SUBMISSION TO THE 2020 VICTORIAN BUDGET

Prosper welcomes the opportunity to contribute to the 2020 Victorian Budget.

We are an independent, Melbourne-based research institute with a focus on the management of exclusive and essential resource allocation through revenue policy. This includes land and other natural resources, essential services that are most efficiently provided by one supplier, and government-instituted monopolies such as taxi and fishing licences.

It is our position that unearned and unproductive streams of private income which derive from these elements of our economy should be more heavily taxed. This will allow taxes on the productive sector to be eased, making for a more equitable and more efficient economy.

It is from this analytical framework that we present our 2020 Victorian budget submission.

The fiscal challenges facing the government are significant due to macro-economic slowdown, revenue volatility, and a deteriorating ecological base coupled with necessary infrastructure investment. However these conditions also present opportunity.

What is needed is a serious look at revenue policy and how to better utilise the land base. The land base needs to be rationalised across the state's various revenue policies, whether it be land value capture or council rating.

Prosper supports the Victorian Government's continued focus on housing and related tax policy. Ongoing commitment to value capture in future major projects such as the suburban rail loop and airport rail link is essential for best practice planning and sustainable funding.

We note a number of positive outcomes in previous budgets, including:

- Phase out of various stamp duties concessions
- Introduction of a residential vacancy tax
- No cuts or further exemptions to State Land Tax
- Introduction of annual land valuations
- Phase out of taxi licenses with partial compensation via a small but fair levy
- Policy to support Land Value Capture for infrastructure
- Reduced payroll tax in regional areas
- Move towards public debt financing rather than expensive Public Private Partnerships (PPP) financing
- Introduction of a Gold Royalty
- Removal of the principal place of residence exemption for contiguous land titles ('tennis court exemption')
- Closure of the heritage valuation loophole
- Increasing the flexibility and convenience in paying State Land Tax

These reforms are contrasted with less sensible demand-side policies which have clearly capitalised into higher land prices in regional markets, including:

- First home buyer grants
- Stamp duty exemption of properties sold ≤$600K
- Regional commercial stamp duty discounts.

In **section one** of this submission, we make a series of recommendations regarding land taxes including stamp duty and ratings reform. We'd like to highlight the detailed work we've done on transition design for stamp duty-to-land tax reform, including robust modelling of the proposals budget impacts[1]. For the purpose of our submission to the Victorian Government Ratings Review, we've also conducted some significant research which demonstrates the superior efficiency and equitability of Site Value (SV) over Capital Improved Value (CIV) as a local government ratings base.

Section two focuses on fiscal policy to support the ambitious infrastructure program being undertaken by the Andrews government. Now more than ever, we must embed sustainable funding sources into urban development projects. Land Value Capture mechanisms must be designed into transport network and urban precinct planning. Late last year, we hosted numerous public discussions to improve the public sector's familiarity with key value capture mechanisms that are being used around the world to fund large scale public transport infrastructure[2].

In **section three**, we implore the Victorian Government to critically assess its current demand side-interventions into the housing market. We present evidence of their failure as well as recommend viable alternatives.

In our **section four**, we make recommendations around the management of state-owned natural monopolies, including land.

Thank you for this opportunity to contribute our unique perspective. Should you wish to contact us, I have provided my details below.

All the best,

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[1] https://www.prosper.org.au/wp-content/uploads/2019/07/Designing-the-Transition_Final_Helm.pdf
[2] https://www.prosper.org.au/wp-content/uploads/2019/09/Prosper_Hale_Transit_Transformation.pdf

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1. Use our best tax better: reform land and property taxes

1.1 Protect and Expand State Land Tax (SLT)

Recommendations:

1.1.1 Focus future tax cuts on non-land based taxes
1.1.2 Flatten the State Land Tax rates by raising lower bracket rates
1.1.3 Lower the State Land Tax thresholds to raise revenue
1.1.4 Include site value change in Land Tax Assessment Notices

1.1.1 Focus future tax cuts on non-land based taxes

Why land tax? **Ultimately, our tax system should reward effort, encourage entrepreneurialism, and protect our natural environment from over-exploitation.** If we capture the rising value of land and other scarce resources, we can replace taxes that damage the economy such as payroll tax and insurance duties.

Our first recommendation is that treasury focus future tax cuts on those taxes that slow economic productivity rather than land-based taxes.

1.1.2 Flatten the State Land Tax Schedule by raising lower bracket rates

Prosper has long advocated the need for the progressive rate to be flattened and broadened.

Land tax is inherently progressive: the value of land reflects the value of the benefits (economic, social, environmental, cultural, aesthetic) provided to that location. Subsequently, progressive rates are horizontally inequitable, as they do not tax each dollar of land value equally.

Furthermore, progressive rates create rapid escalations in SLT at higher thresholds resulting in “bill shock”. This increases the salience of SLT and may have the consequence of eroding support for this tax.

Cutting top tier SLT rates is likely to result in higher land prices, as the tax break is capitalised into a higher willingness to pay. Cutting the top tier, then, would effectively hand a windfall gain to the existing holders of our state’s most valuable real estate. By contrast, changes that flatten SLT rates should avoid generating windfall gains.

Therefore, **we urge treasury to flatten the land tax schedule by raising the lower bracket rates, rather than cutting the top tiers.**

Prosper recommends that reforms to existing SLT rates and thresholds be considered separately to a tax shift from Stamp Duties to Land Value Tax. (See section 1.2)

The current schedule also inhibits institutional investment in real estate. Restricting institutional investment may be desirable as increased concentration in a fixed land market will increase bargaining power over tenants, and lead to higher rents for tenants.

Wholesale changes to the SLT regime should not be made to facilitate the Build to Rent (BTR) sector. BTR should be enabled through targeted policy, designed to offset the risks of market concentration and ensure institutional landlordism is consistent with the public interest (See Section 3.3 for further details).

1.1.3 Lower State Land Tax thresholds to raise revenue

In a growing apartment market where the site value of many individual strata titles may well be under the $250k state land tax threshold, it does not seem fair or reasonable that investors in these properties are exempt from land tax.

There is no good policy rationale for retaining a land tax free threshold and exempting small landholdings from land tax. It is highly probable that the majority of investors in the land tax free threshold would be owners of apartments, small commercial sites, low value regional/rural land, and other attached dwellings.

