2018-19 Victorian Budget Submission

Preamble

Prosper Australia welcomes the opportunity to contribute to the 2018- 2019 Victorian budget.

This submission focuses on the role of State Land Tax (SLT) in the design of an effective policy response to the housing affordability crisis.

Prosper welcomes the Victorian Government's emphasis in housing affordability. Efforts to dampen speculative demand, such as the Vacant Residential Property Tax, are to be applauded. These tackle the underappreciated effects of increased credit availability, low interest rates and federal taxation arrangements that favour property as an asset class.

We are concerned by the normalisation of private indebtedness. Given the current trajectory, Prosper expects lifetime mortgages in the not too distant future.

Large mortgage debts represent an unacceptable level of vulnerability for families and individuals and pose a systemic risk. Increasing economic resilience means lowering debt. Inevitably, any policy that remedies the structural causes of Victoria's housing crisis *must lower the cost of land.*

The extension of First Home Buyer Stamp Duty discounting to all properties (under $600,000), the continued use of First Home Buyer Grants, and the introduction of shared equity will not make housing more affordable. The economic effect of these policies will be to increase the price of housing for those at the bottom end of the market.

State Land Tax has the potential to become the public's first line of defence against the commodification of housing by reducing the utility of housing as a vehicle for speculative investment. SLT acts as a counterweight to land price as the market value will reflect the tax impost, reducing land prices.The higher the land tax, the lower the capitalised land value.

State Land Tax is inherently progressive if levied at an appropriate rate on the site value of property. We are alarmed by the proliferation of regressive, flat service charges such as the Emergency Services Levy. Policy that undermines local government rates must be curtailed.

Prosper's recommendations, when implemented, will ensure that state revenue policy reflects the highest ideals of both economic efficiency and equality of opportunity.

Building the political capital necessary to extend SLT is an urgent task for leadership. We urge the Government to highlight the efficiency and fairness of 'beneficiary pays' taxation. As long as rent-seeking in property is tacitly endorsed by both progressive and conservative governments, Victoria's housing crisis cannot and will not be resolved.

Key priorities

1. Dampen speculative demand in the housing market:

1.1. Protect and expand State Land Tax
1.2. Reform the Vacant Residential Property Tax
1.3. Exchange Stamp Duty for Land Tax
1.4. Reform Government assistance to First Home Buyers

2. Improve the governance of property markets:

2.1. Capture the value of rezoning decisions
2.2. Investigate 'staged' land and housing releases
2.3. Improve the transparency of auction clearance rates
2.4. Ban all political donations from the property sector as per NSW

3. Maximise and sustain public benefit from natural monopolies and public assets:

3.1. Keep all remaining natural monopolies in public ownership
3.2. Retain Victorian Land Titles Office in public ownership
3.3. Seek alternatives to land sales to fund public housing renewals

4. Curtail regressive taxation and increase fairness:

4.1. Promote Site Value Rating as the principal base for municipal rates
4.2. Reform the Emergency Services Levy, Waterways Charge and Parks Charge into a 'State Rate'

1. Dampen speculative demand in the housing market:

1.1 Protect and Expand State Land Tax

Recommendations:
- Flatten the SLT rates (preferably by raising the bottom tier).
- Incorporate estimation of unrealised land price capital gains into SLT notices.
- Land tax thresholds in general to be lowered.
- Investigate shifting valuation from aggregate land holdings to per m^2 value of individual titles.
- Allow for frequent and smaller installments for land tax payments, preferably monthly.
- Remove the PPR exemption from separately titled contiguous land.

1.1.1 State Land Tax Schedule

Rapid land price inflation has exposed weaknesses in the land tax schedule. 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 imposes large escalations in charges, bringing undue criticism of the SLT system.

A flat percentage charge treats all landholders equally.

1.1.2 Lower State Land Tax thresholds

Current median greenfield land prices of $260,000[1] have unsurprisingly followed the upward trajectory of SLT thresholds from $85,000 (2001) to $250,000 (2009).[2]

Land tax is the most effective tool for affordable housing. But existing land tax thresholds benefit first time investors over first home buyers. 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 reduced 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.

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[1] HIA- CoreLogic Residential Land Report https://www.corelogic.com.au/sites/default/files/2017-09/2017-09-04--HIA-CoreLogicResidentialLandReportMar2017Quarter.pdf

[2] http://www.sro.vic.gov.au/node/1435

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.

