LEGISLATIVE ASSEMBLY
FOR THE AUSTRALIAN CAPITAL TERRITORY

STANDING COMMITTEE ON PUBLIC ACCOUNTS
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Inquiry into commercial rates

Submission cover sheet

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PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

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Dr Brian Lloyd
Secretary, Standing Committee for Public Accounts
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Australia

Via email: LACommitteePA@parliament.act.gov.au

14 February 2019

Dear Dr Lloyd

Property Council of Australia (ACT Division)

Submission to the Standing Committee for Public Accounts Inquiry into Commercial Rates.

The Property Council of Australia welcomes the opportunity to comment on the inquiry into the impact of commercial rates in the Australian Capital Territory ("ACT"). The Property Council wishes to highlight that the current settings are opaque and adversely impacting the owners of property and associated businesses which will in turn hurt investment and jobs relative to other jurisdictions.

The Property Council supports the ambition of the ACT in undertaking tax reform to transition away from inefficient transactional based taxes such as stamp duty. However, six years into the 20-year transition, the implementation of the Government's agenda has been flawed.

The current reforms and underlying design of the ACT general rates system are imposing increasingly significant financial burdens on the property industry. For example, while rates have risen by up to 200% in some areas, the rental increase from 2010 has been limited, in most instances being limited to less than CPI.

There is also no clarity on future rate increases over the remaining transition period and current rate components and percentage rates applied, are not disclosed on property rate notices. The lack of transparency is preventing commercial property owners from making long term investment decisions, which reduces competitiveness and confidence in the ACT. Opaque implementation is arguably more inefficient than the stamp duty that is being replaced.

The current level of year on year increases in rates on commercial property in the ACT is unsustainable and the pressure on property owners cannot continue without resulting in significant costs being passed on to business tenants or reductions in reinvestment of capital in existing buildings, stifling growth in the territory.

We recommend that a taskforce is established with representatives from government and industry to undertake a thorough review of the commercial rate settings and current tax reform process, having regard to the broader investment and economic impacts.

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The taskforce should be convened with the following mandate:

- The taskforce members should consist of representatives from government, business community and property industry;
- The overriding goal of the taskforce should be determining the effectiveness of the commercial ratings system and its impact on businesses and property investment in Canberra
- The following specific issues should be included within the ambit of the taskforce:
    - changes to stamp duty, general rates and overall property tax collections for residential vs commercial property under the tax reform process (actual and forecast);
    - valuation methodology applied for determining unimproved rate values, including the reason for the significant increase in 2018 to unimproved rate values applied to commercial and industrial properties; and
    - how this will impact rate notices over the next three years;
    - a fair equitable approach to recovery of historic rates when changes in valuations are backdated; and
    - the dramatic increase in rates across the ACT and the resulting impact on capital values, investment decisions and business viability.

While this review undertaken by the appointed taskforce occurs, rates should be frozen at existing levels to provide businesses with certainty.

In addition, the Property Council recommends essential technical changes to the existing general rates system to create a stable and competitive investment environment in the ACT:

- Encouraging mixed use developments – the ACT tax system financially penalises property owners who create vibrant precincts that bring together office, retail and residential components. This can be easily addressed by fixing the apportionment and valuation rules to have regard to the different uses of the property.
- Simplifying dispute resolution - commercial property owners can incur costs up to $80,000 to simply seek a review of a valuation assessment through ACAT. This is an onerous cost which could be alleviated by establishing a simple and inexpensive mechanism to facilitate disputed rate valuations.
- Improving transparency of rate notices – rate notices should clearly set out details on how the rates were calculated, including the unimproved rate value and the percentage rate applied. To the extent possible, it would also be helpful for commercial property owners to understand how the current general rates amount compares to the pre-reform system where a separate amount was paid in relation to land tax and general rates.

We look forward to appearing before the committee to discuss these issues further and are keen to engage with Government and Treasury to devise a pathway that will support and encourage business investment and economic growth in the ACT, while providing stable revenues to fund our essential services.

Yours sincerely

Adina Cirson
ACT Executive Director

PROPERTY COUNCIL of Australia

Submission:

ACT Legislative Assembly (Standing Committee on Public Accounts)

Inquiry into commercial rates

February 2019

PROPERTY COUNCIL of Australia

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PROPERTY COUNCIL of Australia

1. About the Property Council of Australia

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities.

Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

On behalf of our members, we provide the research and thought leadership to help decision-makers create vibrant communities, great cities and strong economies.

We support smarter planning, better infrastructure, sustainability, and globally competitive investment and tax settings which underpin the contribution our members make to the economic prosperity and social well-being of Australians.

The ACT Property sector is the second biggest industry in Canberra – behind public and health services – employing 1 in 7 Canberrans - equating to some 25,000 jobs– driving economic growth and renewal across our city.

Our sector is critical to the diversity of the economy and contributes 57.5% of all government revenue - more than any other industry, which funds our schools, hospitals, municipal, community and government services. Our contribution to renewing our city at a time of transformation and growth is immense.

Our priorities include:

- **Encouraging urban renewal** that is vital to the future of Canberra's economic and social wellbeing.
- **Planning and Sustainable Development polices** which are outcomes focused.
- **Transport Orientated Development** that delivers density and liveability in the major transport corridors and in our town centres.
- **Housing choice for all Canberrans** including retirement living and affordable housing.
- **Taxes and charges which are fair**, administered efficiently and encourage development where it is needed.
- **Long term infrastructure planning** which will help transform our city.

