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1st July 2016

Cities Division
Department of Prime Minister and Cabinet
1 National Circuit
BARTON ACT 2600

To the Director,

Re: *Smart Cities Plan*

The Property Council of Australia is pleased to provide a submission in response to the *Smart Cities Plan* (the *Plan*).

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.

We welcome the government's clear interest in a long-term and positive approach to changing the way our cities are governed and grow.

If implemented successfully, many of the policies in the *Plan* will fundamentally change how our cities work, unlock economic activity and improve affordability and accessibility.

However, much of the success of the Plan rests on the detail, and we urge government to provide a clear delivery plan, supported by targets, to ensure all levels of government and industry can work together.

We also call on government to provide clear boundaries on issues such as value capture, to ensure a coordinated and sensible approach is taken to encourage, rather than stifle, investment.

Please contact me if you require further detail on anything raised in this submission. Subject to availability; we would of course be happy to participate in any ongoing consultation processes.

Yours sincerely

Ken Morrison
Chief Executive

Submission on the *Smart Cities Plan*

Department of Prime Minister and Cabinet, Cities Division

July 2016

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Executive Summary

Cities are the engine rooms of Australia's economic prosperity, generating more than 80 percent of our gross domestic product.

Cities matter, and we need to make the right policy choices to support their growth.

None of our national economic goals can be met unless we seize opportunities to drive productivity – and in doing so, lift liveability and sustainability.

We welcome the Government's interest in cities, and the clear place their planning and governance is being given on the national policy agenda.

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

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.

We believe there is an opportunity for the Commonwealth Government to take a leadership role in a number of areas:

- Delivering real City Deals to maximise productivity and growth in our cities, in partnership with state and local governments and industry
- Entrenching Infrastructure Australia's role as a depoliticised decision making authority
- Prioritising the development of new and innovative funding mechanisms for infrastructure that do not simply represent a new property tax – and demanding the same sort of rigour from state and territory governments
- Implementing an incentives-based model to encourage much-needed reforms to planning and zoning at the state and local government levels, to improve housing supply and affordability
- Finalising the EPBC Bilateral assessment and approvals agreements and continuing to remove unnecessary green tape
- Retaining an ongoing commitment to the Asset Recycling Fund

While we welcome a number of the initiatives outlined in the *Smart Cities Plan*, much of their success will come down to the detail of their delivery and we urge the Government to established a disciplined and rigorous approach for doing so.

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.

Targets, implementation, measurement and review

The success of any plan requires clear targets, performance measurement and a commitment to review and adjust policy where targets are not being achieved.

While the *Plan* puts forward a number of proactive policies that will unlock the potential of our cities, there is an absence of a clear implementation plan and target outcomes.

Recognising that not every measure can have a clear target, we nonetheless urge government to set a series of outcomes and timeframes around key policy areas.

We suggest the following as a minimum:

- Establish a dedicated Infrastructure Committee as part of the Cabinet process to further strengthen the role and independence of Infrastructure Australia in decision making around major investments – by December 2016

- Develop and release a clear plan for the reinstatement of the Asset Recycling Fund, including ongoing funding commitments – by no later than June 30, 2017

- End the uncertainty around the use of value capture mechanisms to fund infrastructure by releasing a clear set of principles and tests that any proposed approach must take – by December 2016

- Work with state and local governments and industry to deliver a true City Deal for South East Queensland, as well as others identified in Western Sydney, Launceston and Townsville

- Introduce a new competition policy style incentives program to drive state and local government planning reforms that improve housing supply – by June 2017

- Finalise and implement Assessment and Approvals Bilateral Agreements with all states and territories under the Environmental Protection and Biodiversity Conservation Act – by December 2017

- Work with industry to remove barriers currently preventing institutional investment in affordable housing at scale – by June 2017

The policies put forward in the *Smart Cities Plan* have the potential to fundamentally change the way our cities are planned, governed and grow, but only if governments are fully committed and held accountable for delivering on their objectives.

Targets, as part of a broader implementation plan, will be critical to the success or otherwise of the *Plan*.

Smart investment

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, 90 percent of population growth will occur in just our four largest cities, making the right call on infrastructure priorities will be crucial.

Prioritising projects that meet broader economic objectives

Long-term infrastructure planning and delivery are vital in linking where people live and work, and in boosting productivity and growth.

Fundamental to the smarter delivery of infrastructure is a clear plan of priority projects, supported by rigorous business case analysis and well removed from the vagaries of the political cycles.

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.

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.

Treating infrastructure funding as an investment wherever possible

While a sound pipeline for infrastructure delivery is crucial, it must be supported by funding solutions that encourage private sector investment and activity.

