SUBMISSION TO THE 2022-23 VICTORIAN BUDGET

Prosper welcomes the opportunity to contribute to the 2022-23 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 the unearned and unproductive streams of private income derived from these elements of our economy should be more heavily taxed. Meanwhile, taxes on the productive sector should be eased, making for a more equitable and more efficient economy.

Over previous budgets, the Victorian Government has introduced a number of ad hoc revenue measures. Overall these measures have been excellent, especially the Windfall Gains Tax.

Other measures such as land tax and stamp duty increases, and the Social and Affordable Housing Contribution, indicate a need to move towards more holistic reforms to advance Victoria's economic recovery.

We hope we can continue to offer beneficial advice for the Government's policy agenda and direction. Should you wish to contact us, I have provided my details below.

All the best,

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Fiscal Policy

1. Realise the benefits of broader tax reform

The Government over many years has enacted a number of excellent ad hoc revenue measures that have been largely efficient and equitable e.g. phasing out stamp duty concessions, closing land tax loopholes ("tennis court exemption"), a Gold Royalty, vacancy tax, regional payroll tax cuts, allowing land tax bracket creep. We acknowledge that the political and economic climate is turbulent and challenging.

However these easy opportunities are becoming increasingly scarce, and have also neglected a more comprehensive approach to directing the state's tax system. We are encouraged that the government engaged recently in a confidential tax review.[1]

It is increasingly urgent that we realise the benefits of broader tax reform, including the long standing challenges of Stamp Duty to Land Tax, road and congestion pricing etc.

States have the best tax bases within the federation: land based taxes on holding and development, royalties on mineral extraction etc. And some of the worst: transfer duties, insurance duties, payroll taxes etc. Victoria needs to ensure that its own tax bases are fair and efficient.

NSW government's Review of Federal Financial Relations urged a focus on three critical areas of reform in that State:

- Phasing out the worst taxes on the States' books - transfer duties;
- Working with other States to simplify the payroll tax system; and,
- Shifting more of the tax burden to broad-based land taxes.

These are worthy objectives. We urge Victoria to adopt a similar, holistic approach. Additionally, we place a high priority on the following:

- Use value capture to fund infrastructure - increasing Victoria's use of value capture, independently and through the Commonwealth's City Deals architecture would help Victoria to fund infrastructure. Prosper acknowledges the government has done some work in assessing value capture opportunities for the project in its business case for the Suburban Rail Loop.[2]

- Rationalise and structure the Victorian Contributions framework into a well integrated and coherent system - Victoria has achieved some significant ad hoc improvements with its Rezoning Windfall Gains Tax (among other measures). However, as highlighted by the Victorian Auditor General, Victoria lacks an overarching framework

1 https://www.afr.com/property/residential/property-hit-by-2-7b-tax-austerity-plan-in-victoria-20210516-p57sbw

2 https://suburbanrailloop.vic.gov.au/-/media/Project/VicRoads/SuburbanRailLoop/2021-Content/Library-2021/BIC/SRL-Business-and-Investment-Case.pdf

for developer contributions.[3] Victoria should follow the NSW Government and undertake a comprehensive review and reform of the contributions system.[4]

1.1 Enact a Stamp duty to Land Tax transition

Victoria is well placed to phase out transfer duties (stamp duty) in favour of a broad-based land tax. The economic benefits of this reform are well established.[5]

NSW has signalled its willingness to pursue this reform, but Treasury's approach trades away much of the economic benefit. 'Switch on sale' combined with voluntary opt-in may be politically easier to sell, but it entails a massive and unavoidable loss of tax revenue over a transition period lasting for generations.[6]

We think Victoria can do it better. Prosper has produced a detailed transition model which includes immediate abolition of stamp duty and credit for recent buyers.[7] As in previous years, we recommend this work to the Victorian Treasury.

2. Suggestions for State Land Tax

2.1 Flatten the State Land Tax Schedule

In previous budget submissions, Prosper has called on the government to reduce distortions in State Land Tax by flattening the progressive schedule from the bottom. Abolishing tax free thresholds would broaden the tax base.

The increase of thresholds from $250,000 - $300,000 in the last budget was unfortunate. While this has benefited approximately 61,000 land tax payers, these changes undermine efficient use of vacant land and property.