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2. Executive Summary

The Property Council appreciates the ACT's Government's ambition to move towards a more stable and sustainable tax base away from less efficient transactional taxes, such as stamp duty.

The current transition however requires significant review as it has resulted in an unstable and uncertain tax system. As no outline of the transition of rates over the 20-year reform period has been provided, there is significant uncertainty as to costs that need to be borne by business. This is limiting the ability for commercial property owners to make sound investment decisions or adequately price rentals to sufficiently cover costs.

The costs borne by current commercial property owners have become unsustainable, leading to lack of reinvestment in the ACT and reduction in business confidence.

We recommend the following four actions:

Establish a taskforce to review commercial general rates

The Property Council believes that it is of utmost importance that a joint government-industry taskforce be established to review the commercial rates and find a sustainable method for transitioning from transaction taxes to a more stable base.

The taskforce should have regard to the rate at which commercial general rates will rise over the proposed transition period, the impact on long-term property owners, and how this impacts the ACT's competitiveness in attracting investment and business to the territory.

The taskforce should be convened with the following mandate:

- Consist of representatives from government, business community and property industry;
- Adopt an overriding goal to determine the effectiveness of the commercial ratings system and its impact on businesses and property investment in Canberra;
- Include the following specific issues within the ambit of the taskforce:
    - changes to stamp duty, general rates and overall property tax collections for residential versus commercial property under the tax reform process (actual and forecast);
    - valuation methodology applied for determining unimproved rate values, including the reason for the significant increase in 2018 to unimproved rate values applied to commercial and industrial properties;
    - how this will impact rate notices over the next three years;
    - a fair equitable approach to recovery of historic rates when changes in valuations are backdated; and
    - the dramatic increase in rates across the ACT and the resulting impact on capital values, investment decisions and business viability.

While this review undertaken by the appointed taskforce occurs, rates should be frozen at existing levels to provide businesses with certainty.

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Ensure valuation system recognises mixed use precincts

The current ACT valuation approach has resulted in significant disincentive for mixed use and potential build-to-rent developments due to a large rates imposition for commercial and industrial properties. Unimproved land valuations are based on the "highest and best use" which often result in a residential valuation, however the significantly increased commercial rates then apply to the commercial land.

Geographically, the ACT needs to remain competitive in how taxes apply as an imposition of significant costs will not encourage investment in the ACT.

Introduce a simple rate dispute system

While a current dispute process exists in the ACT, reviews generally are required to escalate to the formal review to the ACT Civil and Administrative Tribunal ("ACAT"). Often this will result in costs of up to $80,000 to prosecute disputes. The Property Council suggests that another level of independent review or mediation be provided for prior to proceedings being escalated to ACAT.

Disclose information on current rate notices

Currently rate notices do not separate the previous individual components of the general rates (i.e. prior to the reform process, property owners received a separate notice for land tax and general rates) A singular figure reduces the ability for commercial property owners to have commercial discussions and negotiation around what portion of the components should be borne by the Lessor or Lessee.

To the extent possible, it would also be helpful for commercial property owners to understand how the current general rates amount compares to the pre-reform system where a separate amount was paid in relation to land tax and general rates. The actual unimproved rate value and percentage rates applied for the general rates should also be disclosed.

3. Context

The current inquiry into commercial rates is a continuation of a longstanding review of the ACT tax system beginning prior to 2012.

The ACT Taxation review undertaken in 2012 was outlined as a chance to review the efficacy of the current ACT taxation system, determining "whether the system raises taxes fairly and effectively and provides the stability and certainty required to continue to deliver essential community services to Canberrans[1]".

The report contained 27 recommendations to be implemented, the key recommendations in respect to commercial rates being:

- ***Recommendation 2:*** *With regards to long-term structural reform, over a period of time that is adequate for appropriate transition:*
    - *Abolish duty on conveyances*
    - *Retain a form of tax on payroll to maintain a diversified tax system*
    - *Abolish duty on general insurance and life insurance, and*
    - *Adopt a broad-based land tax as a base for revenue replacement*
- ***Recommendation 10****: Abolish conveyance duty. In doing so:*
    - *Pursue at least a 10 year, and up to a 20 year, transition plan to ameliorate the impact of the change on households*
    - *Have due regard for conveyance duty paid in the years leading up to the change, and*
    - *Recognize the significance of the change and consult with the community on the transition plan.*
- ***Recommendation 19****: Transfer the commercial component of land tax to general rates on commercial properties.*

Subsequent to the report the ACT government announced a transition to modernise the Territory's taxation system. In outlining the reforms, it was stated that *"Importantly, this program will not increase the overall tax burden on the ACT community, with only the foregone revenues resulting from the abolition of inefficient taxes being replaced through the efficient and equitable rates system*[2]*."*

While the government announcement provided a broad outline of the transitional changes, a clear timeline of the transition of rates over the 20-year transition period was not provided.

