2017-2018 Victorian Budget Submission

Preamble

Prosper Australia welcomes the opportunity to contribute to the 2017- 2018 Victorian budget as a leading non-government economic research organisation highlighting the political-economy of land, natural resource and monopoly rents.

This submission focusses on the role of State Land Tax (SLT), which is the fairest and most efficient tax, at a time when the public is clamouring for effective housing affordability policy.

SLT acts as a counterweight to land price as the market value will reflect the tax impost, reducing land prices. In essence, the higher the land tax, the lower the capitalised land value.

SLT has the potential to become the public's first line of defence against the commodification of the property market. Under current settings, Prosper expects lifetime mortgages in the not too distant future.

Prosper's recommendations, when implemented, will ensure that state revenue policy reflects the highest ideals of both economic efficiency and equality of opportunity. SLT can be viewed as a thank you payment for services delivered by government. Governments of all persuasions could be encouraged to portray the most efficient of all taxes in this manner.

Key priorities

1. Protect and expand State Land Tax
2. Exchange Stamp Duty for Land Tax
3. Dampen speculative demand in the housing market
4. Restore Site Value Rating as the principal base for municipal rates
5. Reform the Emergency Services Levy, Waterways Charge and Parks Charge into a 'State Rate'
6. Capture the value of rezoning decisions
7. Retain Victorian Land Titles Office in public ownership

1. Protect and Expand State Land Tax

State Land Tax expenditures

Accurate land tax expenditures are vital.

Victorian land values increased by $75bn last financial year[1] yet total land tax expenditures were listed at $2.93bn (Table 5.2, BP5, Statement of Finances). The paucity of these expenditures needs further explanation.

Frame the Public Interest in discussion of land taxes

We urge treasury to frame the discussion of land taxes with reference to the economic advantages of property ownership.

For example, the current budget papers state:

> "Land tax revenue is forecast to increase in 2016-17 by 28.3 per cent largely as a result of the biennial land revaluation which is currently underway". (Vic Budget Paper 5, Statement of Finances, p148)

Standing on its own, the statement leaves the state open to criticism. The public interest is better protected by spelling out the advantages of property ownership with a statement such as:

> "Land values increased $153.7bn in 2014-15. In 2015-16 the uplift was $75 billion. Land tax revenue is forecast to increase in 2016-17 by 28.3 per cent largely as a result of the biennial land revaluation which is currently underway. This increased revenue represents just 2.3% of expected economic rents. *Landholders will collect 97.7% of the site value uplift*".

Reframing Treasury's discussion of SLT revenue may increase its acceptance and help create a climate for reform.

[1] ABS 520461
http://abs.gov.au/AUSSTATS/ABS@Archive.nsf/log?openagent&5204061_land_value_by_use.xls&5204.0&Time%20Series%20Spreadsheet&2F3B1CA19812B0FFCA258059000EF539&0&2015-16&28.10.2016&Latest

State Land Tax Schedule

With land prices increasing so rapidly, weaknesses in the land tax schedule are exposed. Prosper has long advocated the need for the progressive rate to be flattened and broadened.

Bracket creep from the fourth tier (>$1m to $1.8m) onwards impose large escalations in charges, bringing undue criticism of the SLT system.

A flat percentage charge treats all landholders equally.

At the least, SLT notices require a reiteration of the unearned income enjoyed alongside the responsibility of repaying the public for a small portion of such windfalls. As a proactive measure, Sydney City Council provides this information on their rating notices.[2]

Lower State Land Tax thresholds

Current median greenfield land prices of $237,000[3] have unsurprisingly followed the upward trajectory of SLT thresholds from $85,000 (2001) to $250,000 (2009).[4]

While further research is required, we found a correlation between increases in the threshold and accompanying land prices. Cursory investigation revealed a higher correlation in urban growth areas. This presents a dilemma for policy aimed at improving affordability. Increasing the Land Tax Threshold may provide temporary relief for small investors in residential property, but the land tax bill will be capitalised into higher initial prices. Eroding the land tax base by increasing the threshold undermines its ability to act as a counterweight to the capitalised value.

