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Committee Secretariat
Standing Committee on Infrastructure, Transport & Cities
PO Box 6021
Parliament House
CANBERRA ACT 2600

To the Committee

Re: House of Representatives Standing Committee on Infrastructure, Transport & Cities Inquiry into the role of transport connectivity on stimulating development and economic activity.

The Property Council of Australia is pleased to provide a submission to the Committee for its inquiry into the role of transport connectivity on stimulating development and economic activity.

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion investment industry.

Our members are long-haul investors in cities, so understand the case for improving their productivity, sustainability and liveability – and the essential role played by infrastructure.

We do however remain cautious of the current approach to value capture. Property is already a highly taxed asset class, contributing over 16 percent of all tax revenue across the nation.

There are also myriad taxes that capture value, and we would urge extreme caution around the creation of new forms of taxation that add to the burden.

Our submission does however point to solutions such as tax increment financing and the UK City Deals model, both of which can serve to encourage the right investment in infrastructure and stimulate growth.

Please note: in responding to the Inquiry's terms of reference, we have done so in a collective sense. The structure of our submission reflects this. We have deliberately not sought to explore issues relating to high speed rail as others would have greater expertise.

Please contact me if you require further assistance and subject to availability; we would of course be happy to participate in any public hearings that are scheduled by the Committee.

Yours sincerely

Ken Morrison
Chief Executive

Submission on capturing the value of transport infrastructure

Standing Committee on Infrastructure, Transport and Cities

February 2016

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Executive Summary

The cost of congestion in our cities is rising – harming productivity, livability and sustainability.

The challenge of funding the nation's infrastructure is acute and finding the correct solutions will help the Commonwealth meet its broader policy goal of lifting economic growth.

It can also help underpin the emerging consensus around the value of the Federal Government investing in cities.

There is no doubt that constrained balance sheets across all tiers of government mean innovative funding solutions need to be found.

But the approach to 'value capture' needs to be cautious. It should recognise:

- the need for **clear policy objectives** beyond opening up new tax streams sourced from property to fund infrastructure
- the **high and excessive taxes already paid by the property industry**, including those which capture value
- the case for resolving the complex and **burdensome regime of infrastructure charges** and taxes that already apply to property, particularly new developments
- the intersection between property taxes and **efficient land use**
- the existence of **alternative models** that are readily available, but either not used or only applied selectively
- some of the **inherent challenges** across the myriad forms of value capture

There are smarter ways to fund infrastructure than the current ad hoc approach that applies across the nation, and we are happy to partner with governments to explore sensible solutions.

But we are wary that the current clamour for 'value capture' is being done absent proper analysis and modelling, or recognition of the real challenges it presents.

The property industry – an overview

Let property grow the economy

Property is the nation's largest industry and creates prosperity, jobs and strong communities.

Property is a major part of both the household balance sheet and the Australian economy.

Property:

- directly contributes **11.5 percent of economic activity** – or $182 billion to Australian GDP
- is the nation's second largest employer, **creating 1.1 million jobs** – which is more than mining and manufacturing combined
- helps provide **a wage to one in four Australians**
- pays **$72.2 billion in wages directly**, and another $119 billion in wages indirectly
- delivers 16 percent of the nation's tax revenue, with **$72 billion in taxes** paid to federal, state and local governments
- allows people to save for their retirement and reduce government's pension costs, with **14.1 million having a stake in property through their super funds.**

It is crucial that policymakers work to support the industry given it is vital to Australia's economic fortunes.

About the Property Council

The Property Council champions the interests of more than 2200 member companies that represent the full spectrum of the industry, including those who invest, own, manage and develop property across all asset classes.

Our members are long-haul investors in cities - they have an inherent interest in seeing them prosper and an understanding of the policy settings needed to make them work.

Property taxes

The property industry is highly taxed – contributing 16 percent of the nation's tax base.

The industry pays over $72 billion in revenue to federal, state and local governments.