The current transition has to date resulted in:

- Commercial properties above $600,000 in land value now pay property rates at 5.1675% which in effect, owners are paying the equivalent of a stamp duty-like charge every year.
- Commercial rates are approximately nine times higher than residential rates (comparing the highest marginal tax rates of 5.1675% for commercial to 0.57% for residential)
- The highest marginal tax rate for commercial rates are more than double what they were in 2012 (5.167% compared to 2.361%)

[1] ACT Taxation review May 2012
[2] www.revenue.act.gov.au/tax-reform

- The highest marginal tax rate for residential rates have more than doubled what they were in 2012 (0.57% compared to 0.2727%)
- As an example, commercial property owners have seen up to 25% year on year increases in their 2018 rate notices. These higher tax increases are not being matched with rent growth and are forcing down capital values. On a practical level, lower returns mean there is less money to cover operating expenses and capital improvements which will reduce the amenity of commercial properties.

These significant increases have resulted in the Legislative Assembly directing the standing committee on Public Accounts to inquire into the existing commercial rates, specifically considering as part of the terms of reference *"all issues relating to commercial rates in Canberra" including:*

- *The process for determining ratings factors, the impact of lease variations; how valuations are conducted;*
- *The amount paid by property owners;*
- *The impact on leasing costs, property values and business viability; and*
- *The effectiveness of the commercial ratings system and its impact on the businesses and the property sector in Canberra*[3].

This submission is in response to the call for submissions for this review by the Committee.

4. Certainty around commercial general rates

While a 20-year transitional timeframe for moving from transactional taxes to rates based taxation was outlined in the ACT Taxation review announcements, scant details have been given as to how this rate change will be implemented.

In 2012, the ACT collected $294m in stamp duty and $211m in general rates. In 2018, the budget was forecasting revenues from stamp duty of $275m and general rates of $539m. This shows that even though we are one-third of the way through the tax reform plan, there is still significant reliance on stamp duty and the overall tax collected from stamp duty and general rates has increased significantly.

Commercial rental leases are often on a longer basis than residential rents, the inherent lack of knowledge of what rates will apply to commercial properties has resulted in significant impacts of property owners and businesses who are unable to recover costs from tenants.

[3] ACT Legislative assembly Media release 14 December 2018_ www.parliament.act.gov.au/in-committees/media-releases/2012/2018/media-release-inquiry-into-commercial-rates

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CASE STUDY: ACT Commercial Property in focus:

- A commercial property purchased in 2014 with an unimproved land value of $1.55m would have paid rates initially of approximately $61,272,
- assuming the unimproved land value remains at $1.55m, by 2019, the applicable rates would have increased to $89,696. This is a rate value of 5.78% or an increase of nearly $30,000 over this period.
- If these costs were passed onto a business tenant, that would mean the rent would have increased by $535 a week over the 5-year period (see below case study).
- If unable to be passed on (for example, because the tenant is under a 'gross lease' arrangement) this is a significant loss to the commercial property owner who would have entered into rental terms based on the expected property outgoings at the time.

Commercial properties above $1.5m also do not enjoy the benefit of the reduction in stamp duty cost, remaining subject to a 5% flat duty rate. This 5% stamp duty rate means the ACT remains in the middle of the pack when compared to other states and territories (with rates ranging from 0% in SA to 5.95% in the NT) – this is despite the ACT being one-third of the way through a program which is committed to abolishing stamp duty.

This is exacerbated by our understanding that there are no plans to reduce the top stamp duty rates for commercial property within the current budget forecast period. In 2017-18, total stamp duty revenues (despite the rate reductions) were at 84% of the pre-reform stamp duty revenue base, so property rates will need to keep increasing substantially to transition to a full reduction in stamp duty.

From data collected by the Property Council landlords are generally bearing the costs of these unknown increases. This is resulting in significant impact on business confidence as well as limiting upgrades in existing property and capital expenditure. While rates have risen by up to 200% in some areas the rental increase from 2010 has been limited, meaning a significant cost to business (see Appendix A).

CASE STUDY: ACT Commercial Property in focus:

Local valuation firm budgeted 10% increase in rates from mid 2018 on a Civic Property:

- The budgeted rates (incorporating the 10% increase) equate to approximately $189,000 per quarter
- The actual rates came in at $228,000 per quarter. This is circa $39,000 per quarter over the budget which was based off a 10% increase ($156,000 pa)
- The tenancy is 41,096m² and the lease is structured on a gross basis
- Assuming a notional cap rate of say 6.5%, this equates to a loss in value of $2.4m ($156,000 capped at 6.5%)

In the latest Property Council office market report, there has been an increase in vacancy in Canberra amongst what is considered "C" grade stock, those which would generally be subject to a refurbishment to attract new tenants.[4]

The dramatic increases in rates across all areas of the ACT are having a negative impact on capital values, even where all other issues remain unchanged. Financers will become nervous if capital values continue to be eroded. If ACT further erode financing confidence beyond the current national environment the disincentives to invest in ACT will continue to grow.

The ACT needs to compete for capital with other comparable states and territories. As an example, the abolition of commercial rates over a 3-year period by South Australia which began in 2015 was intended to stimulate business and drive economic growth.[5] South Australia is currently the most confident property market from the latest ANZ/Property Council Survey, with statewide confidence for the March 2019 quarter sitting 21 points above the national average. One of the main drivers of this change has been the combination of stamp duty abolition as well as a commitment by the SA government to reform land tax, with a budgeted $96m commitment to raise thresholds and lower rates.

Geographically, industrial and commercial sites do not have to move relatively far to provide the same services, for example, two civil contractors with similar businesses sizes pay significantly different rates in Queanbeyan over the NSW border vs in Fyshwick in the ACT.

