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Mr Lee Odenwalder MP
Presiding Member
c/- Executive Officer
Economic and Finance Committee
Parliament House, North Terrace
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Rate Capping Parliamentary Inquiry - Submission

Dear Mr Odenwalder,

Thank you for the opportunity to provide a submission to the Economic and Finance Committee's inquiry into rate capping. The Property Council of Australia has long advocated for local Government reform that promotes value for money for ratepayers, greater transparency, efficacy and efficiency. We commend the Committee for examining this policy area and would welcome further opportunities to engage on reform options.

This submission outlines a number of areas for the Committee's consideration with reference to its terms of reference:

- the rationale for reform (term of reference 4);
- the cost of doing business in South Australia (term of reference 4);
- Victoria's reform process (term of reference 1);
- lessons from New South Wales (term of reference 1); and
- alternative infrastructure funding models (term of reference 4).

I would welcome an opportunity to discuss this submission further. I may be contacted on 8236 0900.

Yours sincerely,

Daniel Gannon | SA Executive Director

The rationale for reform

In terms of interstate comparisons, South Australia has more Councils per capita than anywhere else in Australia. We are over governed and economic growth and efficiency are constrained by a multiplicity of decision makers in the state, pulling resources and policy in oftentimes divergent directions.

Council rates fall under the *Local Government Act* (1999) SA and represent more than one billion dollars' worth of revenue for local Councils each year. Industry and residents are overly burdened with Council rates and charges. Furthermore, there are inconsistencies and inequities in the ways different Councils structure their rates.

South Australia has 68 Councils – 19 in metropolitan Adelaide alone. The average population of metropolitan Councils is just 63,000. In 1998, we saw a voluntary amalgamation process where amalgamations took Council numbers from 118 to 68. Further reform is needed. Rate revenue as a proportion of the general revenue base of local Government is at 68 per cent, which is higher than other Australian states. This revenue continues to grow. South Australia relative to GSP has increased by 0.7% per annum (whereas it has declined by 0.3 per cent per year nationally). Councils of course also receive grants from Commonwealth and State Governments.

There is also a wide discrepancy in metropolitan Council population size in South Australia. For instance, Walkerville has a population of 7,000 compared to Onkaparinga, which services 165,000 people.

South Australia's local Governments service on average half the population of Councils in Victoria, Queensland or New South Wales. Granted, South Australia's geography and demography means we have smaller regional centres compared to other States, however, there is still much more that could be done to harness economies of scale and improve efficiencies in local Government.

Despite historical opposition to proposed amalgamations, there is growing anecdotal support from within the local Government sector to see more Council amalgamations in South Australia. The Property Council of Australia has recently commissioned public sentiment research into local Government. This research is still being finalised at the time of writing, however, we would be pleased to brief committee members on outcomes of this research once available.

South Australia needs to critically examine the role of local taxation through the lens of efficacy, consistency and driving economic development. Ratepayers (whether they be residents or commercial property owners) need to be assured that any hikes in rates are the result of careful analysis of cost pressures and service provision requirements rather than simply an arbitrary exercise in revenue raising. A sustainable Council rating system should be implemented that provides local Governments with funding for services without discouraging economic development.

Arguably, rate capping cannot be examined in isolation of other issues surrounding local Government reform. For instance, there are significant economic gains and efficiencies that could be achieved from further local Government amalgamations, encouraging population density around metropolitan transport corridors, and delivery of modern infrastructure. Councils also need to modernise their infrastructure funding models.