By abolishing the tax free threshold, owners of such holdings would also no longer face a sudden flat payment of $275 p.a upon their land value moving from $249,999 to $250,000. **This would further broaden the base, improve efficiency, and make land tax more equitable.**

1.1.4 Include site value change in Land Tax Assessment Notices

All SLT notices should communicate the change in the sites market valuation. Presenting windfall land value gains alongside the proportion payable to the State frames the contribution more positively. This is a small means to increase acceptance of land tax. As a proactive measure, Sydney City Council provides this information on their rating notices.[3] A similar approach could see Victorian Land Tax bills include the graphs in following mock-up:

[3] http://www.cityofsydney.nsw.gov.au/live/residents/rates

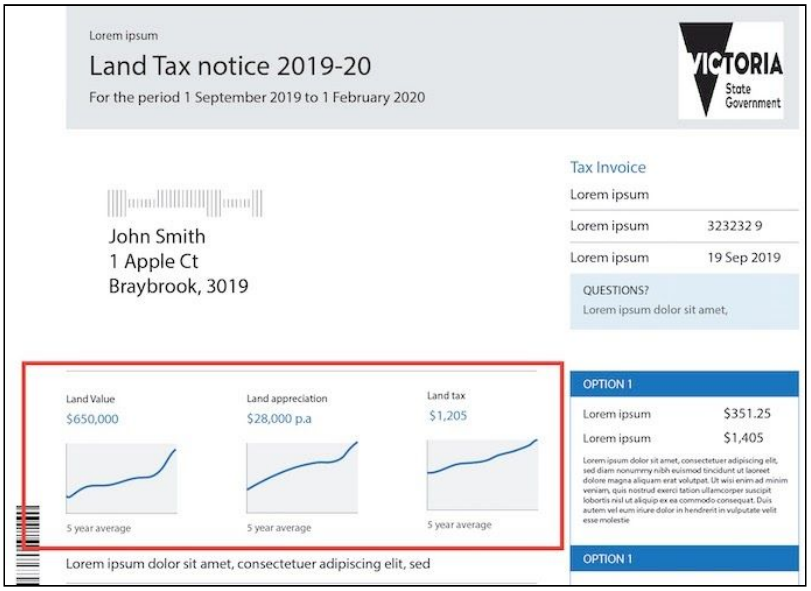

Figure 1. Mock up of Victorian Land Tax notices displaying individual land price gains

1.2 Transition from Stamp Duties (SD) broader SLT

Changes to the existing State Land Tax regime should be considered separately to reforming Stamp Duties.

Recommendations:

1.2.1 Develop a politically viable SD to LVT transition
1.2.2 Redesign non-residential Stamp Duty concessions
1.2.3 Replace Stamp Duty on Foreign Buyers with a SLT absentee landowner surcharge

1.2.1 Develop a politically viable SD to LVT transition

Victoria's Stamp Duty revenue is unstable. Now is the time to develop policy packages to enable a shift away from a tax that costs the Australian economy billions each year. The latest modelling has estimated the deadweight costs at $2.35 for every dollar raised (on NSW data).[4]

Prosper does not view the ACT transition model as preferable or feasible in Victoria. The transition is too long (delaying potential gains), and key issues are not addressed.

We recommend treasury develop a policy that abolishes stamp duty immediately, and makes use of policy design tools that ensure equity in the transition and ease the politics.

Tax credits for recent purchasers are important. Tax deferrals (at commercial interest rates above the Government Bond rate, for owner-occupiers and potentially individual

[4] Centre of Policy Studies, 2018, *The Economic Impact of the NSW and Australian Tax Systems*, Victoria University

non-incorporated investors) could be utilised to build acceptance. A short tax-holiday phase in period could give room for those who are uncertain.

The reform package modeled for Prosper Australia would cost the Victorian budget $33 billion.[5] This can be internally funded at 0.46% flat land tax rate with a supplementary rate of 0.28% over ten years. If this higher rate was maintained over time, payroll taxes could be halved.

On a median $626,000 house with land values of $375,600 would pay $2,779 per annum in state land tax. A summary of the policy instruments that could be used to offset the pain of the tax switch can be found in Table 1 below.

This tax design is fairer, and for those who prefer to defer their liability, solves the problem of owner-occupier tax saliency by aligning the timing of payment with liquidity (asset sale) - as is the case with SD.

Table 1: Suggested policy instruments for the tax transition

Issue	Instrument	Design
Double-taxation of recent buyers	Credit for past duty paid	Wide eligibility (e.g. up to average tenure), cash-out
Politics of new tax on long-held properties	Tax holiday + Deferrals (broad eligibility)	Short phase-in (e.g. 3 years) Commercial interest rates
Future buyers' concerns	Opt-out option	Short open period (3 years) Close period 20-30 years
Asset-rich cash-poor cash flow	Deferrals (narrow eligibility)	Commercial interest rates
Budget (revenue) impacts	Temporary supplementary rate	e.g. 10 years
Other political economy issues (e.g. asset value fears, salience, resilience)	Tax holiday + Deferrals + Messaging	As above

State Government net debt can be avoided by establishing a Public Financial Corporation (PFC) to hold deferred land tax assets and borrowing liabilities (expenditure originally

[5] Helm, T. (2019) *Stamp Duty to Land Tax: Designing the Transition* Prosper Australia: Melbourne https://www.prosper.org.au/wp-content/uploads/2019/07/Designing-the-Transition_Final_Helm.pdf

covered by SD revenues). In this context, tax deferral is effectively profitable lending secured against the property via a lien (a charge recorded on the title like a mortgage).

A Victorian PFC could be capitalised by Government guaranteed debt (or give it a debt financed equity injection), and thereafter pay dividends out of the equity to ensure the government maintains "positive cash-flow" (a surplus) and cover forgone SD revenues.

Property tax deferral could be highly valued by taxpayers, it is revenue-positive for the state, and it could make a substantial difference to the salience of and resistance to land tax.

This policy design is described in detail, along with modelling and methodological assumptions, in our recent report Stamp Duty to Land Tax: Designing the Transition.

1.2.2 Redesign non-residential Stamp Duty concessions

The current *Regional commercial, industrial and extractive industries property concession* (RCIEIPC) is admirable in its goals, but is not well designed to meet its objectives.

The discount allows buyers of existing properties to claim the discount without investing in any additional improvements on the property. Subsequently we expect this discount to capitalise into higher land prices without much additional investment. The existing provision of requiring demonstrated continuous use over 12 months is good, but not stringent enough. We recommend that the government reconceive this discount with a more narrow definition.

The RCIEIPC should be narrowly targeted so only property buyers who have made additional investments in improvements on their land receive the discount. This will subsequently reduce the cost of investing in capital improvements with less leakage of the tax concession. The current concession goes to vendors who pocket the discount, by selling to buyers who have no incentive to further improve the property.

If the policy aims to improve the occupancy and use of non-residential land (relocate and develop new businesses in regional Victoria), a different policy instrument should be used.

Rather, **the government should investigate adopting and implementing a *Property Activation Levy*** similar to the Northern Territory Government (see section 1.3).

1.2.3 Exchange Stamp Duty on Foreign Investment

A higher absentee landowner surcharge, an SLT on foreign investors, will reduce the perception of housing as a deposit box type investment. Recent SD payments could be credited against forthcoming SLT levies.