We urge treasury to further investigate the relationship between SLT thresholds and land prices.

With land values in a number of affordable locations under the $250,000 threshold, investors have been able to buy and wait without a land tax impost. Under these conditions, SLT cannot work where it is most needed - on affordable land. This is reflected over time in the geo-location of vacancies in Prosper's Speculative Vacancies reports:

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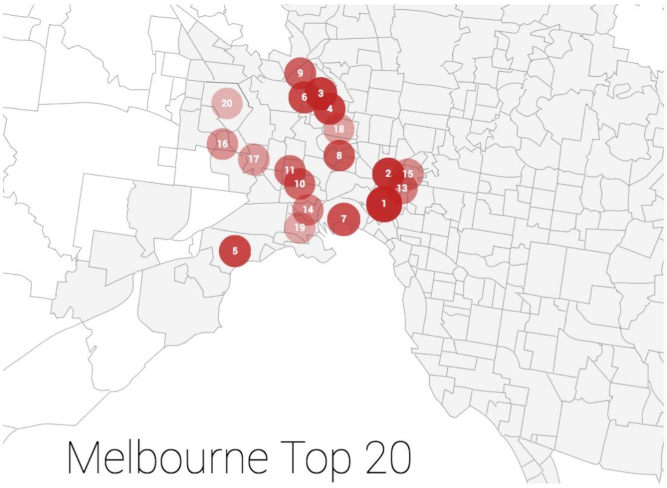
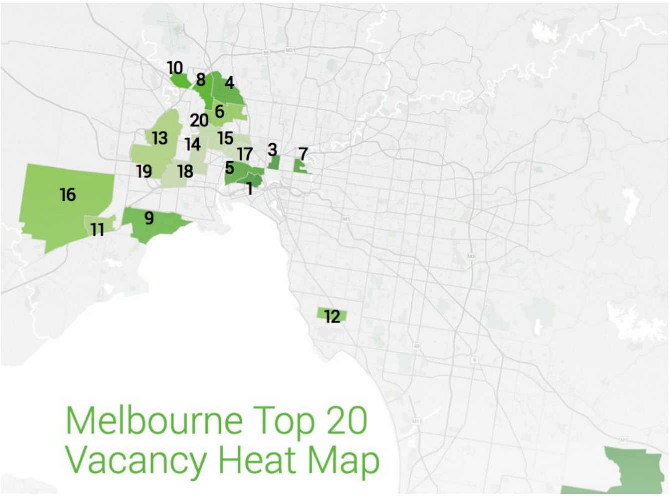
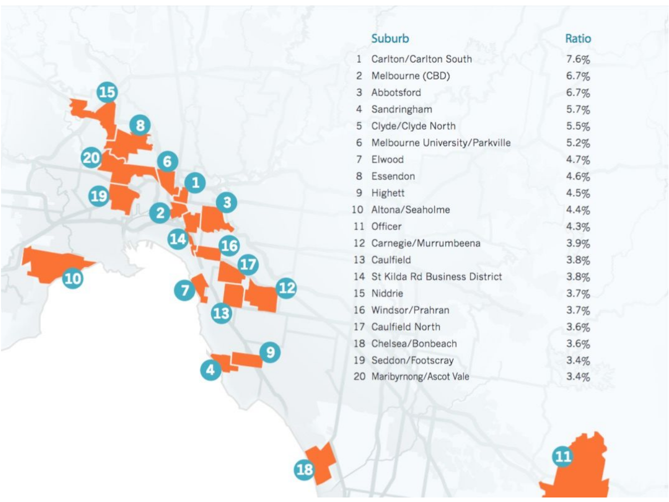
[2] http://www.cityofsydney.nsw.gov.au/live/residents/rates
[3] UDIA State of the Land Report 2017, https://www.dropbox.com/s/9s03laxmnaxdecv/UDIA%20State%20of%20the%20Land%20Brochure%20Online%20VERSION.pdf?dl=0
[4] http://www.sro.vic.gov.au/node/1435



The 2014 findings:



The 2015 report found a higher incidence of vacancies in Melbourne's east, perhaps reflecting the paucity of land tax charges *vis a vis* the $60,000+ imputed rents enjoyed in that year.