CASE STUDY: ACT Commercial Property in focus:

In Queanbeyan a property with a rateable land value of $1.53m would pay rates of $18,115.17 (this includes garbage, water and sewer charges) where as a property in Fyshwick with an average unimproved value of nearly half at $748,000 will pay nearly **double** the rates at $41,655.73.[1]

A clear outline of the applicable rates of the remaining transition period will allow businesses in the ACT to adequately plan for reinvestment and rental pricing.

5. Mixed use assets valuation

Over recent years, Canberra has seen a growing number of 'mixed use precincts' being established in response ACT Government policy settings. These precincts, like in Braddon or New Acton, create vibrant communities that foster small and local businesses while providing fantastic lifestyle benefits for residents.

Unfortunately, the current ACT tax system disincentives mixed use developments because general rates are applied on the commercial portion of the investment on the basis that:

[4] *Vacancy increased from 19.1 per cent to 19.8 per cent due to net absorption of -10,786sqm see*: https://www.propertycouncil.com.au/Web/Content/Media_Release/ACT/2019/Premium_office_space_continues_to_be_in_hot_demand_in_the_Canberra.aspx

[5] https://www.propertycouncil.com.au/Web/Content/Media_Release/SA/2019/Five_reasons_why_confidence_is_up.aspx

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(i) land is valued as if it will be used for residential purposes (typically a higher value than commercial use); and
(ii) general rates are then calculated using the commercial general rates which is eight times higher than the residential general rates.

For example;

1) Build-to-Rent Mixed Used development with 500m2 Ground Floor Commercial and 60 Residential Units (non-strata Titled).

- the area of the shops to units is roughly 1:14, with shops on the Ground floor suited to creating a more vibrant area.
- Currently the commercial units rateable value is based on the value of the entire development being used for residential purposes – i.e. a value of $5.1M. The resultant general rates equate to the commercial rate (5.1675%) multiplied by the rateable value ($5.1M) – being an annual rates charge of **$301,768 pa.**
- If an apportionment was applied and the commercial land was valued for its actual use the same commercial land would be valued at approx. $300,000 and the residential component at $4.8M. The resultant rates charge would be a combination of the Commercial rate charge applied over 500m2 of commercial ($15,000) + Residential rate charge for 60 units ($29,523) + Residential Land Tax for 60 units ($55,433.00). Total Rates are **$99,956 pa**.

The commercial penalty for not adopting an apportioning within the rates calculation is a factor of approximately **300%**.

Changes will need to be made to current legislation to accommodate apportionment. ACT legislation currently states that property is 100% residential or rural, otherwise it is classed as Commercial and therefore the highest commercial property rate is applied.

To provide a practical and fair solution these changes will need to allow apportionment of the unimproved value i.e. separate out the components residential / commercial etc. for an individual unimproved value and then apply the appropriate rate in the dollar for each component.

Without alignment between the use of the property and valuation, investors will look towards the use which maximises returns without looking towards providing the places and facilities that people are craving. The ACT must consider this as a matter of priority, if we are to get outcomes which align with the policy objectives of the government.

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6. Disputing rate valuation

Under existing ACT law when an assessment is received if the assessment is disputed the property owner can:

- Seek more information from office above decision;
- Lodge an objection to an assessment or decision; and
- Apply for a review of the objection by ACAT.

In the experience of our members objections to assessments and decisions are rarely ruled in favor of the taxpayers, resulting in the need to apply to ACAT. Generally, reviews by ACAT are a significant cost to commercial property owners, being up to $80,000.

The Property Council believes that an intermediate authority should be established between lodgment of an objection and the application to ACAT. This could by way of third-party mediation or an independent valuation review authority to mediate disputes to assist in reducing costs.