This includes:

- **$21 billion in taxes to the Commonwealth**, or 6.2 percent of its total tax revenue
  - including company tax, capital gains tax and the GST – all of which **capture the benefits of economic uplift**
- **$27 billion in taxes to the states**, or 34.9 percent of the total state tax base
  - including stamp duty, payroll tax and land tax – which is a mix that reflects economic uplift, or in the case of land tax, **captures land values directly**
- **$23 billion to local government** in rates, fees and charges
  - with the primary contribution coming from **rates – another tax that is based on land values**
- and **infrastructure charges** already contributing to the cost of local infrastructure or **works-in-kind** that directly deliver infrastructure

There are also strong biases against property, particularly commercial property, in the existing tax structure. These include:

- valuation methodologies that vary across the state, including the use **of improved valuation** that hits investment in high-value commercial property
- **capacity-to-pay provisions** in rating systems that sees the weight of taxes fall predominately on commercial property
- inefficient taxes such as **stamp duty** that inhibit transactions and activity
- commercial property paying rates on a **higher ad valorem base**
- differential rates of land tax, including **aggregation for commercial property portfolios**
- the exemption of owner-occupied housing from land tax, again pushing the weight onto commercial property
- **other property taxes** such as fire and emergency service levies that force commercial property to carry a high burden of costs

- a **dysfunctional system of infrastructure charges** across states and local councils.

From a tax perspective, any assessment of value capture concepts needs to first consider:

- how the existing tax system already contributes to the capacity of government to fund infrastructure
- the heavy burden already carried by property across the nation's tax base
- that existing taxes capture uplift, both in land values and from economic activity
- whether the mix of potential solutions encourages efficient and effective land use
- there is substantial benefit derived through the existing tax base from private investment that drives economic aggregation, efficient land use and supply-chain benefits.

Defining value capture

Value capture has become a catch-all phrase for myriad forms of property taxation and infrastructure charges.

In assessing the terms of reference of the Committee, we do note that the current focus by governments on value capture needs to be better defined.

There are myriad models promoted by proponents, including:

- additional taxes that seek to estimate the prospective uplift from potential investment in infrastructure across commercial and residential property
    - but these are often based on assumed rather than real uplift as it accrues, and separated from the actual cost of infrastructure as well as its delivery
- one-off surcharges on commercial property (or their tenants) in a defined catchment to help catalyse the cost of infrastructure
    - but these are regularly arbitrary in the rate, breadth of application and biased against commercial property – and ignore the reality of existing land-based taxes or the ability of businesses to bear further cost increases
- equivalent taxes based on land use or planning decisions by government for commercial and/or residential property
    - but act as an incentive for governments to suppress planning controls and ignore the most efficient and effective land use requirements of our cities
- tax increment financing – a method commonly used in overseas jurisdictions
    - effectively an infrastructure bonds based approach, but one that is not applicable for all types of infrastructure investment projects.

Bar tax increment financing, other models of 'value capture' effectively risk adding to the weight of taxation that already falls on property. Nor do they properly promote effective and efficient land use or mitigate planning risks.

In our view, there needs to be caution applied to the debate about the use of value capture and far better policy objectives established beyond creation of a new revenue stream.

Similarly, there needs to be a clear understanding and acknowledgment by all levels of government that any 'value capture' mechanism will only be appropriate in certain circumstances, and that these approaches will, and should not, fully fund the cost of infrastructure.

We expand on these issues further in our submission.

Shaping choices on infrastructure and cities

The infrastructure pipeline

Delivering the next generation of critical infrastructure is vital to lifting the productivity, liveability and sustainability of our cities.

The cost of congestion is escalating – up to $16.5 billion and forecast to grow by $30 billion by 2030.

And given according to Infrastructure Australia, three quarters of population growth will occur in just our four largest cities, making the right call on infrastructure priorities will be crucial.

Before canvassing funding mechanisms governments need to first establish a clear, rational and independent priority list of projects.

As Infrastructure Australia pointed out in its Australian Infrastructure Plan recently, "*inconsistent delivery of long-term infrastructure planning has impacted the quality and reliability of Australia's project pipeline.*" Recent examples of funding decisions made out of political expediency rather than on the basis of due consideration to business cases have cost taxpayers significantly and damaged industry confidence in government decision making.

Infrastructure Australia's role as a depoliticised statutory authority with the license to develop a rolling plan of national and state level priorities needs to be entrenched and receive unanimous political support.

IA's ideal mandate would include a capital financing function to allow it to contemplate innovative financing approaches to get projects delivered. Analysis of such financing models should form part of the business case presented for each project or investment decision.

This would also complement its role in independently and rigorously analysing projects that should shape the priorities for investment from the Commonwealth.

While IA's recommendations will never be binding without legislative change, they should certainly be given greater weight in the Cabinet decision making processes. A mechanism by which this could happen is the establishment of a dedicated Committee, whose members would be the Chair of IA, Secretaries of relevant federal government departments (Treasury and Infrastructure), and relevant Ministers (Infrastructure, Treasurer, Prime Minister).