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 (the few) investors in the land tax free threshold would be owners of low value regional/rural land, apartments and other attached dwellings. Most should be able to afford up to $275 p.a in land tax without even leasing or using their property - local rates are usually greater.

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. Landholders in existing thresholds could remain unaffected by this change, while those with currently exempt low value holdings would face very small amounts of land tax e.g. up to $275 p.a.

In short, we recommend that existing land tax free thresholds be abolished, preferably by extending the second tax bracket of e.g. 0.2% to $0, replacing fixed rate charges. Alternatively the first tax (free) bracket should have a tax rate that meets the flat payment in the second bracket, e.g. $275 p.a. For example, for general rates the first $0-$250k apply 0.11% and 1.61% for absentees; for the first $0-$25k apply 0.328% for trusts and 1.828% for absentee trusts.

1.1.3 Change valuation from aggregate owner holdings to per m^2

The Victorian Treasury should investigate and model the shifting of the land value tax base away from an owner's aggregate land value holdings and towards a per m^2 value of individual titles, as has been done by AHURI.[3] Modelling should focus around distributional shifts in the land tax burden for existing land tax payers. Ideally this change would be implemented with any major land tax reform.

1.1.4 Allow Land Tax to be paid in monthly installments

Allowing landholders to pay in monthly installments may be more practical and reduce salience, as tax payments could be paid the day after salaries or rent is paid. Alternatively consider at least matching the existing 3 month rego installments option for SLT.

1.1.5 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.

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[3] https://www.ahuri.edu.au/__data/assets/pdf_file/0007/2221/AHURI_Final_Report_No182_The_spatial_and_distributional_impacts_of_the_Henry_Review_recommendations_on_stamp_duty_and_land_tax.pdf

Multiple titled holdings can come about in a number of ways and from a range of landholder intentions. Some are old impractical subdivisions, that have been 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.

1.1.6 Incorporate Estimation of Land price gains into SLT notices

All 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.[4]

1.2 Reform the Vacant Residential Property Tax

Recommendations:

- Remove the exemption for vacant/unimproved land.
- Expand the tax boundary to the urban growth boundary.
- Change the tax base from CIV to SV.
- Ensure adequate resources for compliance, and enforcement of self reporting is backed by onerous fines.
- Consider measures for vacant industrial land, such as escalating SLT over time and a rezoning windfall gains 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.[5] We applaud the proposed Vacant Residential Property Tax (VRPT). It will bring greater fairness to property ownership, while also increasing rental housing availability. However we contend that a vacancy tax would be obsolete if the existing SLT were utilised more heavily and effectively.

Our concerns include:

- *Exemption of Vacant Land.* Currently the VRPT is exclusively applied to residential land, which excludes vacant land. Vacant/unimproved land is more detrimental to housing affordability than residential land with unoccupied dwellings, given the potential for improvements to be made and leased. Vacant land should be heavily

[4] http://www.cityofsydney.nsw.gov.au/live/residents/rates
[5] https://www.prosper.org.au/wp-content/uploads/2015/12/11Final_Speculative-Vacancies-2015-1.pdf

penalised due to the economic costs that underutilisation of land imposes on the community in higher rents and added infrastructure costs due to sprawl. Vacant land brought under the existing VRPT could still qualify for existing “construction and renovation” exemptions. Once the land is developed, the existing framework of targeting the tax towards residential land still applies. If the property is no longer classified as vacant/unimproved land or residential land, then it could remain exempt.

- *Inner city targeting.* The VRPT’s stated objective to target inner city properties is a good start. However, other areas within the Urban Growth Boundary (UGB) remain fair game for speculative demand. While housing affordability is most pressing in the inner city and middle ring suburbs, those who can’t afford to buy in the CBD still face additional pricing pressures on the sprawl. Expanding the policy to all properties within the (UGB) would be a far more effective policy, as reductions in rents and prices at the margin will flow on to improving affordability throughout the entire metropolitan area.

- *Basis of Valuation*. A 1% VRPT levied on Capital Improved Valuations (CIV) 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 and more efficient implementation would occur if the tax was levied on Site Values only. A shift to Site Values would need prudent monitoring to ensure the VRPT is set at a sufficient rate to change incentives.

- *Enforcement.* Significant fines must be implemented and announced under the self-reporting regime. 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 VRPT.