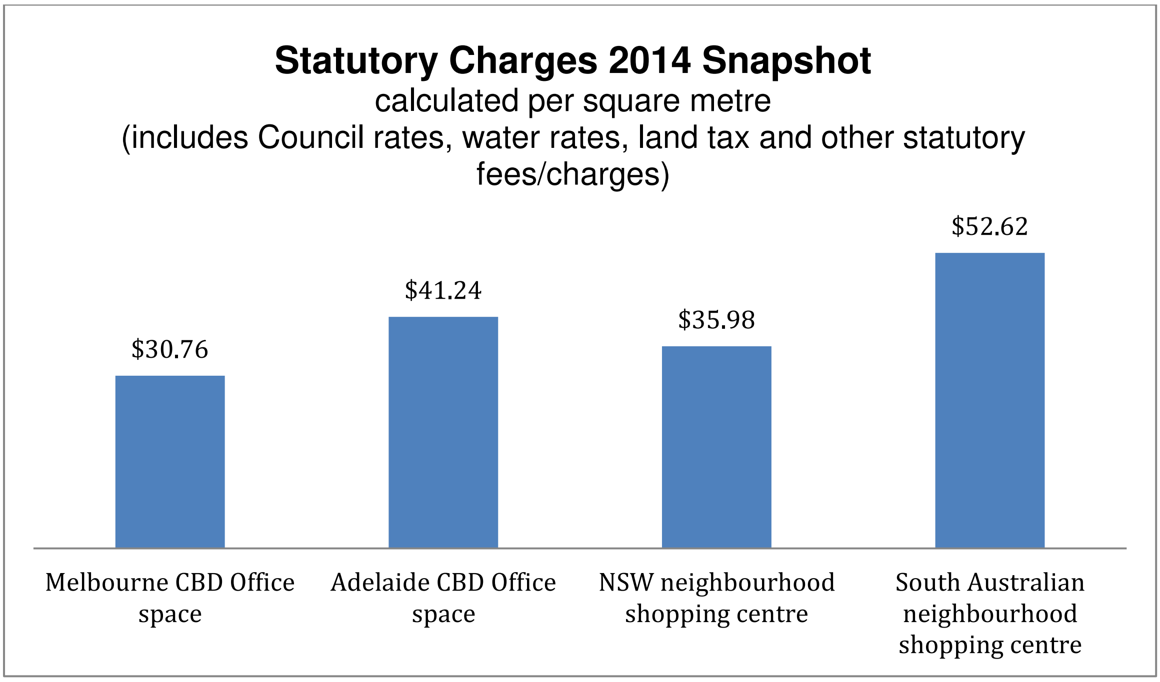
The cost of doing business in South Australia

The Property Council produces its *Benchmarks* publication[1] annually, which tracks and compares the costs of net lettable area in each State and Territory, including statutory charges and fees (which includes Council rates, water rates, land tax and other statutory fees and charges).

In South Australia, ratepayers (particularly commercial property owners) are often hit with increases in their rates that are way out of step with inflation and Consumer Price Index (CPI). Some Councils have demonstrated a propensity for restraint. For example, in this financial year's budget Adelaide City Council capped its rates, referencing economic conditions and pressures on city businesses. This decision was warmly received by the property industry at a time when property based taxes are hurting business owners and tenants.

It is important to reflect on the costs that South Australian property owners face in the context of reform to rate charges. Below are just two comparisons from the 2014 *Benchmarks* publication of the differences in Government taxes and charges for an office building in Adelaide versus Melbourne, and for a shopping centre in a South Australian neighbourhood compared with one in New South Wales (Chart 1). Chart 1 clearly shows the higher tax burden of running an office or shopping centre in South Australia compared to other jurisdictions across the country.

Chart 1 Statutory Charges 2014 Snapshot



[1] See http://www.propertyoz.com.au/Bookshop/Listing.aspx?p=13

Victoria's reform process

The Victorian Government has committed to introducing a rates capping framework. In January 2015, the Essential Services Commission received a directive from the Minister for Finance and the Minister for Local Government to conduct a review and report on a local Government rates capping and variation framework.

The Commission has been tasked to inquire into and advise the Ministers on options and a recommended approach for a rates capping framework for implementation from the 2016-17 financial year. The Commission will also be required to provide advice on the processes and guidance to best give effect the recommended approach for the rates capping and variation framework. The Commission is required to complete its final report by 31 October 2015. In that jurisdiction, the Property Council has recommended a rate capping regime be implemented in line with Consumer Price Index (CPI) increases due to exorbitant raises in rate charges in that state.