All governments are constrained by their balance sheets, but the Commonwealth is currently sponsoring a debate that runs the real risk of states and territories imposing a raft of new taxes and levies on property instead of making better use of their own asset bases or access to debt.

We agree that there is a need to recast infrastructure funding as investment where possible, particularly where it leads to greater rigor being applied to prioritisation and investment decisions.

The proposal to establish an infrastructure financing unit is a step in the right direction to facilitate closer partnerships between government and the private sector. We urge Government to properly resource this group, give it a clear mandate, and ensure that it has the legislative power to deliver on its mandate.

However, the much touted 'innovative financing' models that Government is looking to should not simply be a euphemism for property taxes.

We have previously put forward a number of models that governments would be well-placed considering, summarised below:

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.

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 highly 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.

We also urge the Commonwealth to reinstate the Asset Recycling Fund and provide a clear long-term plan for its future, to give certainty to state and territory governments, and industry.

This plan should clearly outline what, if any, funding will be provided to replenish the Fund, and when that will occur.

Consideration could also be given to a program of audits and potential recycling of the Commonwealth's own surplus or underutilised assets, particularly land – with proceeds reinvested in the Asset Recycling Fund.

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.

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.

We are looking to commission further work – and urge the Commonwealth to explore – how it can deploy its own tax base to support tax increment financing.

Increasing investment

We do not disagree that the infrastructure challenge facing our cities requires a significant investment from governments at all levels.

But we do disagree with the immediate move to value capture mechanisms as the solution.

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

In the *Plan*, the Government clearly states that developer charger, stamp duty, land tax and local rates are all forms of 'value capture' and that better coordination, not new taxes, is the solution to this issue.

While we welcome this enlightened rhetoric, without a clear and substantive policy on the approach to value capture, the development industry remain at the mercy of ad hoc but ever-increasing taxes and charges.

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.

Value Capture

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.

We have previously raised our extensive concerns with existing approaches to value capture. Our most recent submission is attached for reference (Appendix A).

At the most fundamental level, any consideration of value capture mechanisms must take into consideration the already significant tax burden placed on property, particularly new development.

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
- that 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 current open-ended 'discussion' the Commonwealth is having on value capture, including the generalized commentary contained in the *Plan*, has seen several state governments seize it as an opportunity to propose additional property taxes to fund infrastructure projects.

For example, in its draft documentation for the Cross River Rail, the Queensland Government has proposed several new property taxes and cited the Commonwealth's 'demand' for value capture as an excuse.

Innovative financing mechanisms are to be encouraged, certainly. But taxing new development is neither innovative, nor conducive to encouraging investment.

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.

There must be clear direction from the Commonwealth to the states and territories that in the absence of any such modeling, attempts to use blunt new tax measures to fund infrastructure will not be considered.

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

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

Smart policy

The Commonwealth has dipped in and out of cities policy for the last 20 years, but the *Smart Cities Plan* indicates a positive move to longer-term involvement in cities policy.

This interest needs to be matched by smarter solutions to boost productivity, finance infrastructure and encourage growth.

Delivering City Deals

We welcome the government's commitment to delivering 'City Deals' to unlock the potential of our cities.

The Property Council has long championed the UK's model, and we are working closely with the State Government, the Council of South East Queensland Mayors and KPMG to investigate opportunities to translate it to an Australian context.

A true City Deal requires negotiation and commitment from all levels of government to work together.

It requires clear, evidence-based planning and infrastructure strategies, supported by investment from each level of government.

At its simplest, a City Deal is an incentive scheme that also shifts from a project-by-project investment approach to one which invests in a city's plan for growth.

A City Deal is a contract between governments that sets targets for economic performance using measures of Gross Value Added (a local GDP), employment and productivity growth.

Regions or cities are fiscally rewarded for exceeding their growth budget – with the central government returning a share of the windfall tax arising from the additional economic growth.

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

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

If delivered well, it could be a game changer for the way Australia's cities evolve.

Leading regulatory reform

Without significant reforms across a number of key policy areas, even a well-executed City Deal will be limited in the benefits it can bring.

The issues identified in the *Plan* around housing supply and planning reforms have been the subject of much of the Property Council's advocacy work and research for several years.

When it comes to improving housing affordability, the single biggest impact will come from ensuring supply is able to match demand.

Fixing planning systems to reduce the delays and costs that stifle supply will help tilt the balance back in favour of homebuyers, and do much to address the affordability challenge facing policy makers across the country.

Recognising that much of the responsibility for planning and zoning rests with State Governments, there is a role for the Commonwealth in creating an incentives framework that drives reforms.

Similar to the National Competition Policy of the 1990s, a new incentives model would see states and territories receive payments to reform their planning systems, turbocharge housing supply pipelines and deliver innovative affordable housing solutions.