There is no good economic or social benefit rationale for retaining a land tax free threshold that effectively exempts small landholdings. The majority of property investors own only one investment property and are invested in units with a lower value than median CIV.[8]

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[3] Victorian Auditor General's Office (18 March 2020) *Managing Developer Contributions* https://www.audit.vic.gov.au/sites/default/files/2020-03/20200318-Development-Contrib-report_0.pdf
[4] Yap, N (March 7, 2021) Long overdue shakeup of developer infrastructure contributions *Australian Property Journal* https://www.australianpropertyjournal.com.au/2021/03/07/long-overdue-shakeup-of-developer-infrastructure-contributions/
[5] See for example NATSEM submission to the Federal Inquiry into Housing Affordability and Supply https://www.aph.gov.au/DocumentStore.ashx?id=c4aa94c0-e0ca-4e3a-a746-2a3d97aaddb9&subId=712376
[6] Sims, E (July 2020) Getting the Stamp Duty Transition Right https://www.prosper.org.au/2020/07/getting-the-stamp-duty-transition-right/
[7]Helm, T. (2019) *Stamp Duty to Land Tax: Designing the Transition* Prosper Australia https://www.prosper.org.au/wp-content/uploads/2019/07/Designing-the-Transition_Final_Helm.pdf
[8] Core Logic (2016) *Profile Of The Australian Residential Property Investor* https://www.corelogic.com.au/resources/pdf/reports/CoreLogic%20Investor%20Report_June%202016.pdf. While these statistics have not been updated we expect these trends to persist, with the only significant change being the investor share of housing finance which has dropped significantly. https://www.rba.gov.au/publications/submissions/housing-and-housing-finance/inquiry-into-housing-affordability-and-supply-in-australia/pdf/inquiry-into-housing-affordability-and-supply-in-australia.pdf

We expect that the majority of investors in the land tax free threshold hold apartments, small commercial sites, low value regional/rural land, and other attached dwellings. It is of particular concern in regional towns where there are many vacant lots, held as a strategic investment or hereditary surplus. Such threshold increases work against the government's stated aim of increasing land and housing supply.

2.2 Investigate the impacts of SLT progressive rate increases on viability of private residential infill development

Prosper strongly supports increasing the land tax share of Victoria's revenue. However, we are concerned about the adverse impacts of the increasingly progressive rates of state land tax. In particular, we caution that ongoing rate hikes may adversely affect the viability of residential infill redevelopment.

A key directive of Plan Melbourne is to increase the share of new development in established areas. In order for private developers to acquire existing residential sites for moderate infill development they must compete with owner-occupiers buying residential land at current use value (i.e. existing detached dwellings).

We have been made aware of several cases where previously viable development sites have become unviable due to the tax disadvantages. We have not modelled the magnitude of these impacts, but we believe Treasury is well placed to investigate them.

This distortion would be addressed by a broader-based land tax which removed the PPR exemption.

Alternatively, a tax rebate on infill development for land tax expenses incurred within a certain time frame of acquiring an existing residential dwelling e.g. the three most recent years of land taxes incurred prior to development completion would be a useful incentive. However, this intervention may see tax rebates go to developments that would've gone ahead anyway.

2.3 Expand the Vacant Residential Land Tax

Prosper supports the reinstatement of the VRLT in 2022. We believe it is a useful market shaping instrument, promoting efficient use of the existing dwelling stock. We highlight the following opportunities to improve the operation and impact of the tax:

- <u>Improve enforcement and compliance</u> There is a substantial discrepancy in the number of properties using zero litres of water (22,684 in 2019-20), and the reported revenue from the VRLT, noting that we have no visibility on the number of tax exempt properties. We have been advised by the SRO that no fines have been issued for failing to self-declare. This raises questions about compliance.
- <u>Consider expansion into regional areas</u> - In the context of ongoing regional housing pressures, it could be worth considering whether it is feasible to expand the tax into some council areas at their discretion.

2.4 Rationalise Primary Production Land tax exemption

Rapid growth and land supply pressures in regional areas calls for a review of the Primary Production Land (PPL) tax exemption. In Greater Melbourne's Urban Zones, PPL exemptions are strict and narrowly defined. This is to discourage tax avoidance by land bankers. Outside of Greater Melbourne, it is much easier to obtain a PPL exemption

This inconsistency contributes to potential land banking practices that exist in other jurisdictions with similar rules, such as NSW.[9]

An equitable and simple change would apply the stricter exemption rules to Urban Zones across Victoria.

Tightening PPL exemptions may incentivise land use change in high demand regional areas. It would also broaden the land tax base and improve its efficiency.

