergency services from an insurance basis to a land basis.

It also ignores the NSW Government's clear policy commitments in this regard. The NSW Government has been clear with stakeholders that the ESPL will be based on unimproved land value, and this is the basis on which stakeholders, including the SCCA, are currently engaging with NSW Treasury on system design.

Again demonstrating the residential lens that has been adopted by IPART, sweeping statements, like "*…the benefits received from emergency services increase with market value as new capital is invested…*" ignores that considerable capital investment that shopping centre owners invest in fire suppression equipment.

We have considerable modelling - based on actual SCCA member data – with regard to the transition to the ESPL which has already been provided to NSW Treasury. We also have considerable data about the impact of the shift in Victoria.

Although we think that this recommendation should be taken off the table in its entirety, we would be willing to discuss this information with IPART to assist inform its understanding of the transitional impacts of the ESPL.

2) Open ended infrastructure funding

IPART's recommendation 4 will effectively allow councils to impose 'blank cheque' requirements on property owners without any regulatory oversight, no consideration of other infrastructure costs that may have already been imposed on the property owner via development assessment processes (either as cash contributions or 'in kind' works), or any requirement to demonstrate in quantifiable terms that the infrastructure in question in some way 'benefits' the properties on which the levy is imposed.

This recommendation has no relevance to the local government rating system.

It goes far beyond the review's Terms of Reference and is, in effect, a recommendation which could see the imposition of an unregulated property tax at the local government level.

The SCCA believes that this recommendation may have been informed by the current policy debate regarding so-called 'value capture' infrastructure funding (that said, IPART's recommendation is scarier that the wider debate because it demonstrates no contemplation of requiring a link between infrastructure delivery and 'benefit' to property owners).

The SCCA has provided recommendations to the NSW Government with regard to so-called value capture. These views are contained in a comprehensive Policy Position, which is **attached** to this submission (**Attachment 1**).

7 ABOUT US

The SCCA represents Australia's major shopping centre owners, managers and developers. Our members own and manage shopping centres from the very largest ('super-regional') centres to the smallest ('neighbourhood') centres in cities and towns in every state and territory.

8 CONTACT

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SHOPPING CENTRE COUNCIL OF AUSTRALIA

POLICY POSITION: VALUE-CAPTURE FUNDING

The Shopping Centre Council of Australia (SCCA) represents Australia's major owners, managers and developers of shopping centres across metropolitan, regional and rural areas (refer to www.scca.org.au). Our largest five members own and manage in excess of $75 billion in assets, covering 28,600 retailers and $53 billion in retail sales. Our members have a $10 billion investment and development pipeline over the next three years.

We are long-term advocates for productive and sustainable cities including integrated land-use and infrastructure planning.

'Value-capture' funding has been proposed as a so-called 'new' and 'innovative' method to fund infrastructure. While various models exist, we are concerned that 'value-capture' could simply result in yet another property tax and yet another tax where shopping centre owners carry a disproportionate tax burden.

This *SCCA Policy Position* summarises the critical issues, including 'fundamental' issues, we believe need to be properly considered and consulted on in relation to 'value-capture' funding.

The SCCA advocates on issues that relate to 'value-capture fundamentals' such as land valuation, planning, infrastructure and taxation. In our view, the public debate to date has largely been silent on these fundamentals and this *Policy Position* aims to provide useful policy insights on these issues.

The SCCA is well placed to be an informed and key contributor to this discussion and has a track record of providing unique, evidence-based and considered analysis and policy solutions.

1 INTRODUCTION

'Value-capture' has become the phrase *du jour* in recent public policy discussion about cities and infrastructure funding, followed by catchy concepts like 'value-sharing' and references to overseas models.

This approach has been mooted as a possible condition of Federal funding of infrastructure projects.

The basic logic is that an increase in land (or property) values that flow from infrastructure projects (e.g. roads and rail) should be captured, shared and tapped into as a funding (or revenue) stream.

While value-capture funding can take various forms, there is a real prospect it could become yet another property tax on: (1) existing assets (e.g. similar to land tax) and/or (2) new development (e.g. similar to infrastructure contributions). There have already been public references to "…charges on local properties…" making us concerned with the impact on commercial properties, including shopping centres and their retailers.

We find this prospect extraordinary, particularly considering the status of the national tax debate.

2 TEN CRITICAL ISSUES

We have observed different commentary and proposals on value-capture funding, some of which is extremely simplistic and concerning.

The following critical issues need to be considered in consulting, progressing and designing any proposed new scheme (discussed further below).