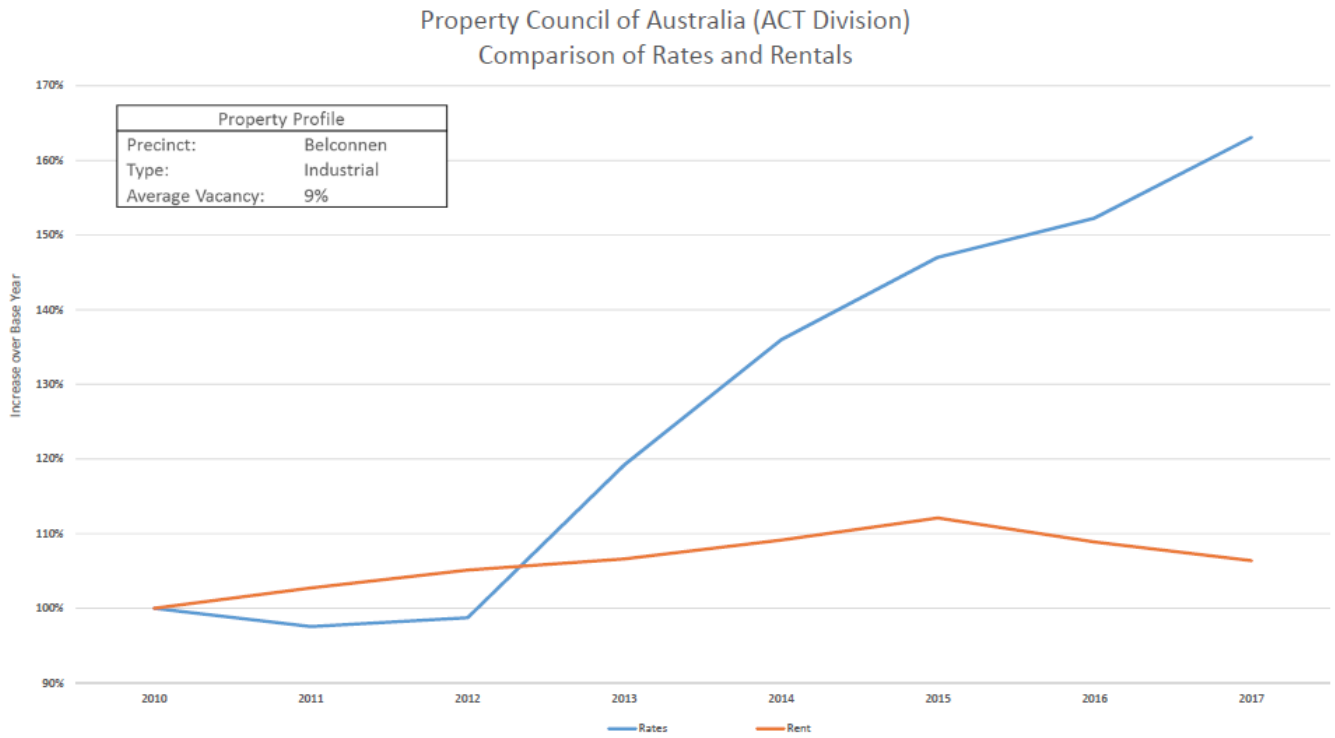
A similar process such as undertaken in Queensland where a conference is held between the two parties which is chaired by an independent (non-government) chairperson will be appointed if the valuation is greater than $5 million would be advantageous to reducing costs.

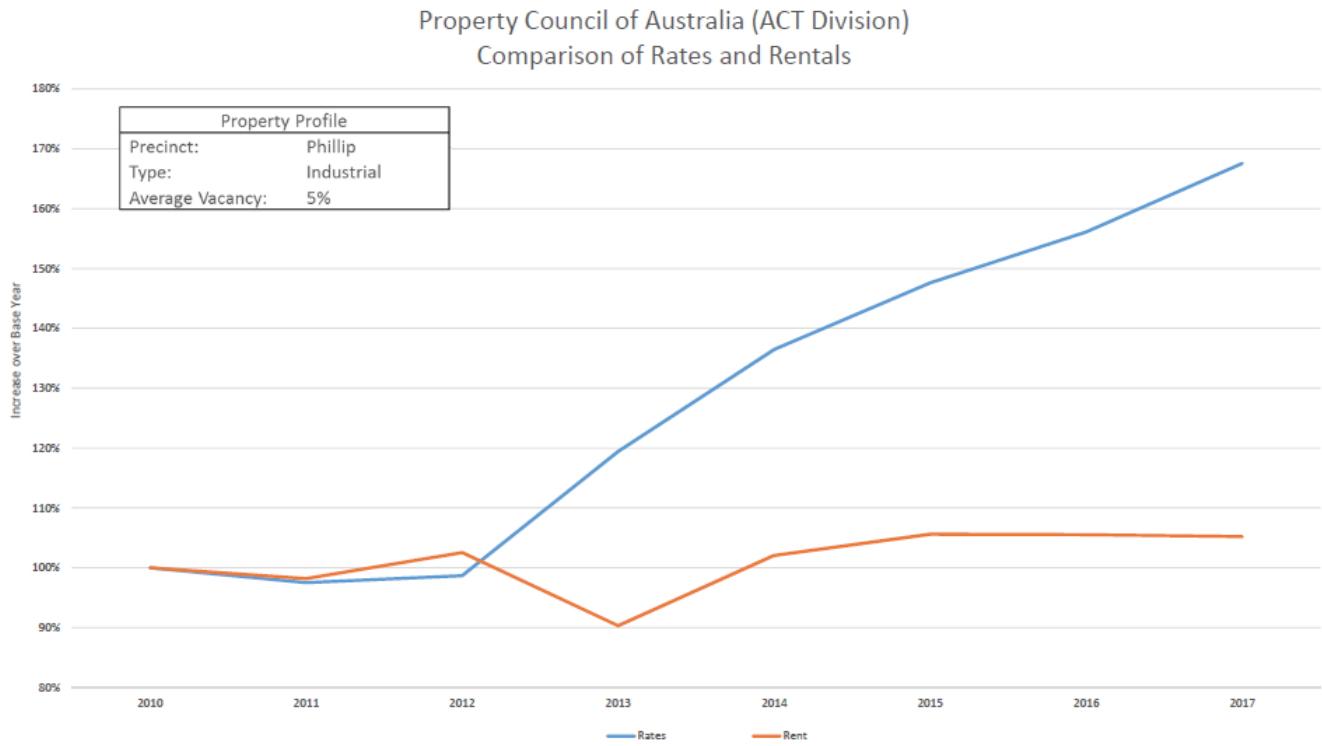
7. Disclose information on the current rate applications