3. Relax council rate capping

Prosper continues to call for the restoration of local council revenue autonomy. Rate capping hurts local democracy and reduces the overall efficacy of the Victorian tax system.

It is fortunate that councils (on average) haven't made up most of their rates revenue shortfalls from fines and fees (despite some increase). They have maintained revenues through greater use of contributions.[10]

However, there is a limit to how much revenue can be shifted to new development.

It is clear that rate caps have achieved the (questionable) objective of moderating local government "employee costs". This is not a sustainable policy in the long run. At some point local government wages and employment need to be able to stabilise and resume growing in line with the Wage Price Index and population growth.

Contractors and consultants are not included in employee costs. These "materials and services" costs have notably grown since rate caps were introduced.

Council costs also go beyond employee costs. The current rate cap makes no consideration for indexation of local government asset maintenance and renewal costs. NSW uses a "Local Government Cost Index" to mitigate this issue.[11]

Councils are not household consumers, and face unique cost pressures better reflected in Producer Price Indexes that relate to their actual capital investment input costs. Rate

[9] https://www.prosper.org.au/2017/06/the-metricon-judgement/

[10] Essential Services Commission (2021) The Outcomes of Rate Capping, second biennial report, https://www.esc.vic.gov.au/sites/default/files/documents/lg-outcomes2021-theoutcomesofratecapping-20210520.pdf

[11] https://www.ipart.nsw.gov.au/sites/default/files/documents/fact-sheet-rate-peg-for-nsw-councils-for-2021-22-8-september-2020_0.pdf

capping needs to account for this. Where Produce Price inflation outstrips Consumer Price Inflation, rate capping will erode local government's financial capacity.

Ratepayers who fund councils should not be insulated from rises in real costs for local government. Councils maintain assets that benefit them. While this issue can be resolved with approved higher caps, it may be complex for councils to properly assess these long term costs in annual applications for rate cap increases.

There is scope to provide more relaxed caps for different classes of councils e.g. allowing cash strapped regional councils a more generous rate cap. We note the government has been willing to apply more tailored policy for regional areas e.g. tax cuts, COVID restrictions, and this could be applied with the rate capping system.

Notably, since the introduction of rate capping, capital expenditure has declined in 23 LGAs, and asset renewal ratios have declined in 31 LGAs. 18 councils (16 of these being regional cities or shires) have endured deteriorating finances. This lends further support for a more lenient rate cap for regional Victoria.

Housing Policy

1. Integrate housing, land-use and transport planning authorities to leverage value creation and value capture

Prosper applauds the government's efforts to expand Homes Victoria into various affordable housing models and development, including shared-equity, additional social housing construction, and the Ground Lease model.

Private (monopoly) land markets are inherently inefficient and cannot be relied upon to deliver optimal social outcomes, well located land needs to be carefully and strategically used due to its scarcity. This is becoming increasingly necessary in Melbourne with the diseconomies and poor spatial outcomes associated with urban sprawl, existing transport commitments, and significant long term population growth.

Homes Victoria presents an opportunity to develop and evolve state government institutions in this space, especially within inner-middle ring suburban infill and urban redevelopment. The government has the opportunity with its new infrastructure investment e.g. the orbital rail loop, to enhance infill through land acquisition and development, as well as expansion of its Ground lease model.[12] There is significant potential for public redevelopment of sites into mixed-use development, with mixed social and private market rental housing around key transport hubs.

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[12] We endorse the Ground lease model as it retains public ownership and control over land and development, while allowing private construction and not-for-profit operation.

Many of the functions of HomesVic, along with those of the VPA, Development Victoria, the Suburban Rail Loop Authority, and Transport for Victoria, for example, could be leveraged into a single Urban Redevelopment Authority.

These include: precinct master planning; land rezoning; achieving value through design; public realm amenity and urban design; subdivision and property sale; as well as embedding a comprehensive and intelligent strategic vision in precinct plans, with clear leadership and accountability. All of these aspects impact on value creation.

Integrating these institutions along the lines of Singapore's Urban Redevelopment Authority (which is responsible for TOD and nearly all housing development), would allow for effective exercise of precinct master planning, rezoning and value capture powers etc. We refer to value capture "Mechanism D" in the following reports:

- 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).*[13]

Urban redevelopment authorities should be seen as a real and promising value capture 'mechanism.'

2. Build-to-rent in the public interest

We are delighted to see the government adopt a Ground Lease model. It was a recommendation we made in 2020 as a superior alternative to corporate Build-to-Rent.