1.3 Abolish Stamp Duties

Recommendations:

- Follow the ACT in moving from Stamp Duties towards a broad-based SLT
- Move from Stamp Duties on Foreign Buyers towards much heavier SLT absentee landowner surcharges.

1.3.1 Exchange Stamp Duties for a Broad Based State Land Tax

State government is frequently criticised for its reliance on stamp duties, and the unsustainable revenue windfalls being generated by the property boom. With the Property Council and groups such as the HIA offering support for the transition from stamp duties to land tax, it is time for action.

To prepare the public for the necessary change, a public education campaign needs to be implemented. We implore the government to do more to educate the public that the $6.02 billion in stamp duties was just 3.2% of the windfall gains enjoyed by residential land holders. The PPR exemption alone costs approximately $2bn, which is already a third of the necessary revenue required to eliminate stamp duties.

Considering the possibility of temporary revenue shortfall following a tax shift, we offer two ideas for managing implementation :

- Securitising land tax revenues: As stamp duty revenues fall, the shortfall could be met by the securitisation.[6] As land taxes are impossible to avoid, the market will price such securities cheaply.

- The use of a ‘City Deals’ framework to attract Federal resources. The current Federal government has expressed support for land value capture and are likely to underwrite a tax switch that adds to infrastructure funding.[7]

Short term revenue shortfalls could be addressed under either arrangement.

1.3.2 Exchange Stamp Duty on Foreign Investment

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

[6] https://australiancentre.com.au/publication/property-tax-transition/
[7] http://www.abc.net.au/news/2016-03-25/uk-city-model-to-be-adapted-for-australia/7276252

1.4 Reform Government assistance to First Home Buyers

Recommendations:

- Remove the First Home Buyers Stamp Duty Discount (FHBSDD).

The tax expenditure costings for the FHBSDD continue to increase. Assistance to First Home Buyers is up from an initial $170m to $422m. The recently expanded FHBSDD has accelerated these costs for little economic return and questionable public benefit.

Since the implementation of the FHBSDD, average First Home Buyer borrowings have increased from $288,000 to $330,000.[8] This confirms our contention that the **full value of the Stamp Duty Discount is capitalised into higher prices**. Banks are the only ones to gain.

This is an abject policy failure and the government's recent extension of the grant will do little to help. The recent imposition of this policy in the UK has seen similar increases in prices.[9]

[8] ABS 560909a

[9] https://www.express.co.uk/life-style/property/903927/house-prices-uk-property-market-rightmove-mortgage-advice-bureau

2. Improve the governance of property markets:

2.1 Capture the value of rezoning decisions

Recommendations:

- Investigate the value of rezoning decisions/windfalls.
- Capture rezoning windfalls, preferably by adopting a levy similar to the ACT's Lease Variation Charge.[10]
- Expand the use of Land Value Capture for funding infrastructure.

2.1.1 Investigate the value of rezoning decisions/windfalls

Government is responsible for ensuring significant value capture is implemented.

Poor public policy outcomes occur when density is increased without appropriate value capture procedures in place. These should be quantified as tax-like 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.

2.1.2 Capture rezoning windfalls

Under current conditions, rezoning decisions have conferred substantial benefits on private landholders. The Government is to be congratulated for introducing the Floor Area Uplift scheme (along with density ratios) to the Capital City Zone and the Fishermans Bend Renewal Area. The Growth Areas Infrastructure Contribution (GAIC) is generating much needed funding. These policies enshrine the 'beneficiary pays principle', as well as disincentivizing speculative behaviour.

These policies can and must be extended to encompass all land rezonings in Victoria.

Obviously, the impetus of 'density bonusing' schemes, such as the FAR/FAU schemes operating in the City of Melbourne, are not appropriate in all locations.

The GAIC, while a definite step in the right direction, has been poorly implemented. The incidence of the tax falls on the purchaser. This design somewhat undermines the

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

'beneficiary pays principle' and reinforces erroneous perceptions that developers are the main beneficiaries of rezoning. Of course it is not the developer but the existing landholder (though oftentimes they are one and the same).

We urge the Government to consolidate its efforts in this area, and adopt a harmonised, statewide scheme modelled on the ACT's Lease Variation Charge. 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 SRO under the framework currently used for the GAIC.

The consequence of windfall gains taxation would be significant revenue for infrastructure and lower land prices.

