Public submission by Prosper Australia to the:

Local Government Rates Capping & Variation Framework Review

Victorian Essential Services Commission 2015

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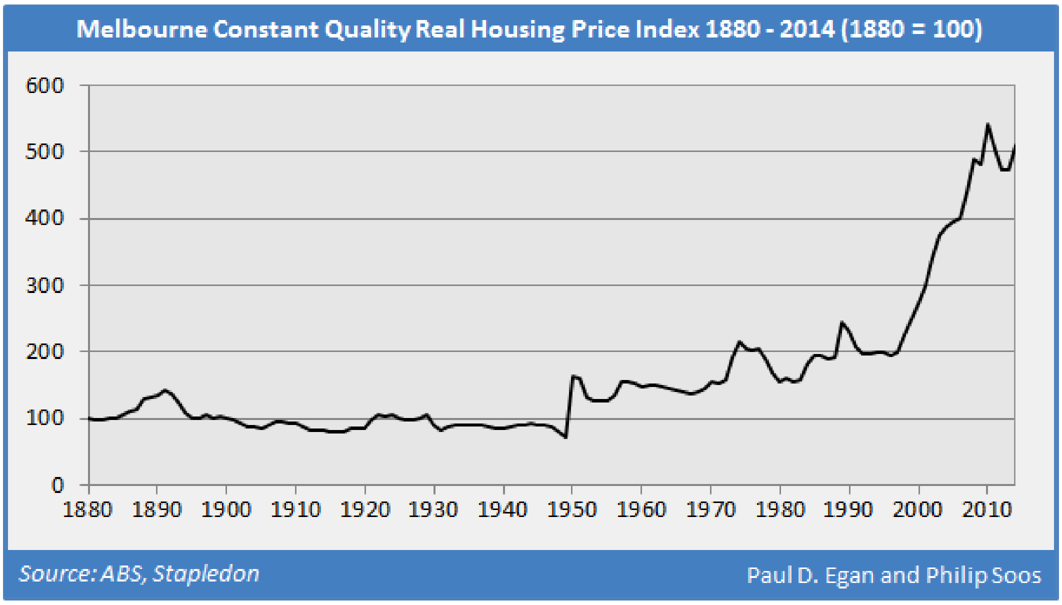
The Minister for Local Government's reform agenda to limit local government rate increases by capping rates through the Fair Go Rates System after fifteen years of six per cent rises in a low inflation environment is entirely understandable. It is also sorely mistaken.

Ratepayer anger at this exercise of monopoly pricing power is genuine – few individuals have enjoyed rises in their incomes of this size.

Council rates have been able to grow strongly because their base, house prices, have skyrocketed in real terms – notably in the last fifteen years.



What appears a coherent state government response has a worrying underside. They will instead remove the very useful automatic stabilizer element from municipal rates – which are intended to rise with land prices and fall when they retreat – even though rates are calculated by dividing the desired revenue by the total rateable property base.

Municipal rates are the only tax moderating principal place of residence landowner behavior. Reducing the rate of increase in rates will simply be capitalised into land prices. It will confer no particular benefit on landowners, while injuring councils, state government and prospective home buyers.

As well, this overlooks a great harm imposed on citizens in the rates bases councils use. There are three main ways rates are calculated:

- Site Value – the market value of underlying land (SV), near identical to Unimproved Capital Value.
- Net Annual Value - the rent a property can command (NAV)
- Capital Improved Value – the market value of land and buildings (CIV)

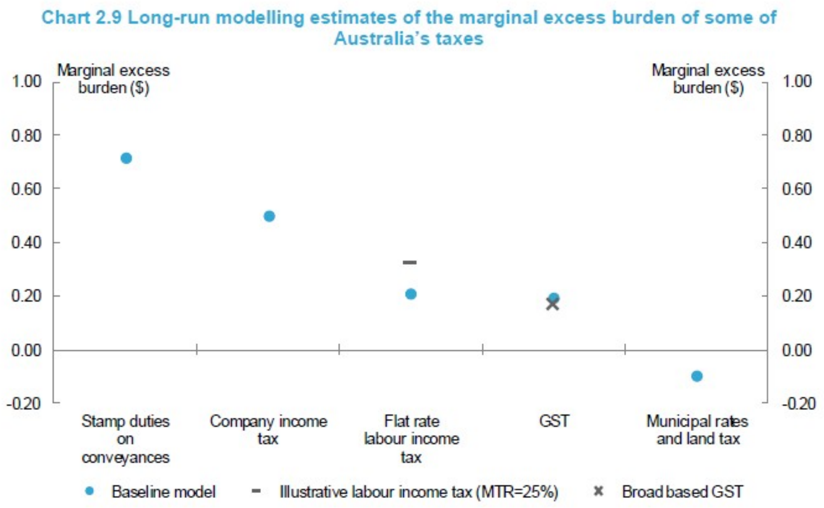
The differences between these rating bases may appear minor. In practice, both NAV and CIV discourage construction by taxing improvements. All properties improved above the municipal average pay more and underdeveloped ones pay less. In fact, there is no natural limit to the percentage penalty on highly improved properties.