The model requires:

- Targets and performance metrics that have been agreed between the states and territories and the Commonwealth Government
- An entity responsible for collecting data on reforms to planning systems and their impact on housing supply or affordability

- An entity responsible for determining the allocation of payments, based on input from the monitoring entity

- Economic modelling that estimates the impact of improvements in housing markets from state or local initiatives outcomes on Commonwealth revenues to determine the size of the benefits achievable and where they accrue

- Payments linked to actions, both ongoing and in recognition of relevant and successful reforms undertaken before the implementation of the new model, and

- Local government involvement in the reform process, and eligibility for incentive payments where appropriate

Modelling from Deloitte Access Economics shows the potential economic gains from improved housing outcomes could be around $3 billion a year.

Further details of the modelling and the potential benefits is included in the attached report (Appendix B).

Reducing Green Tape

In addition to planning and zoning reform, we welcome the Government's stated intention to expand the use of Strategic Assessments under the Environmental Protection and Biodiversity Conservation (EPBC) Act to further reduce the regulatory burden placed on new housing development.

The objectives of the EPBC Act are more than sound – protecting Australia's natural environment is vital to ensuring our cities continue to be among the most liveable in the world.

But there must be a fair balance struck between environmental values and community development needs – one based on evidence and supported by clear and streamlined assessment and approvals processes.

In the past, the application of the EPBC Act and its interaction with state and territory legislation has resulted in significant duplication of processes and delays.

Delivering on the promise of reform will provide enormous opportunity to improve these processes and deliver substantial savings in the regulatory burden faced by the residential development sector.

In addition to the broader use of large scale strategic assessments, a renewed effort is needed to finalise assessment and approval bilateral agreements between the states and territories and the Commonwealth, and really deliver a one-stop shop approach for industry.

Until now, progress on the reforms has been slow and inefficient. We would urge the Commonwealth to set and meet clear deadlines for completion of the reform process – ideally by December 2017.

Market solutions to affordable housing

Housing affordability is undeniably one of the highest priority issues for the community and for governments across Australia.

The most recent reputable assessments show the national shortfall of affordable rental and social housing is around 500,000 dwellings.

The challenge of delivering more housing, including at sub-market or affordable rates, or through public and social housing, is one that the constrained balance sheets of state and federal governments cannot meet alone.

There is no doubt that innovative solutions exist, not only for financing, but also for the delivery of housing at lower costs. The private sector can, and is eager to play a greater role in improving housing outcomes for all Australians.

But the approach to delivering more affordable housing, including public and social housing, needs to be cautious and recognise:

- That planning reform is urgently needed to improve land supply, location and affordability of housing across the board
- The need for risks and returns to be market based and acceptable relative to the returns from other investment classes if the private sector is expected to invest
- That changes to the regulatory and tax frameworks are needed to enable large scale institutional investment in housing
- The role of government incentives, including land contributions, in addressing the funding gap
- The need for greater capacity in the Community Housing Provider sector to manage housing assets
- The existing policy approaches in this area across the states and territories

Residential Real Estate Investment Trusts (REITs) or similar investment mechanisms provide a unique opportunity for the market to deliver affordable housing at scale.

Policy changes to curb development costs and tilt the balance in favour of institutional investment include:

- Governments discounting the value of their own land bank and allowing developers to obtain sites for affordable housing
- Designing concessions on taxes or fees for suitable developments
- Confirming tax flow through status for residential REITs

- Swifter development assessment to reduce holding costs, and
- Improving the flexibility of planning and design regulations

A further substantial step the government can take to attract institutional capital at scale, and close the gap in yield for requirements for institutional investors.

A US-style Low Income Housing Tax Credit (LIHTC) program would give government the ability to leverage existing funds earmarked for affordable housing into an efficient mechanism that delivers affordable housing projects.

The LIHTC program has been operational in the US for almost 30 years, and has created 2.5 million rentals for low income households in that time.

The program operates as an indirect subsidy encouraging individual and institutional investors to finance the development, acquisition, and rehabilitation of affordable rental housing.

Further detail on both some of the barriers preventing institutional investment in affordable housing and the LIHTC model can be found in the Property Council submission to the Federal Working Group on Affordable Housing (Appendix C).

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Appendix A

Property Council of Australia submission to the House of Representatives Standing Committee on Infrastructure, Transport & Cities: *Inquiry into the role of transport connectivity on stimulating development and economic activity*

Appendix B

Property Council of Australia report - *A Federal Incentives Model for Housing Supply*

Appendix C

Property Council of Australia submission to the Affordable Housing Working Group:
Issues Paper – Innovative Financing Models