Remove the ‘Tennis Court’ exemption from land tax

Prosper sees the Principal Place of Residence (PPR) exemption from land tax as one of the most behavior distorting tax concessions. Separately titled land contiguous with a PPR and used solely for private benefit is also deemed exempt under the Land Tax Act.

Multiple titled holdings can come about in a number of ways and from a range of landholder intentions. Some are old impractical subdivisions, overtaken by zoning changes or holder preference. Others are land holders buying more open space - for a vegetable patch, a tennis court or simply to distance themselves from neighbours. For others again, this is a form of land banking sheltered from tax by the PPR exemption.

While individual responses to removing the PPR exemption on contiguous land would vary, the overall consequence would be to prompt economic activity as holding vacant land would have a cost. Holders on old impractical subdivisions can amalgamate titles and restore the PPR status, a straightforward and inexpensive administrative exercise.

2. Exchange Stamp Duty for State Land Tax

Stamp Duty is a handbrake on economic activity. It fluctuates unpredictably with sales volumes and is an unreliable revenue source for government. It imposes high deadweight costs on Victorians, making it expensive and at times impossible to move across town to a better job or around the corner to a bigger or smaller home.

The re-election of the Barr ALP government in the ACT, four years into their 20 year program to wind down Stamp Duty through funding from increased land tax, proves reform *AND* retaining government are possible.

The tangible economic benefits of the ACT reforms are examined by Cameron Murray in *The First Interval - Evaluating Canberra's Land value Taxation Transition*.[5]

The key findings are:

- new home buyers save between $1,000 - $2,000 per annum in mortgage costs
- the impact of the LVT transition has not disrupted the real estate market
- future LVT liabilities have been smoothly incorporated into purchasing decisions.

The federal Treasury and all state Treasuries have been urging this reform to parliamentarians for decades. Meanwhile, Australia's feverish diversion of savings to the empty dreams of rent-seeking and capital gains from land price inflation has starved our industrial base of capital – leaving serious under-employment and staggering import costs.

Carefully reforming where taxes are imposed, based upon evidence, would free up capital to pursue genuine choices that increase and diversify economic activity, reduce taxes and offer the opportunity to provide new and better services.

The first Australian state to reform its property taxes from transactions to a holding charge will enjoy a handy first mover advantage - this change would be a magnet for economic activity relative to other states. As economists repeat *ad nauseum*, new investment goes where it is most welcome and the state with the best tax laws wins.

[5] The First Interval, https://www.prosper.org.au/2016/09/12/the-first-interval-evaluating-acts-land-value-tax-transition-full-report/

3. Dampen speculative demand in the housing market

An inclusive and effective 1% Vacant Residential Property Tax

Prosper Australia has consistently lobbied for an accurate vacancy measure. For the past ten years we have produced an alternative vacancy statistic based on water usage data, reported annually in our Speculative Vacancies Report.[6] We applaud the proposed Vacant Residential Property Tax (VRPT). It will bring greater fairness to property ownership, increasing rental housing availability.

At present, it is unclear what types of properties will be eligible for the VRPT. There are a number of issues that we would like to see addressed in the design and implementation of the VRPT:

- *Vacant Land*. Whilst our Speculative Vacancy report has found some 80,000 empty homes in Melbourne, there are hundreds of thousands of vacant sites sitting idle in sprawling development estates.