1.3 Refine the Vacant Residential Property Tax (VRPT)

Recommendations:

1.3.1 Apply VRPT to all properties within the urban growth boundary
1.3.2 Apply VRPT to vacant land
1.3.3 Apply VRPT to vacant non-residential property
1.3.4 Switch to Site Value as the VRPT base
1.3.5 Investigate the use of a property activation levy for Victoria
1.3.6 Revise VRPT terminology

Prosper Australia congratulates the Government the introduction of the Vacant Residential Land Tax (VRLT, previously *Vacant Residential* ***Property*** *Tax*).

We offer the following refinements:

1.3.1 Apply VRPT to all properties within the urban growth boundary

The majority of high vacancy rates are found within the existing tax boundary. However expanding the policy to all properties within the urban growth boundary would be a far more effective policy, as reductions in rents and prices at the margin will improve affordability throughout the entire metropolitan area.

1.3.2 Apply VRPT to vacant land.

Currently the VRLT is exclusively applied to residential land, which excludes vacant land.[6] The vacancy tax will not deter land banking and the profitability of retaining a property option to delay development.[7] If applied to vacant land, the VRLT could discourage under-utilisation and speculative land banking.

Measures should also be considered for vacant industrial land, such as escalating SLT over time and a rezoning windfall gains tax. This could be more effective at curtailing speculative holding of such land than an expanded VRPT.

1.3.3 Apply VRPT to vacant non-residential property.

Currently non-residential property (predominantly commercial and industrial property) demonstrates very high and rising vacancies in a number of inner-middle ring suburbs. At least three suburbs have vacancies of over 25%, and a further five have vacancies of over 10%.[8] While tackling affordable housing is rightly a priority of the government, it is clear that small-medium businesses are under pressure from excessive rents relative to actual available rental supply.

High rents prevent new businesses from starting up and taking on tenancies, which inhibits investment, job creation (demand for labour) and wages growth. The Government should subsequently consider expanding its targeting of vacancies to non-residential properties - preferably through surcharge rates of State Land Tax (on the site value).

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[6] https://www.sro.vic.gov.au/vacant-residential-land-tax
[7] https://www.fresheconomicthinking.com/2018/04/delay-or-develop-what-really-determines.html
[8] https://www.prosper.org.au/wp-content/uploads/2019/04/Speculative-Vacancies-9.pdf

1.3.4 Switch to Site Value as the VRPT base

If levied on a Capital Improved Value (CIV) basis, marginal dwellings (e.g. ageing stock) may be demolished in order to minimise tax on improvements, especially given vacant land is exempt. Vacant homes are penalised over and above vacant land under the tax compared. The loss of marginal housing stock has implications for affordability among the most vulnerable. A fairer and more efficient implementation would occur if the tax was levied at higher rates on Site Values only for non-strata titles.

1.3.5 Investigate the use of a property activation levy for Victoria

We note the Northern Territory Government is implementing a *Property Activation Levy* applied to CBD commercial land.[9] Like the residential vacancy tax, localised property activation levies would incentivise landholders of unused/underutilised non-residential land to reduce land costs to businesses looking to locate and develop in the regions. If the tax is well designed, landholders of vacant land will develop/occupy their own land, offer cheaper/discounted rent to attract businesses, or put their land on the market at a discount to businesses looking to develop/occupy to avoid the tax. Subsequently occupancy and relocation costs will fall for businesses in regional Victoria by reducing rents and land prices.

1.3.6 Revise VRPT terminology

Use the correct terminology of "Vacant Residential Property Tax" if the tax is to be levied on CIV. Vacant Residential Land Tax is misleading and inaccurate. "Vacant Residential Property Tax" should be retained if our previous recommendation on switching to site value (SV) over capital improved value (CIV) as a tax base is implemented.

1.4 Site Value (SV) rating for municipal rates

Recommendations:

- Use Site Value (SV) instead of Capital Improved Value (CIV) as a Local Government Rates base
- Allow differential rating for SV as with CIV

We thank the Government for undertaking a review into the rating system before introducing the changes mooted in the 2018 Local Government Bill. We recommend our submission[10] to the review as well as the findings of recent research into the equity and efficiency of different rating bases.[11]

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[9] https://treasury.nt.gov.au/dtf/territory-revenue-office/property-activation-levy

[10] https://s3.ap-southeast-2.amazonaws.com/hdp.au.prod.app.vic-engage.files/9415/7318/6722/82_Prosper.pdf

[11] https://osf.io/mxg3j/

The highlights of this research include:

- Rates under SV are more aligned than CIV with household incomes and other household socio-economic metrics (e.g. Index of Economic Resources, which includes wealth). Subsequently SV is consistently more progressive than CIV on this basis.
- SV is more concentrated among fewer properties, so a shift from CIV to SV will reduce median rates and the rates of most ratepayers
- The effect on increased construction investment could be 20-50% from a CIV to a SV switch rates base switch over a period of ~5 years.

1.5 Remove Rate Capping

Prosper suggests that rate capping is not a sustainable or effective solution to escalating rates increases. **Treasury should advise the Minister for Local Government to mandate and resource long term financial planning for councils.**

Reliance on rate capping will not solve underlying issues: many essential long term expenditures will go unfunded. Furthermore, costs shifted away from municipal rates will be inevitably funded by less efficient and regressive taxes, such as the GST. By shifting away from rates, which penalises speculation, current land use and equity issues will be compounded. This is a step in the wrong direction.

Council planning in New Zealand, where rate capping is unnecessary, provides an instructive example. New Zealand is regarded as having best practice and has far more sophisticated planning, with 10 year forecasts for future rate increases and rating strategies. **We recommend Treasury help facilitate development in this area through financial resourcing, capacity building, and extending technical expertise.**

Whilst concern has focussed on the revenue side of council operations, we note the outcome of thirty years of council cost outsourcing and rationalisations has not been thoroughly assessed. We welcome the Victoria Auditor General's investigation into the use of contractors and consultants in the Victorian public sector.

1.6 Review the Fire Services Property Levy (FSPL), Waterways, and Parks Charges

Recommendations:

1.6.1 Reduce fixed charge and CIV & NAV components of the FSPL, waterways, and parks charges in favour of higher rating on SV

1.6.2 Levy the Waterways and Parks charges on contemporary SV annual valuations, abolish the minimum charge, and/or roll them into existing fixed charges

1.6.3 Hypothecated mental health levy should be designed as a property levy on SV

1.6.1 Reduce fixed charge and CIV & NAV components of the FSPL, waterways, and parks charges in favour of higher rating on SV

The salience of the Fire Services Property Levy (FSPL), waterways, and parks charges may be the lowest of any property based tax in the state (including council rates).[12] This may be due to their hypothecation to services which result in a direct benefit connection, and bundling into utility bills (with the exception of the FSPL in rates notices).

Despite their low salience, these hypothecated property levies have yet to realise their full potential. Most are split between a fixed charge component and a Capital Improved Value (CIV) or Net Annual Value (NAV) component (both of which include improvements in the tax base).