#1: Value is already 'captured' and taxed multiple times
#2: Value and valuation need to be properly understood
#3: Shopping centres already pay disproportionately high taxes
#4: Land-based taxes can distort investment and reduce asset value
#5: Developers already make infrastructure contributions + infrastructure should be linked to demand: not value
#6: 'Value-capture' catchment lacks alignment with actual users/beneficiaries
#7: Fair's fair – governments should pay fair value
#8: Governments should remove regulatory barriers to value
#9: Overseas examples are just that: overseas examples
#10: Other funding options

#1 – VALUE IS ALREADY 'CAPTURED' AND TAXED MULTIPLE TIMES

A shopping centre's value – whether it's statutory value (which includes land value for land tax in all states and council rates for NSW and Queensland, and improved value for council rates in Victoria, SA and WA) or market value - is already captured, taxed and 'shared' multiple times by Australia's Governments. This includes capturing the value of any infrastructure projects. Taxes include land tax, local council rates and fire and emergency services levies (and even water pricing).

The statutory valuation basis of such taxes is also controlled by Government policies generally administered by the relevant Valuers-General. This is a further regulatory risk for shopping centre companies.

Shopping centres are also extremely productive assets and significant generators of GST through retail sales. Australia's Top 10 shopping centres account for $9.5 billion in retail turnover. It is the investment of shopping centre companies and their retailers that allows the creation of these GST collection hubs.

TYPICAL LARGE SHOPPING CENTRE

(Source: Flaticon.com)

SNAPSHOT: VALUE ALREADY TAXED

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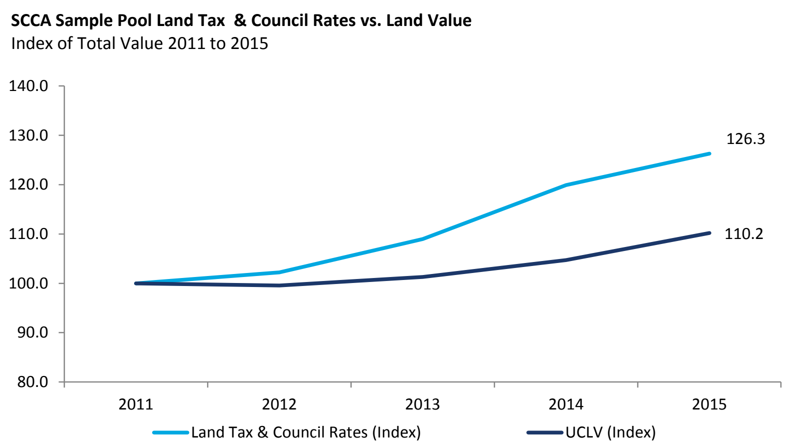
Land value: $44 MILLION
Land tax: $970,000
Council rates: $2.7 million
Fire Services Levy: $190,000

Moving Annual Turnover (Retail Sales): $465 million
GST estimation: $18 million

In recent years, the tax take from land value based taxes for shopping centres has also outstripped the growth in land valuation, meaning that shopping centres are being taxed more than their 'fair share'.



Source: SCCA Member Data

#2 – VALUE AND VALUATION NEED TO BE PROPERLY UNDERSTOOD

Shopping centre value is driven by shopping centre companies, and every day is spent managing risk and driving value in their assets. This can also be the catalyst to help drive value in surrounding properties. Value and valuation also isn't a simplistic concept for shopping centres and for this reason, shopping centres are generally treated as specialised asset classes for statutory valuation purposes. The general or mass valuation approach of residential property certainly can't be applied to shopping centres, nor could a generic value-capture model.

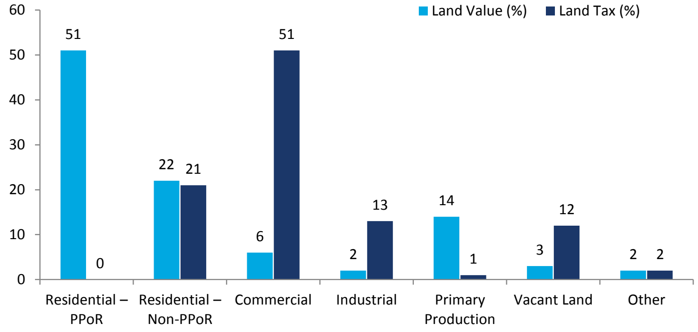
Valuation also occurs at a point in time and value is principally driven by issues such income and occupancy rates.