- *Basis of Valuation*. A 1% VPRT levied on Capital Improved Valuations may create perverse incentives. Vacant land will not face the full impact of the tax; empty vacant homes will. If levied on a CIV basis, marginal dwellings (e.g, ageing stock) may be demolished in order to minimise tax on improvements. This may lead to decreased marginal housing stock, with implications for affordability among the most vulnerable. A fairer implementation would occur if the tax was levied on Site Values only.

- *Enforcement.* Significant fines must be implemented if a self-reporting regime is adopted. Importantly, significant resources must also be allocated to audit and enforce the VRPT. The Federal Government's neglect of investor oversight is telling. Property spruikers regularly advise investors to 'post-code hop' in order to avoid the Capital Gains Tax on primary residence. Despite questioning by Senator Scott Ludlam in Senate Estimates, little has been done on the oversight of such behaviour. Such workarounds may well occur with the VPRT.

The 1% vacancy tax needs policy coherence. A CIV-based charge includes a core design fault - those improving homes for rental will be penalised for renovating.

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[6] https://www.prosper.org.au/wp-content/uploads/2015/12/11Final_Speculative-Vacancies-2015-1.pdf

Exchange Stamp Duty on Foreign Investment

The higher Stamp Duty imposts on foreign owners is having little effect. A higher absentee landowner surcharge, the SLT on foreign investors, will reduce the capitalisation rate and thus the incentive to perceive housing as a function of investment. Recent SD payments could be credited against forthcoming SLT levies.

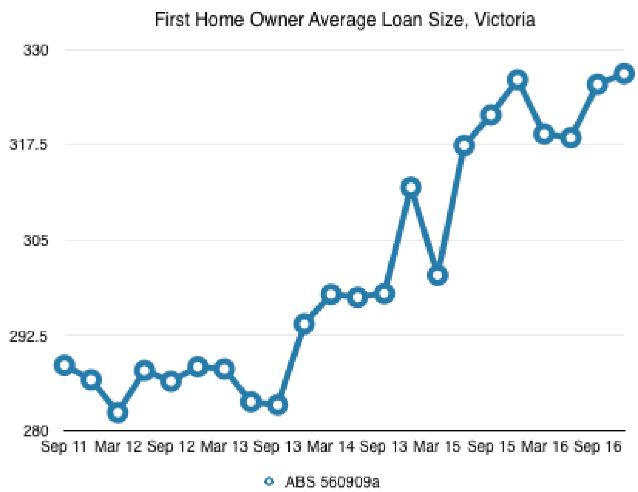
Greater utilisation of a Land Tax on foreign ownership would soon see an end to this supply blockage. Whilst we accept the Andrews government has made bold policy moves in this area, we are yet to see any favourable pricing outcomes.

Remove the First Home Buyers Stamp Duty Discount (FHBSDD)

The tax expenditure costings for the FHBSDD continue to increase, up from an initial $170m to $195m. The recently expanded FHBSDD will accelerate these costs for little economic return.

Since the implementation of the FHBSDD, average First Home Buyer borrowings have increased from $290,000 to some $328,000.[7] This confirms our contention that the full value of the Stamp Duty Discount is capitalised into higher initial prices.

This is an abject policy failure and the government's recent extension of the grant will do little to help.



[7] ABS 560909a

Investigate ‘Staged Releases’

Despite continual rezonings over the last 15 years, affordability has worsened, rather than improved.

Treasury analysis of supply-side elasticities is needed in this core component of housing delivery. The ability to manufacture scarcity, whether deliberately or inadvertently, is of concern. Such practices suggest there is an element of drip-feeding to the market to maintain housing prices.

While we accept Government must balance a fair rate of return for developers with its public policy of increasing housing affordability through extensive rezonings, we suggest SLT is set too low to spur these immense master planned land banks onto the market.

An escalating land tax schedule over time will assist land prices to move in line with local incomes.