Fixed service charges, while being non-distortionary (assuming property owners cannot opt-out of charges by opting out of service), are regressive, subsidising owners of higher value land relative to owners of marginal land. This is only appropriate for direct, quantifiable benefits that can be tied to servicing a particular property e.g. waste. However emergency services, waterways, and parks are public goods. These types of services have more generalised benefits to all sites that vary with location, size of the site etc. These are more appropriately funded from rates on SV rather than fixed charges. This would make the funding base more progressive, concentrating bills towards inner metro areas which have a much higher capacity to pay.

In addition to poor equity, the accumulation of various CIV/NAV levies (including council rates and now the Vacancy Tax) raises the spectre of accumulated deadweight costs - especially for non-residential property. SV on the other hand is both a superior efficient and progressive tax base.[13] Hence, SV should be used as the tax base to take advantage of low tax saliency, while improving the equity and efficiency of the state's property tax regime.

It is also not clear whether higher levels of capital improvements of *individual* sites increase emergency service standby costs. We do not believe that this warrants the use of CIV as the rate base for the FSPL, as the associated increasing costs to emergency services comes from development. It is a social cost of granting development rights (upzoning), and should be borne by landholders collectively irrespective of whether they choose to develop.

A larger proportion of the FSPL should come from ad valorem rates (preferably on SV) than fixed charges. We advocate that at a minimum, the weighting be reversed from a ratio of approximately 70% fixed charge to 30% CIV rating, to a ratio of 70% CIV rating to 30% fixed charge.

[12] https://annualreview1819.sro.vic.gov.au/results/objections-and-appeals
[13] https://osf.io/mxg3j/

1.6.2 Levy the Waterways and Parks charges on contemporary SV annual valuations, abolish the minimum charge, and/or roll them into existing fixed charges.

In the case of the Waterways and Parks charges, ***1990*** *property values are used subject to a minimum charge.*[14] We note that this effectively freezes the charge as a type of fixed charge, which has the merits of no longer penalising additional improvements. However this is clearly opaque, outdated, unfair and regressive, and does not align with the Government's move towards annual valuations for State Land Tax. Nor is it consistent with the FSPL.

We urge the Government to update the enabling legislation. These charges should be preferably rolled into an SV charge based upon annual valuations, and/or rolled into the existing fixed charge component. Rating on up to date CIV/NAV valuations will subsequently penalise improvements and should be avoided.

1.6.3 New mental health levy should be designed as a hypothecated property levy on SV

Regarding the proposed levy to fund increased mental health services, we encourage the government to examine the options for a broad based property levy similar to the FSPL.

As mentioned previous (Section 1.4), SV is the most efficient and equitable tax base for property taxes. This would concentrate the levy towards areas with higher capacity to pay and SV, which are predominantly inner suburban areas. These areas have a greatly underutilised rating base and low rating effort due to arbitrary council borders, and so the state government should leverage off the statewide land base (especially within metropolitan Melbourne).

Prosper recommends that the levy be broad based and that every property be subjected to it. In principle this means there should be no tax free threshold. This will make the levy appear fairer, and also spread the burden to keep the rate low.

However given the rating pressures on many rural and regional councils and different levels of rating effort, **we suggest some fiscal equalisation be built into the levy by levying different rates for Metropolitan, regional and rural areas**. This could be done by location with different Local Government Areas classifications, or with a progressive rating structure using different land value per m^2 based thresholds. Prosper also rejects the idea that fixed or minimum charges should be included in the levy, as proportional rates are more equitable and progressive.

[14] (Page 14) https://media-2.yvw.com.au/inline-files/2019-20%20Pricing%20Handbook%20Edition%201a.pdf

1.7 Replace the Metropolitan Planning Levy with a land-based tax

The MPL is in principle, bad tax policy. At a rate of 0.13% of the development cost for developments exceeding $1,076,000, it is a tax purely on improvements. This in turn drives up the cost of improvements and encourages lower quality buildings.

There is no sensible rationale for this tax. It does not correct for any negative externality and raises a paltry sum of revenue.

The hypothecated purpose - to fund the Victorian Planning Authority and Plan Melbourne - would be more sensibly addressed through a land value based levy, since the value of planning decisions ultimately flow through to land values. (See section 2.3.2)

2. Embed sustainable funding models into the urban development process

Recommendations:

2.1 Support value capture

2.2 Mandate that property value and development activity impacts be included in business cases reviewed by Treasury

2.3 Quantify land value uplifts due to rezoning decisions and the revenue impact of rezoning windfall gains taxation

2.3.1 Undertake detailed investigation of the applicability and adaptation of successful schemes from other jurisdictions

2.1 Support value capture

Treasury is the primary beneficiary of an effective value capture for transport funding. We urge Treasury to consider its role in ensuring that land value capture mechanisms are in play at the appropriate stage in the planning and delivery cycle for major transit projects.

To operationalise value capture or beneficiary funding mechanisms, they must be integrated cleanly into an overall project planning and decision-making process. **This requires funding strategy and policy to be positioned at the apex of transport and land-use planning.**

When it comes to mass transport, it is clear that Victoria suffers from a highly cyclical and politically-oriented approach to project planning and funding decisions. Despite the initiation of several city-shaping road and rail projects, Victoria is yet to produce a comprehensive transport plan with projects listed for programmatic delivery within a workable (10-20 year) time horizon.

Ad hoc projects create a lack of certainty and continuity for industry, stakeholders, and ultimately transport users and cities. This in turn hampers the opportunities for predictable, sustainable funding strategies, and ultimately threaten future State budgets.

Since the publication of *Victoria's Value Capture and Value Creation Framework* in February 2017, we have yet to see the development of consistent, publicly communicated mechanisms.

It is critical that government puts LVC mechanisms and frameworks in place <u>before</u> it engages in activities which create value i.e. boost land rents and values. This is including but not limited to:

- strategic planning frameworks with new transport or land-use changes
- introduction of new statutory zones and/or overlays
- announcement of key transport land corridors

Even at the preliminary feasibility planning stage, value creation is anticipated and will dissipate to private landholders unless LVC planning coincides with early spatial planning and development processes. **If all value is dissipated to private landholders, it is no longer available as a sustainable, equitable source of public revenue.**

We are encouraged by the Government's expansion of the Floor Area Ratio & Uplift (FAR/FAU) scheme to Fishermans Bend. The Premier has indicated that the Suburban Rail Loop Authority will draw from Hong Kong's experience in direct property investment and sale and auction of development rights. This is a welcome and necessary continuation of Victoria's past successes with Melbourne Central and the Southern Cross Station.