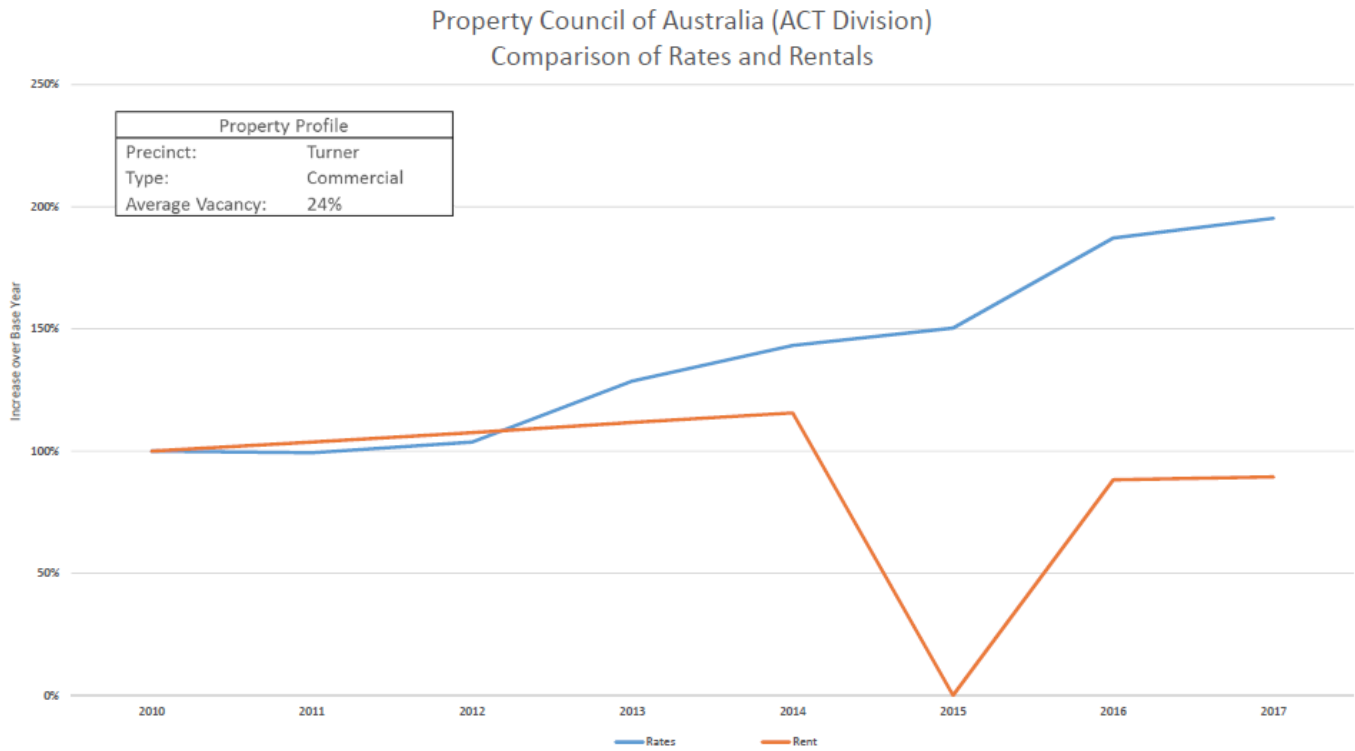
Prior to the amalgamation of land tax and general rates into a single 'general rate', landlords and tenants were able to agree who would be responsible for individual taxes and charges (and subsequent increases/decreases) as part of tenancy negotiations. With the singular general rate this no longer is easily ascertained.

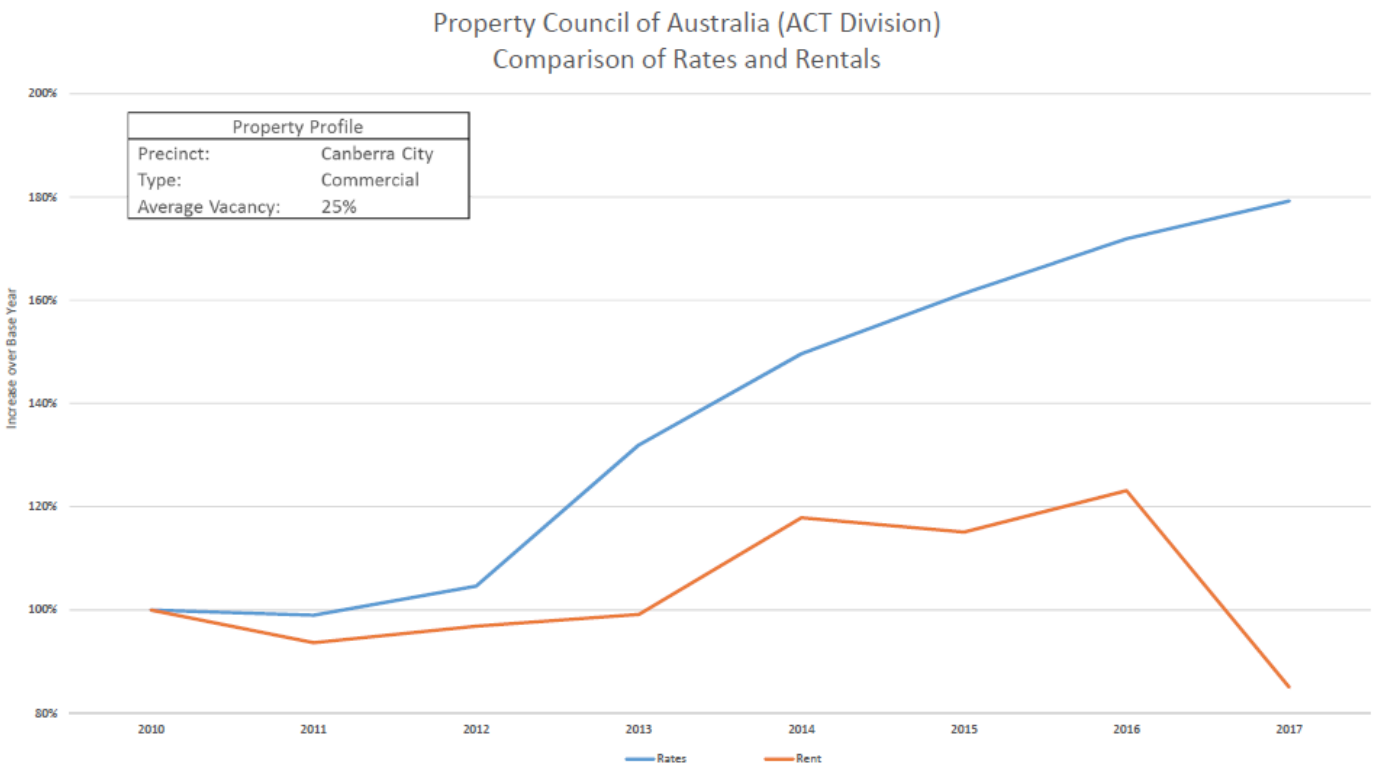
To provide landlords and tenants flexibility in negotiating the individual components of the general rates, it would be helpful for general rate notices to set out these different amounts as well as the unimproved land value and applicable percentage rates applied.