NAV and CIV encourage land vagrancy – deliberately leaving lots vacant or with buildings in ruinous condition. They free-ride on nearby civic and private improvements, even hoping to coax up-zoning of vacant land by frustrated councils trying to prompt it into use. Both are deeply regressive in nature as their severity increases exponentially as the degree of improvement rises above the average level for the city.

Site Value rating has none of these vices. It does not penalise any class of property. It charges a rate based on the market value of the land without regard to whether it is improved or not. Any perceived penalty is only relative as compared with the charge under NAV or CIV, which in effect subsidise under-developed properties. The rate penalty borne by the least improved property is limited by the market price of vacant land.

Fresh modelling of tax bases by the Commonwealth Treasury in the Re:think tax discussion paper[i] reveals that land tax – of which SV is a form – has the remarkable property of costing citizens *less* than the amount it raises.

This comes about as foreign and domestic landowners pay the tax while it is spent entirely on domestic households.



Source: Re:think

The Land Values Research Group has produced a considerable body of work demonstrating the real world consequences of poor rate bases. There are a number of studies on the LVRG website[1].

[1] http://blog.lvrg.org.au/2009/01/archive.html

In 1964, South Melbourne Council changed to SV after a ratepayer poll with astounding consequences: a spectacular transformation and redevelopment by private enterprise when it was no longer penalised by higher rates for investing in improvements. Here is what happened.

$'000	NAV	NAV	SV	SV	SV	SV	SV
	1963	*1964*	*1965*	*1966*	*1967*	*1968*	*1969*
New Dwellings	124	522	218	1 128	4 274	1 273	774
Alterations & additions to:							
Houses	58	72	154	122	81	94	123
Other	366	494	548	318	196	217	150
New Factories	1 130	554	1 568	608	1 104	933	1 057
New Office Buildings	2 868	380	8 334	2 017	1 547	725	11 321
New Other Business	1 008	154	1 260	603	383	349	875
Shops	122	10		43	30	37	354
Hotels	400		240	43	148	2 216	60
Education	38	14	54	140	444		623
Religious	24						28
Health	652			896	104	224	252
Entertain & Recreation	22	328	24	18	157		
Nat. Cultural Centre			7 284				
Miscellaneous		12		8	71	295	133
TOTAL	6812	2 540	19 684	5 911	8 539	6 363	15 750
Of which: Government Building	1 174	564	7 480	1 958	4 407	696	1 439
Private Building	5 638	1 976	12 204	3 953	4 132	5 667	14 311

South Melbourne's experience demonstrates shifting rates from the value of buildings to sites makes it economic for both private and public bodies to undertake re-development and put land to its best and highest use.

Instead of applying SV rating, a few councils are imposing penalty charges to long held vacant sites to drive them into use. This is entirely a second-best option and leaves all the other vices of NAV and CIV in place.

Essential Services Commissioners will no doubt be scratching their heads wondering what all this has to do with the task before them: limiting the rate of increase in municipal rates.

Prosper Australia urges the Victorian Essential Services Commission to go back to the Minister for Local Government and recommend no limits to the rate of change of council rates and that the rating base be changed in all cases to Site Value.

The Victorian government needs to be seen to be doing something to contain the cost of rates. This reform, which would drive construction in particular and economic activity in general, can be sold to voters as pro-growth and an end to the taxing of buildings - a higher objective than merely containing ratepayer costs. By the time voters have absorbed the consequences of this change construction activity will have already begun to transform their municipality.

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[i] http://bettertax.gov.au/files/2015/03/TWP_combined-online.pdf