The following documents provide a clear categorisation of five LVC mechanisms available to treasury derived from an international evidence base:

- Prosper and Hale Infra Strategy, *The transit transformation Australia needs*,
- Asian Development Bank, *Sustaining Transit Investment in Asia's Cities: A Beneficiary-Funding and Land Value Capture Perspective (p. 38-42).*[15]

These offer further clarity and opportunity beyond those included in *Victoria's Value Creation and Value Capture Framework*.

Treasury should, as the primary departmental beneficiary of sustainable infrastructure funding, take a leading role in coordinating value capture policy across relevant departments.

2.2 Require property value and development activity impacts to be included in business cases reviewed by Treasury

Treasury should use its formal role as Gateway Reviewer to mandate the inclusion of holistic benefits appraisal within infrastructure projects. Property value and development activity impacts should be explicitly researched, modelled and included in the business cases reviewed by Treasury.

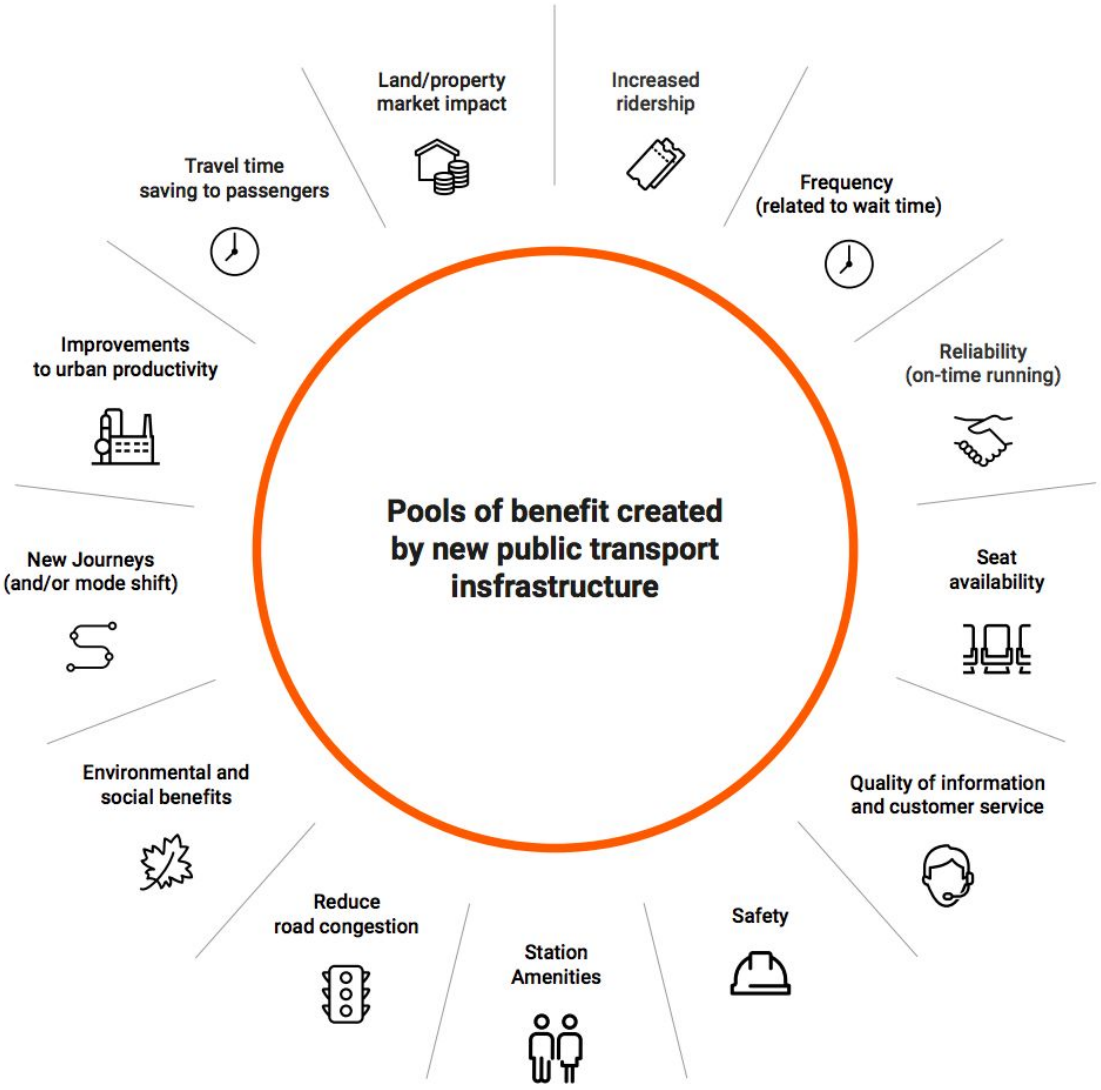
Traditional approaches to project appraisal focus excessively on narrowly-defined transport-related impacts, such as travel time savings or congestion-reduction outcomes from road links.

Land use-related or productivity-related benefits and impacts are conceptualised as 'non-traditional', 'non-core', or somehow of limited relevance. However, the land use, business-related, and whole-of-economy benefits from major transport projects comprise some of the most legitimate and significant of all project benefit pools. As such, they should comprise core criteria upon which project decision-making rests.

[15] http://dx.doi.org/10.22617/ARM190085-2

The diagram below provides an overview of the pools of benefit arising from new public transport infrastructure.

Figure 2: Pools of benefit created by new public transport infrastructure



While value capture opportunities formed part of the business case for Melbourne Metro, potential value capture through tax increment financing and/or new levies and contributions were inexplicably and regrettably excluded.

In contrast, London's Crossrail project involved innovative value capture funding streams including a property rates levy and developer contributions. These mechanisms were supported by detailed modelling of property gains within the station catchments.[16] Similarly,

[16] https://learninglegacy.crossrail.co.uk/wp-content/uploads/2016/02/4C-005-crossrail_property_impact_study_main-_small.pdf

Transport for NSW has undertaken modelling of property gains around the Sydney Metro project.[17]

Without information about the property related impacts decision-makers and planners lack a realistic picture of who benefits from the Metro project, and the magnitude of those benefits. Without this information, Government is less able to make the case for value capture. Treasury has an opportunity to ensure responsible authorities and departments measure and understanding these impacts.

2.3 Quantify land value uplifts due to rezoning decisions and the revenue impact of rezoning windfall gains taxation

Rezoning windfall gains taxation can be extended to encompass all land rezonings in Victoria.

Treasury can provide leadership by:

- **Undertaking detailed investigation of the applicability and adaptation of successful schemes available from other jurisdictions, and**
- **Modelling the revenue impacts of such a scheme**

2.3.1 Review existing mechanisms and how these can be expanded/improved

The Government is to be congratulated for introducing the Floor Area Ratio/Floor Area Uplift (FAR/FAU) scheme to the Capital City Zone and Fishermans Bend. The Growth Areas Infrastructure Contribution (GAIC) is generating much needed funding. These schemes enshrine the 'beneficiary pays principle'.