4. Restore Site Value Rating as the principal base for municipal rates and remove rate caps

Restore Site Value Rating for Local Government (SVR)

Prosper wants Victoria to use the best rating system available - one that imposes no deadweight costs, fosters economic activity and promotes the highest and best use of the land. Capital Improved Value does not exhibit these virtues. There have been repeated inquiries into SVR versus CIV. All found firmly for the SVR.[8]

The most comprehensive Australian inquiry into rating bases was undoubtedly the New South Wales Royal Commission on Valuation and Rating (1965-67) under the late Justice Rae Else-Mitchell. After detailed consideration of the arguments raised, the Royal Commission came out strongly in support of rating on land values only.

The second-most detailed inquiry into the subject was arguably the City of Brisbane Rating Study of 1989, chaired by Sir Gordon Chalk. This inquiry also supported the principle of rating land values rather than capital improved values.

If we tax buildings, there will be fewer buildings. But if we tax land, there will not be less land. If we tax values of buildings, we will get not only fewer buildings, but also inferior buildings. But if we tax the value of land (exclusive of buildings and other improvements), we will get neither less land nor less valuable land, because land is not the product of private effort or enterprise - its value is conferred by the surrounding community, not by the landholder who pays the tax.

CIV is an economic disincentive to densification, and is at odds with the strategic objectives of *Plan Melbourne.*[9]

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See also:

- Queensland Committee of Inquiry into Valuation and Rating 1989, chaired by Sir Gordon Chalk
- The Wellington City Committee, 1989
- The Internal Affairs Department Coordinating Committee New Zealand, 1989
- Commission of Inquiry into Land Tenures, 1973-76
- NSW Royal Commission of Inquiry chaired by R Else—Mitchell 1967
- Inquiry chaired by Justice Hardy Queensland, 1966
- Inquiry chaired by N L Buchan Queensland, 1964
- Queensland Committee of Inquiry chaired by Sir A Bridges QC 1960
- The Royal Commission on Local Government Finance 1958
- Australian Country Party Inquiry 1933

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http://www.planmelbourne.vic.gov.au/__data/assets/pdf_file/0007/377206/Plan_Melbourne_2017-2050_Strategy_.pdf

Remove Rate Capping

Rate capping limits local government's capacity to raise revenue from the land base. Restricting this revenue stream increases Council's reliance on Commonwealth grants to deliver key services.

This means key services provided by Local Government are funded by less efficient and regressive taxes such as the GST.

Furthermore, the result is a funding shortfall. Interstate evidence points to ensuing financial pressures. The IPART report 'Fit for the Future' found 63% of NSW local councils financially unfit for the future.[10] This is unsurprising as councils have endured twenty five years of limited revenue sovereignty enforced by poorly targeted rating caps. The Municipal Association of Victoria finds "NSW councils effectively spent only 55% of the average capital expenditure by local government in other states, leaving a multi-billion dollar black hole for future generations."[11]

Further analysis is needed of the effect of 30 years of privatisations and their burden on council expenditures.

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http://www.themandarin.com.au/56018-nsw-govt-gets-way-council-merger-report-deems-63-unfit-future/

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http://www.mav.asn.au/News/Pages/state-property-taxes-rise-dark-side-of-rate-capping-revealed-20oct15.aspx

5. Reform the Emergency Services Levy, Waterways Charge and the Parks Charge into a ‘State Rate’

The natural tax base to fund fire services, waterways management and parks is land.

Fire services protect structures. They give citizens the confidence to build – and build bigger and better. But like all civic amenities, the benefit of the fire service is capitalized into land values. A quality fire service raises land prices, whether a building is put up or not.

The Waterways and Drainage Charge on water bills funds watercourse maintenance and improvement; the Parks Charge plays a similar role for parklands. The benefits of both also devolve directly to land values.

The Emergency Services Levy is calculated on Capital Improved Value - the value of land and improvements. It is further tainted by the fixed residential minimum component currently set at $105. This is an economic equivalent to Margaret Thatcher’s Poll Tax. Both the Waterways and Parks charges are calculated on Net Annual Value - the amount a property or piece of land could earn in rent over a year.