It is important that a rezoning windfall gains tax is extended to all land-uses. Rezoning windfalls gains taxation is currently quarantined to urban areas, where the political economy of land-use is most hotly contested. However, there is no justification for this reactive approach.

2.1.3 Value Capture

To build political will towards a shift from Stamp Duty to broad-based Land Tax, Land Value Capture (LVC) mechanisms offer a way to demonstrate 'beneficiary pays' funding models. For LVC to retain progressive features, it is imperative that contributions are levied on a percentage basis. NSW has erred in charging a $200 per square metre Special Infrastructure Contribution for the Parramatta light rail project. A flat rate does not distinguish between the relative benefits delivered to different locations; it ignores locational advantage.

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

- HoR Standing Committee on Infrastructure, Transport and Cities submission.[11]
- Department of Infrastructure submission.[12]
- Select Committee into the Scrutiny of Government Budget Measures submission.[13]
- Submission to the Inquiry by the Outer Suburban/Interface Services and Development Committee of the *Parliament* of Victoria.[14]

2.2 Investigate 'Staged Releases'

Recommendations:

- Investigate an escalating land tax schedule *over time.*
- *Record the cumulative number of* undeveloped lots with planning permission and make this data public.

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

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. We are concerned that large landholders in Melbourne's growth areas are able induce land scarcity by holding lots off the market, or "drip feeding the market via staged releases in 'master-planned' estates. Whether a deliberate or inadvertent response to commercial opportunities and constraints, the practice of 'staged releases' has an impact on supply elasticities. The government has an interest in quantifying this impact to understand the role of the private sector in maintaining a historically high level of housing unaffordability.

We accept Government must balance a fair rate of private sector return with its public interest in delivering affordable housing. Successive governments have delivered supply through extensive rezonings on the peri-urban fringe, and inner city renewal precincts.

We suggest SLT can play a greater role in spurring these immense land banks onto the market.

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

Prosper also recommends that a more thorough analysis of land supply is provided. DELWP's Urban Development Report provides details of development-ready sites (with Precinct Structure Plans) and also total broadhectare lot construction. However, there is limited analysis of the cumulative, unbuilt rezoned land.[15] Prosper's analysis of the figures provided reveals that an average of just 7.24% of appropriately zoned lots have been constructed over the last five years. Of note was the counter-cyclical drop in output during 2013-14 (5.5%) and 2014-15 (5.4%).

Any other industry that had a 92% inefficiency rate would attract serious public controversy. The UK is currently holding a Parliamentary Inquiry into land banking.[16] The graph below highlights the cumulative volume of appropriately zoned land over time in the UK, the volume of housing starts, and the volume of projects with approval that remain unbuilt. [17] We urge the Government to produce similar graphs of Victoria's land supply.

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15 https://www.planning.vic.gov.au/__data/assets/pdf_file/0017/27440/Urban-Development-Program-2016.pdf

16 http://www.mortgagesolutions.co.uk/news/2018/01/15/land-banking-review-kicks-off-broker-admits-significant-barriers-persist/

17 http://progressive-capitalism.net/2016/01/boosting-britains-housing-stock-stop-blaming-the-planning-system-for-everything/

2.3 Independent Auction clearance rates

Recommendations:

- A relevant government agency be commissioned to produce the weekly auction results.

Auction clearance rates are a key market metric that deserve greater transparency. Prosper Australia's experience investigating housing vacancies revealed that industry figures suffer a downward bias. Prosper is concerned that market sentiment is flavoured by a positive bias in regards to auction clearance rates.

We first started writing about this issue in 2010. On Saturday December 16th, 2017 the Domain Group reported a clearance rate of 68.8% from a sample of 887 reported auctions. A total of 1320 auctions were scheduled for the weekend, with vendors withdrawing 29 homes from auction.[18] But the reported figures revealed 304 presumably unsold homes had disappeared from the auction figures. If they were included, the clearance rate would drop to a market-sapping 47%.

Property is the largest single purchase most voters make. The Victorian government can ensure all property data is recorded and published as accurately as possible by *an independent body*. Online data portals could be administered by a relevant government body to ensure transparency.

2.4 Ban all donations from the property sector

Recommendations:

- Ban donations to political parties by individuals, corporations and third parties associated with the property and construction sectors.
- Impose a four year restriction from the end of a politicians career until they can work in a related lobbying field.
- Curtail the ability of the property sector to donate to local council candidates.