We remain concerned about the market power of a build-to-rent industry, as well as the behaviour of and incentives for corporate landlords. The concentration of corporate ownership in the private rental sector in Europe and the US post-GFC has raised alarm among housing advocates.[14]

We are relieved that the 50% land tax discount will eventually sunset. We recommend that the land tax discounts for Build-to-Rent developments be amended to require affordable housing thresholds. For example, a requirement that 50% dwellings be let at a rate of 30% of the median income for those in the lowest quintile be met. Additionally, a mandated minimum average occupancy rate (e.g. 85% over 3 years) will ensure that this new supply is delivered to the market at competitive rates.

3. Regional housing stress response

The COVID-related migration to regional areas has resulted in substantial housing pressure, especially in regional lifestyle areas. Regional Victoria faces critical housing shortages for key workers.

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[13] http://dx.doi.org/10.22617/ARM190085-2
[14] 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;

We are encouraged by the government's commitment to planning reform, and the assistance being provided to local governments to ensure their land supply pipelines.

The VPA's Key and Essential Worker Housing Action Plan is now two years old. Notably, Colac Otway Shire declared a key worker housing crisis some nine months *after* this plan was released. Implementation of some short-term measures seems glacial.

We note that NSW has escalated their response with a Regional Housing Taskforce established July 2021, and has committed $30million to a Regional Housing Fund for local governments.[15]

3.1 Enable the citizen-led housing sector

The citizen-led housing sector has enormous potential to reduce the pressure on low to medium housing markets. However, it is currently stymied by a lack of coordination and funding constraints.

Models such as Community Land Trusts, co-housing, cooperatives are characterised by meaningful engagement, consent, and control throughout the development process. The benefits of each project, such as affordability or sustainability, are clearly defined and legally protected in perpetuity.

This kind of deliberative development facilitates higher quality design outcomes, and diversity of housing typologies. Older Australians want to stay in their known community or – as shown in recent research – move into cohousing style communities where they have access to 'co-care', a model of pooled resources and peer support.[16]

These modes need to be supported with enabling planning frameworks, low-cost financing options, land and cash subsidies, educational and other facilitative resources. In the UK, for example, funding is available to groups at every stage. The UK central government committed a further £4million in 2021 to support the Community Led Homes network.[17] The Netherlands state and municipal governments act as funding guarantors, enabling lower cost finance for creative housing models.[18]

We applaud the inclusion of a Community Land Trust in the VPA's Key and Essential Worker Housing Action Plan. However, the CLT model proposed does not replicate the land lease model, as land leases are to be conducted on a peppercorn basis. Evidence from the ACT's land rent scheme shows that not only can such models support revenues for the Territory, but have saved buyers 37 - 52% over a decade when compared to renting.[19]

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[15] https://www.planningportal.nsw.gov.au/regional-housing
[16] https://percapita.org.au/wp-content/uploads/2019/09/Mutual-Appreciation_formFINAL.pdf
[17] https://www.communityledhomes.org.uk/
[18] National Economic and Social Council, (2014). Financing of Social Housing in Selected European Countries. NESC Secretariat Papers. Paper no. 11. July 2014. p16.
[19] https://www.prosper.org.au/wp-content/uploads/2018/09/Unspoken-Alternatives-final_print_web.pdf

Further, Victoria needs a planning framework for rural land sharing. These provide for multiple occupancy in appropriate settings. At present, there is no provision for small scale farming hubs of 3 - 5 dwellings on a suitably sized allotment (e.g. 10 hectares).

- Rural land is increasingly expensive due to COVID migration (tree-change) trends and sophisticated investment including by superannuation funds.
- Ecovillages and small scale farming hubs respond to social and ecological imperatives, while leveraging technological changes that take pressure off Councils to deliver site services e.g. micro-grids, localised septics.
- Income diversity and local employment prospects are a boon in some rural communities that have suffered long-term economic decline.

Many Australians want medium density, semi-attached housing typologies that aren't being offered by standard speculative developers.[20] The reasons for this are complex, but citizen-led models offer an opportunity to get more of the housing we'd choose. Further incentives to assist such third market alternatives can result in happier communities, reducing the drain on social service resourcing.

3.2 Short Term Rentals

Short term rentals (STRs) is an area of housing policy that urgently needs further research and development.