We believe there is no credible method to properly isolate and quantify the contribution made by an infrastructure project, let alone a proposed *future* infrastructure project, to an asset's land value. In this regard, it would also be very challenging to credibly determine the value baseline or benchmark against which any supposed increase in value would be assessed. Conversely, in progressing with value-capture funding, would governments be willing to compensate land-owners where infrastructure (or lack-thereof) decrease its value? It is also critical that 'income' isn't conflated with 'value' which can often be the case and lead to flawed perceptions that some companies have a 'capacity to pay' additional taxes and charges on their land.

#3 – SHOPPING CENTRES ALREADY PAY DISPROPORTIONATELY HIGH TAXES

Shopping centres already pay disproportionately higher taxes than other types of land and property as a result of progressive tax rates. The *Victorian Fire Services Levy* commercial property rate, for example, is up to 7 times higher than the residential rate. Similarly, using South Australia as an example, commercial land also accounts for 6% of overall land value but 51% of land tax contributions in South Australia (as illustrated below).

South Australia FY14 Private Land Tax Composition
Contribution to total by Land Usage



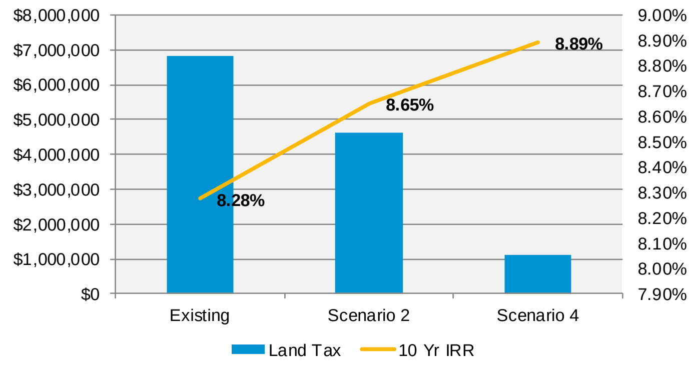
Source: RevenueSA / SCCA Research

Meanwhile, Principal Places of Residence (PPoR) land value accounts for 51% of total land value, but makes no contribution as it is exempt from land tax, and Primary Production land, which accounts for 14% of land value, makes a 1% contribution. It would be unfair to further tap into commercial land value without capturing the value from land and property that currently makes no contribution (ie. broadening the land tax base).

#4 –LAND-BASED TAXES CAN DISTORT INVESTMENT AND REDUCE ASSET VALUE

Commentary about land-based taxes theorise that they are efficient insofar as land is immobile. The reality is very different. In addition to numerous existing exemptions for certain land (noted above), land-based taxes are not-benign from an investment perspective (particularly when the same land is being taxed many times over). As illustrated below, three different modelled scenarios we undertook for a recent tax review identified that different land tax scenarios have a different impact on investment (Internal Rate of Return or IRR).

Hypothetical investment analysis



Further, additional or increased taxes can impact Net Operating Income (NOI) and subsequently a shopping centre's asset value. Based on a capitalisation rate of 6.25%, every $1 million increase in a new tax could result in a $16 million decrease in asset value. We doubt this would be an intended consequence of any possible value capture model.

Some jurisdictions are also already higher taxing than others (e.g. South Australia, Victoria, NSW from a land tax perspective) which means the 'starting point' needs to be properly considered. Further, shopping centres are unique as land tax cannot be recovered as an outgoing from tenants in Victoria, South Australia and Queensland. How 'value-capture' would impact retail tenants also needs to be considered.

#5 – DEVELOPERS ALREADY MAKE INFRASTRUCTURE CONTRIBUTIONS + INFRASTRUCTURE SHOULD BE LINKED TO DEMAND: NOT VALUE

Our members already make contributions to infrastructure at the development and redevelopment stage, and there is generally and rightly a nexus with infrastructure demand generation. As an example, the Queensland system imposes an infrastructure levy on shopping centres of $180/square metre of additional retail space. For a typical average Queensland development of 20,000 square metres of space - this is a contribution of $3.6 million. As shopping centres are the only asset class that generally expand over time (e.g. Chadstone shopping centre in Melbourne has had over 30 stages of expansion), they can be required to contribute to infrastructure many times over.

Infrastructure funding should be linked to infrastructure demand created by an asset and its users (e.g. vehicle movements on a road); not value. That this link could be severed under a value-capture arrangement is a cause for concern, and could also give rise to an unlevel playing field between competitors. Why should two similarly sized shopping centres – with a similar demand on infrastructure – but with different land-values be levied differently to contribute to infrastructure? This would not be a fair or equitable outcome.