Appendix A Comparison of Rates and Rentals




Property Council of Australia (ACT Division)
Comparison of Rates and Rentals
Property Profile
Precinct: Phillip
Type: Industrial
Average Vacancy: 5%
Increase over Base Year
180%
170%
160%
150%
140%
130%
120%
110%
100%
90%
80%
2010
2011
2012
2013
2014
2015
2016
2017
Rates
Rent


Property Council of Australia (ACT Division)
Comparison of Rates and Rentals
Property Profile
Precinct: Turner
Type: Commercial
Average Vacancy: 24%
Increase over Base Year
250%
200%
150%
100%
50%
0%
2010
2011
2012
2013
2014
2015
2016
2017
Rates
Rent


Property Council of Australia (ACT Division)
Comparison of Rates and Rentals
Property Profile
Precinct: Canberra City
Type: Commercial
Average Vacancy: 25%
Increase over Base Year
200%
180%
160%
140%
120%
100%
80%
2010
2011
2012
2013
2014
2015
2016
2017
Rates
Rent

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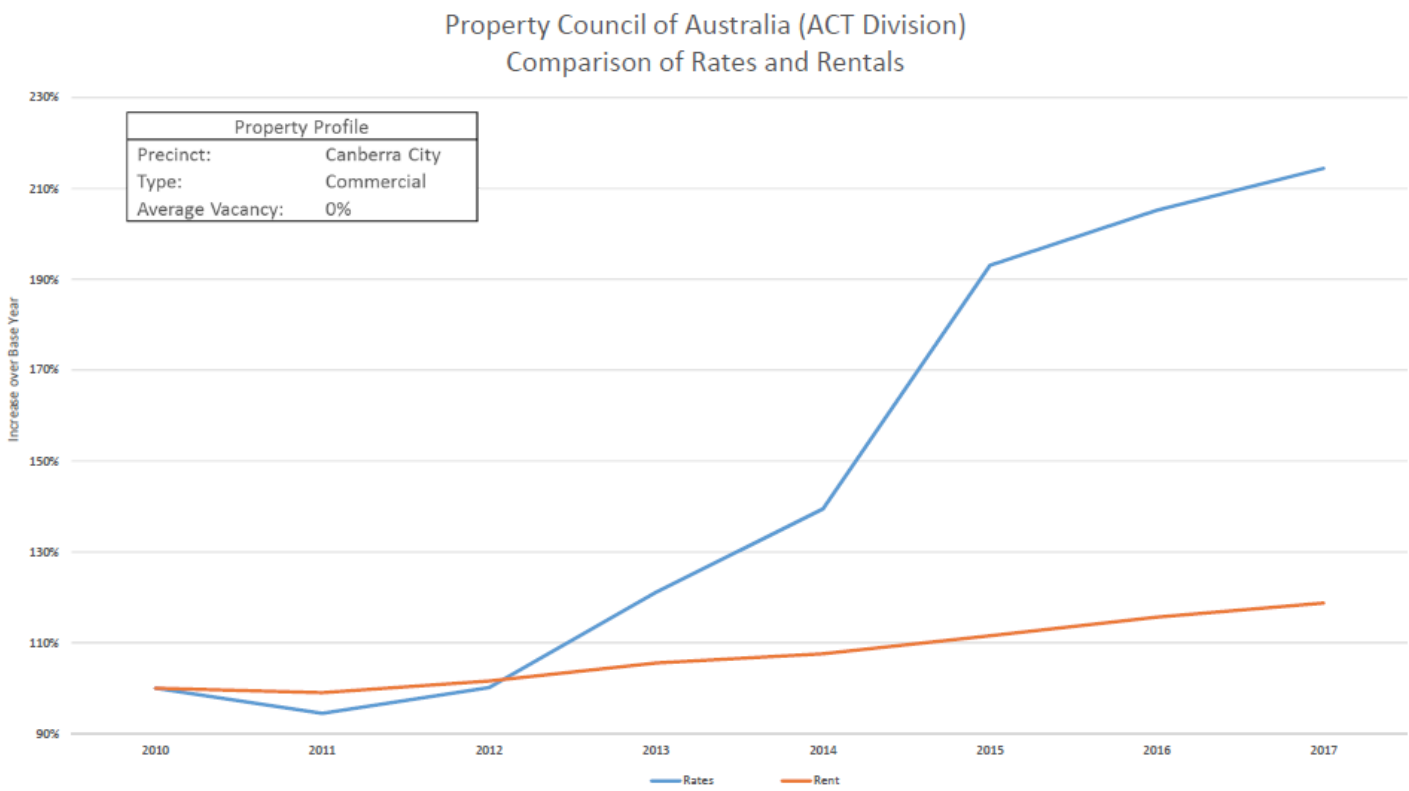