It is regrettable that Precinct Structure Plans continue to be gazetted in the absence of adequate mechanisms to capture the windfall gain from upzoning.

Developer contributions (DCs) are an existing form of land value capture which has been recommended in the Productivity Commission's Inquiry Report *Public Infrastructure* (2014). It is notable that DCs are efficient and are capitalised into lower land values, thereby having zero negative impacts for housing affordability.[18]

However, DCs are not always directly a form of LVC, as in many instances they are levied before any value is created or realised in land value uplift. They operate more as a direct tax on existing landowners, who may or may not realise future value creation depending on the duration for which they hold their property for. This makes DCs an efficient and useful funding source, but not necessarily an equitable form of land value capture.

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[17] https://www.luticonsulting.com.au/wp-content/uploads/2013/12/Sydney-Transit-and-Urban-Renewal-Value-Creation-Report.pdf

[18] Murray, C.K., 2018. Developers pay developer charges. *Cities*, *74*, pp.1-6. https://doi.org/10.1016/j.cities.2017.10.019

The standardised per hectare formulation benchmarked against infrastructure provision costs of Victoria's Infrastructure Contribution Plans bears no reference to the market value of the additional development rights generated by rezoning. **An effective value capture mechanism captures value proportional to the market value of benefits received.**

It is also worth noting that developer contribution plans are spread over 30 years in some local government areas. This has led to a situation where the need for and delivery of infrastructure by local government is not congruent with payment streams. This is unsustainable where rate pegging is enacted, and underscores the need for funding strategies to be developed as part of the structure planning process.

2.3.2 ACT's Lease Variation Charge

The Government should consolidate its efforts in this area, and investigate a harmonised, statewide scheme modelled on the **ACT's *Lease Variation Charge*.**[19] Applicants seeking planning permission to rezone a property would be liable for a charge equivalent to 75% of the uplift in the market price generated by the rezoning. Such a scheme could be administered by the State Revenue Office under the framework currently used for the GAIC.

The consequence of windfall gains taxation would be significant revenue for infrastructure and lower land prices. Estimates of forgone value for Victoria are in the range of $5.7bn p.a. [20] This revenue could replace the Metropolitan Improvement Levy more than thirty times over.

Table 1: Estimated revenue from adoption of ACT system of capturing planning windfalls

	Capital city median price	Private new dwelling completions	Price ratio	Dwelling ratio	Total markup	Revenue 2018-19 ($m)
NSW	$805,000	73,420	1.3	15.0	20.0	8,218
Victoria	$635,000	64,953	1.1	13.3	14.0	5,735
Queensland	$492,000	39,008	0.8	8.0	6.5	2,669
SA	$428,000	11,942	0.7	2.4	1.7	711
WA	$436,000	16,387	0.7	3.4	2.4	993

[19] http://www.planning.act.gov.au/topics/design-and-build/fees/change_of_use_charge_-_lease_variation_charge

[20] Murray, C., & Frijters, P. (2017). Game of Mates: How favours bleed the nation. Cameron Murray. p.20

Tasmania	**$459,000**	**2,691**	**0.8**	**0.6**	**0.4**	**172**
NT	**$389,000**	**768**	**0.6**	**0.2**	**0.1**	**42**
ACT	**$604,000**	**4,882**	**1.0**	**1.0**	**1.0**	**410**
Total						**18,949**

Sources: ACT Suburban Land Authority 2018-19 annual report (total SLA return), ACT 2018-19 Statement of Finances (LVC revenue), CoreLogic capital city medians (Sep-19), ABS 8752.0 dwelling completions (trend).

3. Effective fiscal policies for perpetually affordable housing

3.1 Redirect demand-side housing subsidies

Recommendations:

- Continue to curtail Stamp Duty tax concessions e.g. First Home Buyers Stamp Duty Discounts (FHBSDD), off-the-plan Stamp Duty concessions for owner-occupiers
- Limit the FHBSDD to new properties, and eventually phase out
- Phase out the First Home Owners Grant (FHOG)
- Discontinue the Regional First Home Buyers Grant

Combined tax expenditure and subsidy assistance to First Home Buyers and owner-occupiers is estimated at $900m for (2018-19)[21] and continues to grow. The recently expanded FHBSDD and regional FHOGs has accelerated these costs for little economic return and questionable public benefit.

It is no surprise that following the expansion of the FHBSDD on 1st of July 2017, First Home Buyer borrowings accelerated dramatically (Figure 3).[22] This confirms a well known fact that the **full value of the Stamp Duty Discount is capitalised into higher prices**, as previously highlighted by the Grattan Institute.[23] As noted in previous submissions, the imposition of this policy in the UK resulted in similar home price inflation.[24]

Demand-side subsidies constitute quick fixes. As a property market stimulus, they are short lived. Demand-side subsidies bring forward latent demand and result in some homebuyers outbidding investors (and each other), which boosts prices.

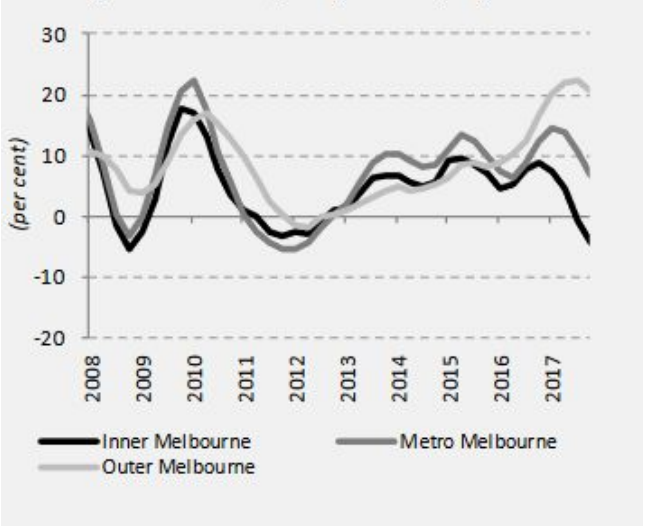
[21] https://annualreview1819.sro.vic.gov.au/benefits/land-transfer-duty
[22] ABS 5609.09b
[23] Daley, J., Coates, B., & Wiltshire, T. (2018). *Housing affordability: re-imagining the Australian dream*. Grattan Institute. (p135-137)
[24] https://www.express.co.uk/life-style/property/903927/house-prices-uk-property-market-rightmove-mortgage-advice-bureau

Figure 3: First home buyer's average loan size

Source: ABS 5609.0 Table 9b

As demonstrated in the previous year's budget paper, the segment of Australia's overheated housing market which did not ease during the recent correction is also the segment most exposed to the FHBSDD.[25] **This is especially the case now in regional markets which have access to additional demand subsidies.**[26]

Figure 4: House price growth by region



Source: 2018-19 Victoria State Budget - Statement of Finances (p.143)

[25] 2018-19 Victoria State Budget - Statement of Finances (p.143)

[26] https://www.domain.com.au/news/geelong-is-no-longer-the-states-hottest-real-estate-market-report-finds/

In terms of a policy response, the FHBSDD has a poor return for public expenditure. For the cost of hundreds of millions of dollars (soon to be billions) every year, a few thousand extra homebuyers *may* have entered into the housing market slightly earlier. However given the counterfactual that prices would have otherwise fallen, it is not certain this is true.