The proposed Victorian donation reforms announced in September 2017 are welcome developments.The limited terms of reference given to the Independent Broad-based Anti-Corruption Committee demands additional checks and balances to maintain respect for our democratic institutions. The $1000 per annum limitation in individual donations will curtail the influence of lobbyists. More detail is required on the ‘undisclosed revenues’ that deliver so much for both sides of politics. Improvements in transparency regarding time lags are positive developments.

However, any undue influence of the property and construction sectors over policy making, whether actual or perceived, is compounded by campaign contributions.

The windfall gains generated by rezoning decisions are extensive. Governments must ensure they do not act to confer private benefit at the expense of public good. To this end Government must do all it can to distance itself from private sector interests in the determination of planning regulation.

Further, public asset privatisations present an opportunity for immense private profit. The opportunity for private sector profit generates an incentive for private interests to rent-seek. Banning donations from these sectors can ease the pressure on public officials and remove a dilemma for policymakers. Such a reform would help rebuild the public’s confidence in democratic politics at the state level. NSW has built a useful legal framework upon which to base this reforms.[19]

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[18] https://www.domain.com.au/news/quiet-credit-squeeze-could-hit-melbourne-auction-prices-harder-next-year-observers-say-20171217-h066pn/

[19] http://www.elections.nsw.gov.au/fd/political_donations/unlawful_political_donations

3. Maximise and sustain public benefit from natural monopolies and public assets

3.1 Keep all remaining natural monopolies in public ownership

Recommendations:

- Refrain from further privatisation of natural monopolies.
- Investigate the effect of privatisation on the cost structures of the state economy.
- Do not sell off any remaining public land. Consult with stakeholders for alternatives.

3.1.1 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.

The Land Titles Office is a public asset that generates a profit for the public. Public ownership ensures common ownership of land and spatial data, and enables the government to deploy this information in the public good at least cost.

The function of the register is a natural monopoly, and it is **most** economically efficient and socially beneficial for it to be owned in common.

Under Australia's globally-admired Torrens Title system, government guarantees title against fraud and abuse without limitation. Land information generated and maintained in title offices has a documented and legally valid audit trail. This will no longer apply if the register is sold to the highest bidder and privately provided.

This is not only key to the success of land and property markets, but is critical to many public services such as infrastructure engineering, emergency management, or disaster responses. Consider the consequences of any recording error by the private provider.

Providing regulatory oversight of the private sector will require additional layers of governance. This is an unnecessary complication of an effective and transparent system that generates ongoing profit for the government.

3.1.2 Seek alternatives to land sales to fund public housing renewals

Selling public land for a once off renewal of public housing stock is unsustainable and uneconomical.

No one would advocate selling the family home to pay for a new car, or recommend selling the farm to buy a tractor. Yet, these amount to the policy being pursued by the Government and the Department of Housing and Human Services (DHHS).

The potential to leverage existing public land for public housing renewal is very significant, and *does not* require sale of the land to be realised.

Along with other concerned community groups, planning academics and community housing providers, we seek a feasible alternative to the proposed plan. However, the Government and the DHHS are withholding information. They cite “commercial in-confidence” despite the mammoth public land subsidy involved. Under these conditions, no properly costed and feasible alternative can be presented.

We have asked the Government and the DHHS to:

- Release the business case, including determinations around value for money.
- Require developers to ‘open their books’ on projects’ costs and anticipated profits.
- Release outcomes of future profit-sharing provisions, including any share received by the Victorian Government, and where the monies are directed.
- In the event of transaction, reveal the price at which public land is sold.

The significance and value of public land cannot be understated. Land is a fixed and finite strategic resource that increases in value, especially in prime locations.

The government is selling not only the land but all future gains on that land. Private land rent is already politically difficult enough to recover with land tax. The current sell-off proposal exacerbates the problem by placing more land rent into private hands.

Land costs continue to accelerate faster than inflation. Once public land is sold off, funding for future public housing and land needs will be either borne by the taxpayer or be completely unmet.

Both outcomes represent an unacceptable loss for present and future Victorians.

4. Curtail regressive taxation and increase fairness

4.1 Promote Site Value Rating for Local Government (SVR)

Recommendations:

- Promote the use of Site Value Rating as the sole rating base for all property related taxes at both state and local government.
- Allow differential rating to be based on Site Value - Local Government Act 1989 discriminates against SV.
- Reintroduce citizen initiated polls within municipalities to elect ratings base.