Entrenching IA as the singular authority for coordinating the nation's infrastructure pipeline would add value to collaboration with the states.

Matching IA's capability with similar authorities in each jurisdiction, including the weight given to recommendations from those bodies in State/Territory Cabinets, would also assist in the task.

We note that this has been done in some jurisdictions and welcome it, however better integrated long-term land use and infrastructure planning remains a problem in most jurisdictions.

We strongly support Infrastructure Australia's call to change the culture of decision making and delivery across infrastructure sectors to one of robust and transparent decision making, with an emphasis on better governance and long-term integrated infrastructure and land use planning.

Investing in productivity by investing in cities

The Property Council has welcomed the Federal Government's heightened interest in cities – headlined by creation of a specific new portfolio.

In our view, it recognises the productivity uplift available as cities already generate 80 percent of the nation's GDP.

The creation of a sound pipeline for infrastructure delivery, as well as associated funding solutions, needs to align with sound strategic planning for our capital cities.

This should include:

- creation of equivalent bodies to Infrastructure Australia (and Infrastructure NSW) in each state and territory
    - with federal contributions to infrastructure dependent on assessment by the statutory authority
- better and more integrated strategic planning through establishment of independent planning commissions (akin to WA and the Greater Sydney Commission) to plot the growth of cities
- adoption of innovative financing solutions that do not restrict or distort investment, including a UK Cities Deal model and tax increment financing (see below for more)
- seeding a National Competition Policy-style model to encourage states and territories to establish clear housing supply pipelines, reform to planning systems, and review existing inefficient taxes and charges.

Coordinated strategic planning across land use and infrastructure means the Commonwealth would be better placed to make the right choices on investment, and secure a better return through improved productivity.

Game-changers versus the basic essentials

One challenge that governments need to reconcile is the difference between funding substantial transport projects and fine-grain urban infrastructure.

The latter is relevant to this inquiry, in so far as any form of value capture needs to have regard to the dynamics of land use and development, and existing infrastructure charges.

However, value capture and other innovative financing approaches should not be contemplated for the provision of infrastructure that does not provide significant economic uplift to the broader community, and would otherwise be the fundamental responsibility of state or local governments.

The delivery of fine-grain urban infrastructure is, to a large extent, already provided for through the current regime of infrastructure charges across the country, which:

- involves a complex system of levies, fees and charges that varies in each jurisdiction, and often across local government areas within the same state
- is open to substantial discretion and at times 'gaming' by consent authorities
- rarely considers the true costs of development, including land and/or site amalgamation costs
- ignores planning risk and the extended timelines attached to projects involving rezoning in particular, if not actively contributes to it
- rarely considers the impact the timing of infrastructure delivery relative to charges and within the development cycle
- creates perverse outcomes where cash contributions/payments are preferred over infrastructure assets delivered by developers, despite the latter generally resulting in better and more timely infrastructure provision
- and can often depart from the sound principle of nexus being established between the demand for infrastructure generated by projects and the rate of infrastructure charges.

In contemplating any new model for infrastructure charging, we would urge policy makers to bring better discipline and rigour to the existing regime and ensure it is integrated – rather than adding to the tax burden.

Any assessment of charging regimes for infrastructure should also understand the different costs incurred through developments, depending on the type.

For example:

- the time and cost of amalgamating fragment land can be significant and can vary depending on land values and historical ownership patterns within different parts of cities
- the degree of planning risk that a proponent needs to absorb can shift across consent authorities, and adds to holding costs and the overall cost of capital
- requirements for infrastructure between greenfield and brownfield sites will be substantially different but are sometimes provided by developers

- developers of market-leading product across both residential and commercial projects will make investments in economic and social infrastructure and improved urban amenity to help create their own value.

We would urge independent and transparent modelling be undertaken on any proposal relating to proposed forms of value capture with a view to testing:

- the desired outcome of a value capture mechanism, and the degree to which it will achieve that for any given project
- its effects on property investment and development
- how it can ease the burden and inefficiencies inherent in the existing regime of infrastructure charges
- its capacity to help establish a more accessible and integrated system
- the implications for efficient and effective land use
- whether it truly captures real value, or assumes it
- the correct point of payment in the development cycle with reference to the timing of the delivery of the infrastructure itself
- whether it is based on sound valuation principles.