These formulas ignore the superior rate mechanism Site Value - an *ad valorem* tax on the unimproved value of land that disregards the value of buildings, personal property and other improvements.

Rolling these three property charges into a ‘State Rate’ based on Site Values directly links services to beneficiaries, significantly reducing the administrative expense of tax collection.

6. Capture the value of rezoning decisions

Investigate the value of rezoning decisions/windfalls

Government is responsible for ensuring significant value capture is implemented. If 10% of the windfall gains were repaid over time, there would be both significant infrastructure revenues and lower neighboring household prices.

Planning mistakes continue to be made when density is increased without appropriate value capture procedures in place. These must be quantified as tax expenditures. It would, for instance, be instructive if Treasury were to compare the windfall gains at Fisherman's Bend to the windfall gains surrounding Parkville and Arden stations.

A strong PR campaign educating the public about the immense windfalls that infrastructure developments and their accompanying land rezonings deliver will assist in winning public support for policy development. Case studies for current level crossing developments demonstrating how much value is created will be useful education tools.

Rezoning

Landholders have an obligation to the community to build on rezoned sites in a timely manner. A 'Use it or Lose it' clause needs further discussion. An escalating SLT scale needs consideration on rezoned land banks. A possible time frame of five years is recommended. This will spur development and limit the timeframe for staged releases.

Capture rezoning windfalls

A significant 'betterment' tax is worthy of consideration for any location favourably rezoned. The windfall gains that a bureaucrat's golden pen-tick delivers to landholders deserves public transparency at the very least, and may well justify recoupment on behalf of the community. For too long land bankers have been able to lobby for rezoning only to 'sit on' sites at minimal charge as they escalate in value. The ability to leverage such sites are advantages unparalleled in any other sector.

The issue is compounded when the rezoned site is quickly resold. The public revenue system needs to deliberate on this regular practice. Greater public scrutiny on the probity of these transactions is warranted.

Value Capture

As momentum continues to build towards the replacement of Stamp Duty by a broader Land Tax, the Land Value Capture (LVC) system can be of use as a demonstrative measure.

It is imperative the levy is charged on a percentage basis in order to account for the variation in locational value. Parramatta City Council has erred in charging a $200 per square metre charge. This makes no distinction of locational advantage.

Further commentary can be found in Prosper's LVC submissions to government:

- HoR Standing Committee on Infrastructure, Transport and Cities submission[12]
- Department of Infrastructure submission[13]
- Select Committee into the Scrutiny of Government Budget Measures submission[14]
- Submission to the Inquiry by the Outer Suburban/Interface Services and Development Committee of the *Parliament* of Victoria [15]

[12] https://www.prosper.org.au/wp-content/uploads/2017/04/PA_LVC_Submission-Final_HoR2016.pdf
[13] https://www.prosper.org.au/2017/02/21/value-capture-verve/
[14] https://www.prosper.org.au/2015/11/10/value-capture-variants/
[15] https://www.parliament.vic.gov.au/images/stories/committees/osisdv/iugb/OSISDC_UGB_sub70_Prosper_Aust_12.10.09.pdf

7. Retain Victorian Land Titles Office in public ownership

Prosper is stridently opposed to the sale of government land registries and has spoken out against it repeatedly.

This is a core government function: "Each state and territory has a central register of all land in the state which shows the owner of the land. The land title is the official record."

Under Australia's globally-admired Torrens Title system, government guarantees title against fraud and abuse without limitation. This will no longer apply if the register is sold to the highest bidder and privately provided. Consider the legal argy-bargy that will be certain to arise over any recording error by the private provider.

We respect the Andrews government's current position. Please don't sell Victoria's land registry.

Conclusion

Thank you for the opportunity to present this submission for consideration as part of the Victorian Government budget deliberations.

Contact

Karl Fitzgerald
Project Director
karl@prosper.org.au
9328 4792