There is no sound macroeconomic (or normative) argument to use FHB subsidies to prop up the property market. Other potential expenditures provide better multipliers, such as supporting employment and wages growth, or direct job creation. The RBA has highlighted that this is where policy should be focused.[27] Furthermore, the RBA finds *"Consistent with international research, we find evidence that high levels of owner-occupier mortgage debt reduce household spending."*[28]

As growth rates slow, governments must grasp that higher land prices means larger household debts, and ultimately reduced aggregate demand.

3.2 Alternative tenure models - *Land Rent Schemes* (LRS) and *Community Land Trusts* (CLT)

Recommendations:

3.2.1 Redirect savings from demand-side subsidies into alternative tenure models that leverage public land assets

3.2.2 Convert HomesVic into a *Land Rent Scheme* or *Community Land Trust* program

3.2.1 Redirect savings from demand-side subsidies into alternative tenure models that leverage public land assets

Both first home buyers and Victoria's budget would be better off if all tax concessions and direct subsidies for owner-occupiers were phased out, and the savings directed towards land tenure models that directly reduce the cost of land for first homebuyers.

Existing tax expenditures and subsidies are not effective in that they are captured by vendors rather than buyers, and do not enable perpetually affordable housing. Subsequently ever increasing amounts of money are directed to the problem without a lasting impact.

Prosper recommends that the government ceases to fund these types of housing affordability policies. Instead the government should fund land acquisitions for affordable housing programs that directly reduce the price paid using "third-market" housing options (See section 3.3.2).

[27] https://www.abc.net.au/news/2019-02-22/reserve-bank-governor-philip-lowe-parliament/10836828
[28] https://www.rba.gov.au/publications/rdp/2019/pdf/rdp2019-06.pdf

3.2.2 Convert HomesVic into a Land Rent Scheme or Community Land Trust program

When it comes to government schemes to promote homeownership, the HomesVic private shared equity model is a small step in the right direction. However, *community shared equity* is a superior and proven model that has a low budget impact. The central flaw in private shared equity schemes like HomesVics is to add demand into the housing market without dealing with the fundamental problem of escalating land prices. Private shared equity contributes to the financial arms race that makes housing perpetually unaffordable; HomesVic is not intergenerationally equitable.

It is both fairer and more economically sustainable to fund **direct land acquisitions** (still admittedly a demand side intervention) for third-market housing.

Third market-housing includes *Land Rent Schemes* as in the ACT, or *Community Land Trusts*. These community shared equity tenure models create affordable housing by lowering the cost of land for homebuyers in perpetuity.

Details can be found in Prosper's report on *The Unspoken Alternatives to Expensive Housing*.[29]

In addition to the existing HomesVic pilot, **we recommend that the government investigates a Land Rent Scheme as used in the ACT**, which has delivered significant savings for first home buyers (up to 37% compared to private rental).

3.3 Build-to-rent (BTR) in the public interest

Recommendations:

3.3.1 Investigate the NSW approach - PPPs with BTR developers via direct public land leases

3.3.2 Create a Public Financial Corporation (PFC) to facilitate land acquisitions

3.3.1 Investigate the NSW approach - PPPs with BTR developers via direct public land leases

It is important that if the Government wants to explicitly encourage BTR it does so in the public interest.

The private sector is already undertaking BTR pilot projects without tax concessions. It is clear if the private sector wants to do BTR it will do so. In the context of facilitating BTR, changes to the SLT regime should **not** be made without a clear and unequivocal public benefit.

[29] https://www.prosper.org.au/wp-content/uploads/2018/09/Unspoken-Alternatives-final_print_web.pdf

BTR is often presented as a solution to the lack of affordable rental housing. However corporatisation of the private rental sector does not constitute a public benefit. Indeed, the concentration of corporate ownership in the private rental sector in Europe and the US post-GFC has raised alarm among housing advocates.[30]
The UN Special Rapporteur for Housing states:

> *"The financialization of housing has dramatically altered the relationship of States to the housing sector and to those to whom they have human rights obligations. Rather than being held accountable to residents and their need for housing, States' housing policies have often become accountable to financial institutions and seem to pander to the confidence of global credit markets and the preferences of wealthy private investors."*[31]

The State should engage in special Private-Public Partnerships with developers by adopting a model similar to the NSW's *Community's Plus* model.[32] As illustrated below (Figure 5), a PPP approach where the state is an equity partner eliminates barriers for private BTR and institutional investors created by the progressive land tax schedule. This ensures it can maximise commercial rental revenue through direct leases rather than land taxes.

The Government may subsequently run tenders either to maximise lease revenue, or maximise affordable housing provision for a given recurrent leasehold fee. We suggest that the government should build mechanisms into the lease to capture the incremental increase in the value of land e.g. via rent indexation to a relevant rental inflation index (not CPI), or periodic market rent review.

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[30] See Aalbers (2018) Financial Geography II: Financial geographies of housing and real estate *Progress in Human Geography* 1-12; Janoschka, M *et al.* (2019) Tracing the socio-spatial logics of transnational landlords' real estate investment: Blackstone in Madrid *European Urban and Regional Studies* 1-17;

[31] http://www.unhousingrapp.org/user/pages/04.resources/Thematic-Report-3-The-Financialization-of-Housing.pdf p12

[32] https://static1.squarespace.com/static/5625d102e4b0040b09643cc5/t/5b628b222b6a2845023d81ad/1533184893522/Communities+Plus+Build+to+Rent_Redfern.pdf p4