‘Value capture’ gone wrong

In contemplating value capture concepts, we would urge governments to first assess variations of the model that have already been tested – and failed.

Voluntary Planning Agreements

In NSW, Voluntary Planning Agreements (VPAs) were originally conceived as a vehicle for innovation and forward funding of critical infrastructure. They were also supposed to be sponsored primarily by project proponents.

Used properly, they help facilitate innovation in the built form; unlock sites across our CBDs, urban renewal precincts and greenfield land; and help forward fund critical infrastructure.

However, they have since morphed into a revenue play by councils. In short, the bulk of Sydney councils require projects using a VPA to allocate 50 percent or more of perceived increase in value as a contribution to the consent authority.

This practice:

- establishes no nexus between the cost of infrastructure and the charge being imposed
- fails to recognise the rezonings are required to facilitate feasible development outcomes, as existing planning controls are out of date
- encourages councils to suppress planning controls in order to produce a revenue stream
- obliges developers to pay the contribution, or risk their project being refused rather than assessed on merit, and
- ignores the fact council rates already capture the uplift in value that accrues.

Councils are also now forcing projects which should be subject to a DA pathway only into planning proposals as a way of securing VPAs and the associated income streams.

Lease Variation Charge

In 2011, the ACT Government introduced the Lease Variation Charge, which applies in three primary circumstances – residential subdivisions, site redevelopment, or charge of land use to underpin urban renewal.

The original proposition was that Government should capture 75 percent of any increase in value from a lease variation – on top of stamp duty and land tax.

At the time of its introduction, the Property Council warned the LVC would:

- raise the cost of housing, and stifle development
- suppress urban renewal essential for the modernisation of Canberra, and
- fail to raise anticipated revenues.

The ACT Government's own budget data for 2015 makes clear this has occurred, with:

- the original budget estimate from 2012 of $23 million in revenue failing to be achieved
- the revised budget target for 2015 of $14 million not achieved – falling short by 20 percent
- Canberra having one of the highest office vacancy rates in the country at 15.3 percent, as the LVC had prevented the conversion of empty, redundant C and D grade offices.

In short, the Lease Variation Charge has both failed as a revenue stream, and discouraged good urban planning outcomes.

Solutions for funding infrastructure

In exploring the best ways to fund infrastructure, we urge the Committee to canvass options beyond some forms of value capture that effectively represent a new property tax.

It should be acknowledged and understood that value capture mechanisms of any sort are not applicable to any or all infrastructure projects, and nor should they be.

Similarly, value capture mechanisms represent a contribution to the cost of infrastructure provision, the size of which will depend on the model used, the nature of the project and the degree to which investment results in increased economic activity.

Below is a discussion of financing mechanisms that the property industry would urge government to consider as a priority.

Asset recycling and private financing

All governments are constrained by their balance sheets, but some are using them more effectively than others.

Where there is capacity, consideration should be given to the use of public debt to fund initial investments in infrastructure, with the gains from increased economic activity being reinvested into further projects.

Asset recycling has been used at a limited scale – and should be accelerated.

Positive examples include:

- the **Commonwealth Asset Recycling Initiative** – with $5 billion in funds set aside to provide incentive payments to states
- **the NSW Government's program to divest itself of 49 percent of its energy assets** to generate over $20 billion
- the **disposal of state-owned ports** across several jurisdictions
- the **sale of non-strategic land and property holdings** in some states
- the **use of unsolicited bid frameworks** to help accelerate the financing and delivery of infrastructure, and
- using **PPP-style financing to capitalise major infrastructure projects**, most notably roads but in select cases, transport and social infrastructure as well.

But in some states, the leasing or sale of infrastructure which can be more effectively operated and managed by the private sector has halted – often for ideological reasons alone.

In our view, it is questionable whether governments that fail to effectively manage their own balance sheets should be able instead resort to new taxing methods to resolve self-imposed funding constraints.

UK City Deals

The UK Government's City Deals model has helped increase economic activity, fund infrastructure and boost development certainty in a number of cities.

A City Deal is an incentive scheme which directs infrastructure funding to projects that boost productivity, employment and economic growth.

The City Deal contract sets targets for the economic performance of a region using measures including Gross Value Added (a local GDP), employment and productivity growth.

In Australia, it would allow a contract to be established with the federal government, relevant state government and local governments to set a budget for infrastructure delivery. State and local funds could pool investment in agreed priority infrastructure and matched by the national authority.