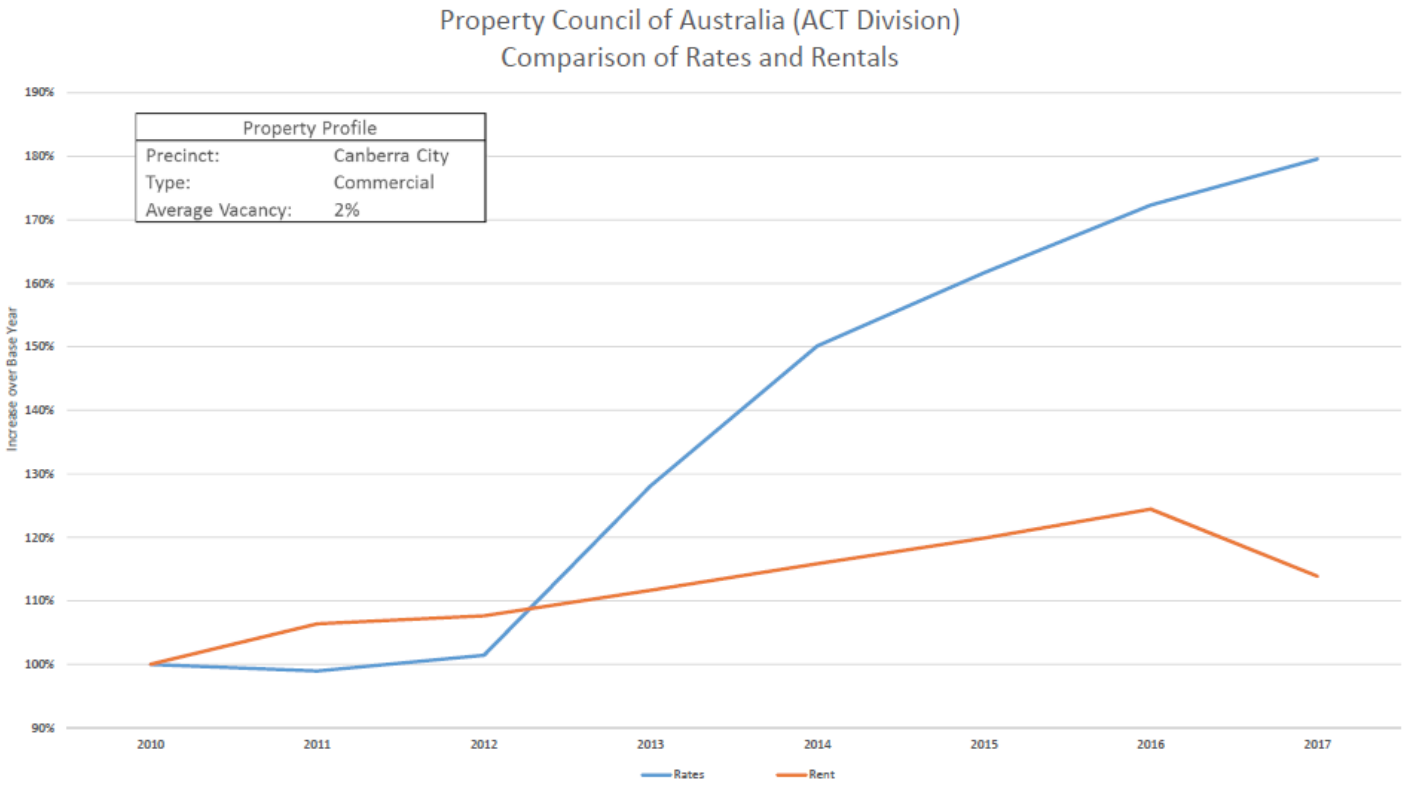
Property Council of Australia (ACT Division)
Comparison of Rates and Rentals
Property Profile
Precinct: Canberra City
Type: Commercial
Average Vacancy: 2%
Increase over Base Year
190%
180%
170%
160%
150%
140%
130%
120%
110%
100%
90%
2010
2011
2012
2013
2014
2015
2016
2017
Rates
Rent

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