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 SVR.[20]

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 values of buildings, we will get fewer, inferior buildings, and higher rents; but if we tax the value of land (exclusive of buildings and other improvements), we will get neither less land nor less valuable land. 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.

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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

CIV is an economic disincentive to densification, and is at odds with the strategic objectives of *Plan Melbourne.*[21]

Local councils should be given the same flexibility with using rates on SV as the do with CIV. Sections 161 and 161A of the *Local Government Act 1989* should be harmonised so as not to discriminate against SV. Changes to the ratings base by citizen initiated polls (Local Government Act 1958 Part XI) should also be restored, as citizens have repeatedly demonstrated their desire for a better rating base over many decades.[22]

4.2 Remove Rate Capping

Recommendations:

- Remove rate capping immediately
- Commission an audit of expenditure pressures associated with private contractors at local (and state) jurisdictions.

Rate capping reduces land's share of the tax burden while increasing municipal dependence on Commonwealth grants, which are paid out of consumption or income taxation. This is a step in the wrong direction.

Entrenching the role of inefficient taxes undermines Victoria's 'education state' economy. Rating on land delivers efficiency, increases municipal resilience and improves economic behaviour.

Proposed changes to the *Local Government Act 1989,* which limit flat fee charges (such as garbage collection) to 10% of all revenue are welcome in isolation. However, in the context of rate capping, limiting flat fee charges erodes the fiscal capacity of Local Government.

In NSW, Councils have endured twenty five years of limited revenue sovereignty enforced by poorly targeted rating caps. The IPART report 'Fit for the Future' found 63% of NSW local councils financially unfit for the future.[23] 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."[24]

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

22 http://www.prosper.org.au/wp-content/uploads/2007/11/aius-report.pdf

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

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

Costs shifted away from municipal rates will be inevitably funded by less efficient and regressive taxes, such as the GST.

If removing rate capping is not an option, the rate cap formula should be weighted more towards the wage-price index, as is done in the ACT for its stamp duty to land tax transition.

Whilst concern has focussed on the revenue side of council operations, the influence of 30 years of privatisations and their burden on both council and state expenditures must be considered. The Victorian Auditor-General must be directed to analyse the cost of service provision by the private sector. The recent Australian National Audit Office's report into the cost of privatised services at the federal level was instructive.[25] Private consultancy fees see defence contractors imposing a 40% cost premium vis a vis public employees. IT consultants are $100,000 more costly per year.[26] A progressive and fiscally responsible government must investigate extensive consultancy fees to determine if taxpayers are receiving value for money.

4.3 Reform the Emergency Services Levy, Waterways Charge and the Parks Charge into a 'State Rate'

Recommendations:

- Reduce fixed charge components of the ESL, waterways, and parks charges in favour of higher rating on site values.

Land is the natural tax base to fund fire services, waterways management and parks.

Fire services protect structures. They give citizens the confidence to undertake bigger and better building projects. 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 are also capitalised directly into land values.

The Emergency Services Levy, calculated on Capital Improved Values, is further tainted by the fixed residential minimum component - in effect a flat fee. This minimum component is economically equivalent to Margaret Thatcher's Poll Tax: an inherently regressive form of taxation.

[25] https://www.finance.gov.au/procurement/statistics-on-commonwealth-purchasing-contracts/

[26] http://www.afr.com/business/accounting/mps-alarmed-at-government-consultancy-spending-20180119-h0kvqz

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, reducing the administrative expense of tax collection.

Conclusion

An election year is the time to deliver a budget with vision. Victoria must meet the challenges of rapid population growth, declining productivity and wage stagnation, as well as skyrocketing land prices. The intergenerational wealth inequality being produced by the housing market can and must be reversed.

The land base must play a bigger role in Victorian revenue policy. A reformed State Land Tax, along with land-based rates and levies, can positively shape land markets: dampening speculative demand, increasing supply, and encouraging development. Distortionary subsidies, and incentives to rent-seek in property, must be removed.

Natural monopolies should be held in common to achieve ongoing, sustainable public benefit. This means retaining public land and housing, retaining monopolistic functions like the land titles register, and seeking innovative means to leverage public assets.

Further privatisations will not bode well for future generations. Long term thinking demands that we gravitate towards more efficient taxes.

Please incorporate our perspective in further policy developments.

Contact

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