Regions are rewarded fiscally for exceeding their agreed growth targets – with the national government returning a share of the windfall tax arising from higher economic activity.

The deal would have Treasury oversight as an independent authority with special financing vehicles monitored under strict governance arrangements.

Benefits of a City Deals approach include:

- a more **rigorous approach to the prioritisation of infrastructure investment** based on the capacity of infrastructure to deliver productivity and jobs growth
- an infrastructure plan that **depoliticises** the provision of infrastructure
- creation of **long-term baseline funding** for infrastructure
- a structure that allows for the **removal or reform of inefficient taxes**, further contributing to growth
- encouragement of **innovative capital formation partnerships** between government and private sector
- ensures **stakeholders at all levels are accountable for delivery** against agreed benchmarks

More detail on UK City Deals can be obtained through the research commissioned by the Property Council and available here:

https://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Documents/uk-city-deal-economic-growth-productivity.pdf

Tax Increment Financing

Tax increment financing is a method of funding infrastructure used commonly in the US and UK – and should be trialed in Australia.

Its benefits include:

- a more **transparent approach to infrastructure** selection and provision
- a sustained **commitment to infrastructure provision** which is removed from the vagaries of the electoral cycle
- the provision of **infrastructure is appropriately timed**
- governments having a stake in making **integrated decisions** around infrastructure and land use
- avoiding the trap of other forms of value capture by **using existing taxes and tax rates** – and only capturing value as it truly accrues

In short, it involves governments issuing bonds to pay for infrastructure – and recapitalising them through the tax revenues arising from economic growth that follows.

Tax increment financing involves:

- identification of a suitable precinct or project and establishment of a TIF authority
- preparation of a plan for the area's growth, infrastructure requirements and financial commitments
- establishing the pre-existing tax revenues currently derived from the area
- issuing bonds (usually, government-backed) to fund infrastructure works
- repaying the bonds from the incremental increase in property taxes (above the pre-existing base) generated by new infrastructure and development, and
- ensuring that once the bonds are repaid, all property tax revenue for the area returns to general revenue.

In 2008, the Property Council commissioned research and modelling with PwC on the potential application of tax increment financing in Australia. A copy of our research report is available here:

http://www.propertycouncil.com.au/Web/Content/Submissions/National/2015/New_thinking_on_infrastructure_funding.aspx

It primarily tested the capacity of state and local taxes to help refinance the bonds underpinning tax increment financing.

However, we will also be looking to commission further work – and urge the Commonwealth to explore – how it can deploy its own tax base to support tax increment financing.

For example, capital gains tax, income tax and the GST – among other revenue sources – that are derived from economic growth could be deployed.

Approaching value capture

As discussed throughout this submission, we are deeply concerned by the current embrace of value capture as a funding solution, particularly absent meaningful analysis.

In our view there are a number of principles and tests that should first inform any consideration of value capture by government.

These are:

- The existence of **independent, clearly justified and long-term infrastructure plans**
    - Before financing can be considered, a clear business case for the investment in infrastructure, including the economic benefits expected, must exist
- The **policy objectives** of any value capture mechanism and the degree to which it can be achieved on a given project
    - Value capture mechanisms are not appropriate for all projects
    - Value capture mechanisms are a means of financing **part** of the cost of infrastructure, and should not represent a new revenue stream for governments
- the **integration of any new model with the existing infrastructure charges** and property tax regime
    - how it can ease the burden and inefficiencies inherent in the existing regime of infrastructure charges, rather than becoming an additional tax
- A **clear understanding of the different costs incurred through the development cycle**, depending on type
    - Time and cost of amalgamating fragmented land
    - Degree of planning risk to proponents
    - Differences in the infrastructure requirements between greenfield and brownfield sites
    - The investments developers already make in economic and social infrastructure and improved urban amenity
- The **effects of any value capture mechanism on property investment** and development
    - there is substantial benefit derived through the existing tax base from private investment that drives economic aggregation, efficient land use and supply-chain benefits

- The implications for **efficient and effective land use**
    - reduction of planning risk for proponents
    - and removing the incentive for consent authorities to suppress planning controls
- Whether it **truly captures real value**, or assumes it
    - the nexus between the charge and the actual cost of infrastructure must be demonstrated
- The **correct point of payment in the development cycle**
    - with clear reference to the timing of infrastructure delivery

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