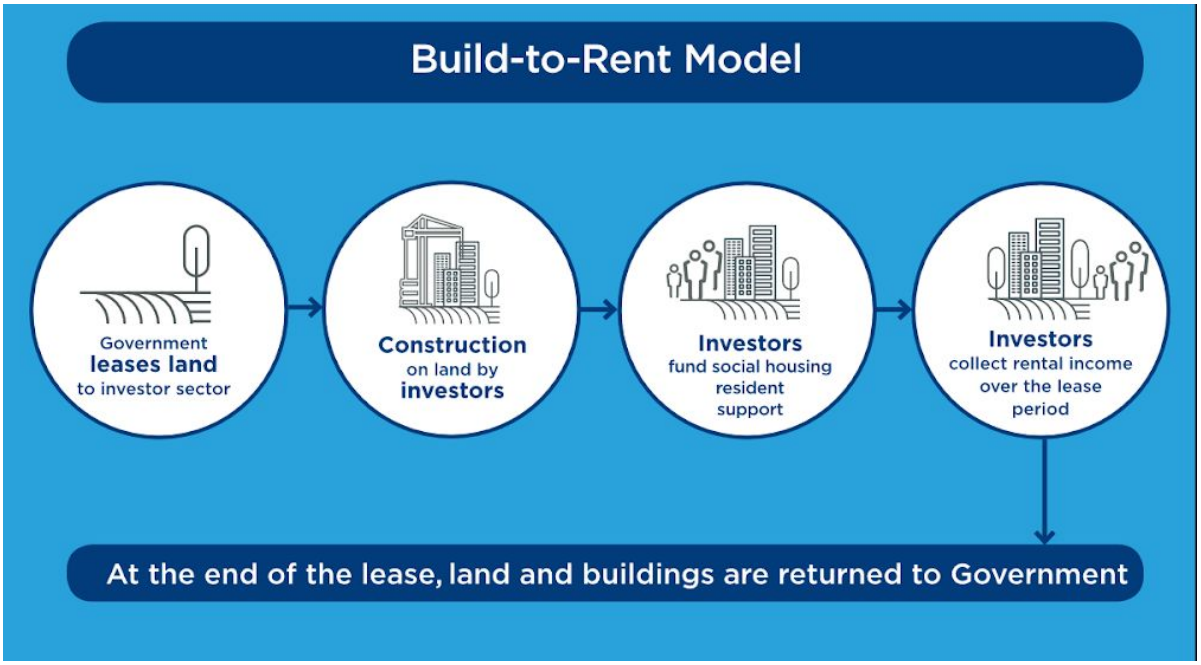

Figure 5: Public interest Build-to-Rent model

3.3.2 Create a Public Financial Corporation (PFC) for land acquisitions

In order for the Government to engage in expanding alternative land tenure models (e.g. LRS and CLTs) and equity PPPs for affordable rental housing, it will need to raise capital. This could be done by **the creation of a PFC which functions effectively like a public Real Estate Investment Trust (REIT)**.

The PFC could raise capital via (Government backed) bond sales or via the new social housing bond aggregator (on its own balance sheet) to acquire land. The PFC can then allocate the land to either budget neutral LRS/CLT schemes, or affordable BTR projects. Additionally, it could create a tender system to buy up surplus land from developers and landowners during a land price downturn for these schemes. The PFC would then start generating income from leases, which in turn would cover borrowing costs.

Eventually the PFC could even return dividend income to the government, or reinvest such income in expanding LRS/CLT affordable housing schemes. Capital gains from land price appreciation would ensure the PFC maintains a strong balance sheet to borrow against for further land acquisitions.

4. Maximise and sustain public benefit from exclusive public assets

4.1 Keep all remaining exclusive assets in public ownership

Recommendations:

4.1.1 Refrain from further privatisation, extensions and concessions of exclusive public assets to the private sector

4.1.2 Fairly evaluate and compare the public alternative to PPPs

4.1.3 Do not sell off public land for residential purposes - consult with stakeholders for alternatives. Hypothecate land sale revenue for non-residential purposes to purchasing land for affordable housing models

4.1.1 Refrain from further privatisation, extensions and concessions of exclusive public assets to the private sector

Prosper recommends the government continue to prosecute the case for more debt financing and demonstrate how this is vastly more cost effective and in the public interest than privatisation, the availability PPP model and "market-led" proposals.

Prosper welcomes the Andrews Government's willingness to revisit public debt based financing after decades of public debt "taboo". Inefficient expansion of exclusive public assets, such as road networks and utilities to the private sector entails more costly financing.

For example, the Land Titles Registry (LTR) was privatised on a 40 year lease for $2.86bn. The LANDATA, and the registration and systems components of Land Use Victoria's titles function generate about $120m per year according to Department of Treasury and Finance estimates.

At July 2018, the Victorian Government could borrow at 2.95% over 10Y. These are among some of the lowest borrowing costs in the state's history. For the sum of $2.98bn, the interest bill alone would be $87.91m p.a.

Considering the LTR's annual revenue was $120m, we can estimate this as a yield or alternative borrowing cost of 4.03%.

This privatisation has cost Victorians $32m in revenue foregone.[33]. In terms of comparing interest rates (4.03% – 2.95%), an interest premium of 1.08% will be paid out over the next 40 years.

[33] ($120m – $87.91m) = $32.09m in lost revenue annually

Leasing the land titles registry is no different for the bottom line than the sale of Government bonds (borrowing) to raise a large amount of money upfront, with the additional interest cost later.

4.1.2 Transparently evaluate the public alternative to Public-Private Partnerships (PPPs)

Similarly to the Land Titles Registry privatisation, the Westgate Tunnel Project involves trading capitalised toll revenue rights to Transurban in exchange for upfront financing of infrastructure. Transurban's monopoly profits based on *Earnings Before Interest Tax Depreciation Amortisation* (EBITDA) data suggest that the public is getting a raw deal in these projects, given the exploitation of depreciation and debt costs to hide profits. The Government (and the public as stakeholders), could save money by if it did these projects via the public sector.

Clearly the private sector has higher financing costs as well as additional considerations such as profit margins. Given the low cost of borrowing, public debt financing is the superior option for major projects in the short and medium term. The constraints the Government imposes on itself when it comes to public debt-financing are political, rather than economic.

When engaging in infrastructure projects, **the Government always needs to ensure it properly and fairly evaluates a public alternative in all areas. These estimates must be released for public scrutiny.** This will ensure Victoria does not squander resources on unnecessary PPPs, including in public financing. **Tenders for public works need to include an option for public provision to ensure the public gets effective value for money.**

4.1.3 Moratorium on selling public land as freehold

As stated in last year's budget submission, Prosper believes that the sale of public land is unsustainable and uneconomical policy. This is particularly the case when such sales are to fund Public Housing Renewal.

Our submission (see section 3) this year has outlined the need for **direct land acquisitions** to achieve a number of strategic housing policies. Selling public land runs contrary to these objectives.

In circumstances where surplus land is not suited for residential purposes, **land sale revenue should be hypothecated towards the purchasing of land for affordable housing purposes.** This may include strategically purchasing non-residential land and then rezoning it to residential to capture windfall gains to reduce costs.

Conclusion

The fiscal challenges facing the government are significant due to macro-economic slowdown,revenue volatility, and a deteriorating ecological base coupled with necessary infrastructure investment. However these conditions also present opportunity.

What is needed is a serious look at revenue policy and how to better utilise the land base. The land base needs to be rationalised across the state's various revenue policies, whether it be land value capture or council rating.

It is also crucial that the government gets the best leverage out of public assets, including land. The affordable housing issue may have become less relevant in a depressed market, but this is the time for the government to be proactive. It is important that this issue is addressed countercyclically through government intervention in the land market. How the government directs funds to create affordable housing in perpetuity is crucial. Alternative land tenure models being the most successful.

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