With the growth of regional tourism, rents have jumped in some rural areas.[21] Towns such as Apollo Bay are at risk of losing key workers, in part, due to rental platforms.[22]

Prosper took a cursory "back of the envelope" look at advertised short term rentals (STRs) as a percentage of advertised LTR stock (Figure 1). This basic analysis of the flow of stock demonstrates that even in second tier tourist towns like Seymour and Stawell, STR's dominate the rental market.[23] [24]

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[20] Kelly, J.F., Weidmann, B., and Walsh, M. (2011) *The Housing We'd Choose*, Grattan Institute, Melbourne. https://grattan.edu.au/wp-content/uploads/2014/04/090_cities_report_housing_market.pdf

[21] https://www.abc.net.au/news/2021-02-14/regional-australia-major-boost-airbnb-impact-long-term-rentals/13130424

[22] It has been reported that even medical doctors cannot afford to rent in the town because of the proportion of the housing supply committed to STRs. See for example, https://www.abc.net.au/news/2021-04-24/apollo-bay-healthcare-crisis-due-to-lack-affordable-housing/100087066 https://www.abc.net.au/news/2021-08-28/coastal-families-lose-homes-to-airbnb-and-owners-fleeing-cities/100380642

[23] Listings current at 20 December, 2021 except for Inverloch which was viewed Feb 9, 2022.

[24] AirBnB listings include entire homes and private rooms which may bias results. A more accurate measure would be to compare only the dedicated AirBnbs (entire home rather than a spare bedroom)

Figure 1: Ratio LTR properties advertised on Domain to STR advertised on AirBnB

City	AirBnB	Long Term Rental	% of LTR/ AirBnB
Apollo Bay	580	12	2.1%
Daylesford	300	6	2.0%
Frankston	133	197	148%
Inverloch	300	49	16.3%
Kyneton	74	13	17.6%
Mansfield	174	8	4.6%
Sale	90	17	18.8%
Seymour	138	5	3.6%
Stawell	27	5	18.5%
Warrigal	39	34	87.2%

Overall, Australian research on the impacts of STR on the long term rental (LTR) market is lacking. Previous AirBnB funded studies compared STR listings to the entire residential market.[25] We believe this may understate the impacts.

Recently, AHURI research found that the 70% reduction in Hobart's AirBnB listings during the pandemic (March-June 2020) translated to an increase in long term rental listings, reducing rents at that point in time.[26]

While the problems caused by STRs are felt at a municipal level, state governments are best placed to act.[27] Many jurisdictions have considered responses such as outright bans on AirBnB, or limiting the total number of rental nights. NSW enables LGAs to cap STR stays to 180 nights per calendar year.[28]

The existing planning framework leaves regional LGAs ill-equipped to respond to the housing market risks of STR. Are STRs as-of-right "bed and breakfast" uses in residential zones? Or are they tourism accommodation uses that require planning permission? What is

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[25] https://www.sgsep.com.au/publications/insights/what-impact-does-airbnb-have-on-the-sydney-and-melbourne-housing-market; https://news.airbnb.com/wp-content/uploads/sites/4/2017/07/Economic-effects-of-Airbnb_Australia_Web.pdf

[26] Buckle and Phibbs, http://www.housing-critical.com/home-page-1/challenging-the-discourse-around-the-impacts-of

[27] M Valverde, https://theconversation.com/airbnbs-adverse-impact-on-urban-housing-markets-109772

[28] Gurran, N., Zhang, Y., Shrestha, P., Gilbert, C., 2018, *Planning responses to online short-term holiday rental platforms*, Research report for the Australian Coastal Councils Association, The University of Sydney, Sydney https://apo.org.au/sites/default/files/resource-files/2018-09/apo-nid194081.pdf

the “threshold criteria” between categories (i.e. number of nights listed, or maximum number of visitors)?

If council is to place restrictions on the number of STRs, what is the fairest way to determine the value of permission to list a property on AirBnB?

Under a ‘cap and trade’ approach, councils would calculate a reasonable percentage of rental stock to be guaranteed for key and essential workers. From there a residual of total rental stock could be annually auctioned off as short term rental rights. The revenue could then be utilised to support affordable housing projects in that town.

This is one of a number of options. It is imperative the Victorian government moves to develop more robust policy responses to STRs.

Conclusion

We are heartened by the government's willingness to sculpt Victoria’s revenue effort towards the land base. With Victorian land prices increasing by $444 billion in FY 20-21, it must be reiterated that our economic success, the sum of our collective enterprise, is capitalised into land prices. Voters must be consistently reminded of the advantages landownship bestows, and the superprofits land development can afford. We will continue to shine a light on these advantages, and always appreciate the opportunity to assist Treasury.