#6 – 'VALUE-CAPTURE' CATCHMENT LACKS ALIGNMENT WITH ACTUAL USERS /BENEFICIARIES

Value-capture proposals can also suggest that properties surrounding (e.g. within a 400m 'walking' catchment) a piece of infrastructure are the ones that principally benefit and hence, whose value may be captured. However this approach would fail to recognise the real catchment of users of that infrastructure, such as a train station (entries and exits). For example, we have analysed properties around a Sydney suburban train station (the busiest in the AM peak in terms of entries and exits) and estimate around 2,000 land-holdings within a 400m radius. However, official statistics paint a much broader 'user and beneficiary' picture of that infrastructure, including 9,000 entries and 5,000 exits in the AM peak (6:00am-9:30am), 2.44 million tickets issued per annum, and a modal split of around 30% that use rail to get to work at that location. This location is also subject to a parking space levy, which is used to fund public transport infrastructure. How could it be fair that only 2,000 land-holdings surrounding the station could be levied to fund infrastructure, including where some of those properties already pay a parking space levy and further, while other properties (and actual users) would not be captured and levied?

#7 – FAIR'S FAIR – GOVERNMENTS SHOULD PAY FAIR VALUE

Our members can host government infrastructure on their land such as bus interchanges (and even libraries) which is generally imposed on them by governments and then based on a license with negligible or nominal rental income. At the expiration of a license, a recent attempt by a shopping centre to place such an arrangement on more commercial 'value' terms (e.g. the same land could be used as a drive-in restaurant or car-wash) was resisted and rejected by a government. It can be the case that governments like to not only tax value, but then deprive an asset owner the chance to increase their value by imposing 'take it or leave it' terms.

#8 – GOVERNMENTS SHOULD REMOVE REGULATORY BARRIERS TO VALUE

Various governments impose regulatory barriers and duplication which limits the value potential of shopping centres. Some of these have been cited ad nauseam in various reviews, such as Productivity Commission reviews and the recent Harper Competition Report, but with no real commitment or pathway to resolve the issues. These include trading hour restrictions, retail floor space caps, real estate licensing, retail lease legislation and restrictions on truck delivery times. These issues should be addressed in company with any value-capture scheme design.

#9 – OVERSEAS EXAMPLES ARE JUST THAT: OVERSEAS EXAMPLES

We are well aware of overseas examples that are often referenced in value-capture discussions such as the London Crossrail Levy (LCL).

While possibly instructive in concept, there can be vast differences in the valuation and taxation process – or scheme design - that need to be properly considered. Similarly, industry regulation and barriers can be different between jurisdictions.

#10 – OTHER FUNDING OPTIONS

We hope that other funding options are being considered in the context of value-capture funding. While a broader, simpler and fairer approach could include capturing 'value' currently exempt from land tax (e.g. Principal Place of Residence) it could also include road-user pricing which was recently recommended by the Harper Report into Competition Policy and accepted in-principle by the Federal Government. In addition, public transport fares should be part of the funding considerations to ensure that actual users and beneficiaries are making a direct contribution.

3 NEXT STEPS: ANALYSIS + CONSULTATION

There is an obvious need for detailed analysis and consultation on value-capture funding, particularly with potentially affected stakeholders.

The SCCA respectfully urges the Government to ensure a considered approach to the issue, which specifically notes the current taxation basis for shopping centres and their retailers whereby value is already captured and taxed multiple times.

We believe that the current tax burden on shopping centres should not increase under the value-capture model or be disproportionate to the contribution made by other properties or users and beneficiaries of infrastructure.

The SCCA has more detailed information on the 10 critical issues raised above and would be pleased to discuss them further.

4 ABOUT US

The Shopping Centre Council of Australia (SCCA) represents Australia's major shopping centre owners, managers and developers. Our members own and manage shopping centres from the very largest ('super-regional') centres to the smallest ('neighbourhood') centres in cities and towns in every state and territory.

Our members are AMP Capital Investors, Blackstone Group, Brookfield, Charter Hall Retail REIT, DEXUS Property Group, Eureka Funds Management, GPT Group, ISPT, Ipoh Management Services, Jen Retail Properties, JLL, Lancini Group, Lendlease Retail, McConaghy Group, McConaghy Properties, Mirvac, Perron Group, Precision Group, QIC, Savills, SCA Property Group, Scentre Group, Stockland and Vicinity Centres.

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