Lessons from New South Wales

New South Wales is the only jurisdiction to currently have a statutory rate capping model (or 'rate pegging' as it is commonly referred to in NSW) in Australia. This was introduced following gouging of property owners for rate revenue by Councils and a similar model is currently under consideration in Victoria due to spiralling rate increases. Unfortunately, in South Australia rate increases (particularly for commercial properties) are out of step with CPI and reform is urgently needed to encourage greater fiscal responsibility, efficiency, efficacy and transparency. There are, however, important learnings from New South Wales that must be considered in terms of shaping a rate capping mechanism for South Australia.

Rate capping was introduced in NSW in the context of extreme rate rises in that jurisdiction. For instance, between 1973 and 1976 rates had increased on average by 188 per cent, whereas wages increased by 75% and inflation was at 56 percent.[2]

Section 506 of the New South Wales *Local Government Act (1993)* empowers the Minister for Local Government to set a limit on the percentage increase in total general income that Councils can raise from rates (although Councils can apply for Ministerial approval to exceed the rate-peg percentage).

In NSW, the Property Council has noted that rate capping policy has resulted in some Councils deferring important infrastructure investment. The Property Council in New South Wales has called for changes to rate pegging in that state as part of a **wider reform package of the entire sector**. Councils should be subject to:

- greater fiscal discipline and accountability of local Government;
- compulsory infrastructure strategies with a forward capital expenditure program;
- Council amalgamations; and
- linking rate increases with a decrease in levies.

[2] Johnson, A. K. (2001) *Beyond the Three R's: Financing Local Government* (Armidale: Centre for Local Government, University of New England), p5.

Any introduction of rate capping here in South Australia must have mechanisms to ensure fiscal responsibility, sound infrastructure investment and asset management systems.

Local Governments should have sophisticated asset management systems for the whole of life planning, acquisition, registration, operation, maintenance, disposal and renewal of each component of its infrastructure. Adequate funds should be set aside each year for routine maintenance, renewal of depreciating assets and the expansion of the asset stock to meet future needs of the local community. Councils in New South Wales have been criticised for dedicating little of their own budgets to new infrastructure projects, relying too much on levies to pay for it.

Alternative funding models for infrastructure

Local Government needs to harness innovative procurement, funding and financing solutions. This submission briefly touches upon a few models available to Councils for the Committee's consideration. Such models include Tax Increment Financing (TIF), which has long been advocated for by the Property Council of Australia.

TIF involves forecasting the future growth in revenue from rates and taxes that result from infrastructure investment and borrowing funds against this projected income. This model is used in other jurisdictions, such as the United States and the United Kingdom.

As outlined in a recent EY study, there are also joint property development models available to Councils:

Joint property development models typically involve partnering between Councils and private developers to create funding streams to offset the costs of providing infrastructure. This model allows Councils to capture value through the development of adjacent real estate by diverting some of the profits from the real estate into community infrastructure funding. [3]

This EY report provides a number of recommendations for Councils to leverage funding in innovative ways to invest in infrastructure[4]:

To meet this need, councils should consider:

- ► Raising additional capital from alternative sources, and in particular making greater use of responsible debt financing
- ► Improving the processes by which they prioritise infrastructure investments
- ► Achieving procurement efficiencies through alternative delivery models, in particular those that involve a degree of project and financing risk transfer to private sector partners
- ► Enhancing regional networks and achieving efficiencies through effective cross-border collaboration
- ► Investigating the most appropriate ownership structure of community assets.

Notably, local Councils underutilise debt to finance infrastructure and rely too heavily upon rates revenue for capital works programs.

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[3] EY Report: *Strong Foundations for Sustainable Local Infrastructure*, (2012) p 25.

[4] As above note 3.

In South Australia, the Local Government Finance Authority (LGFA) enjoys a state guarantee and the same credit rating as the State Government. Despite this mechanism, South Australian Councils have relatively low levels of debt. Recent ABS figures show that South Australian local Government had a gearing ratio of bank debt versus net assets of 3.8 per cent and a debt servicing ratio of just 1.6 per cent.[5]

A 2008 Productivity Commission report found that "*borrowings, when undertaken prudently, are an appropriate means for local Governments to finance long-lived infrastructure assets — the costs of which are often large or 'lumpy' and might be delayed in the absence of borrowing. The servicing of debt through rates or user charges (where appropriate) enables the cost of the asset to be matched with the benefits from consumption of the services over the life of the asset, thereby promoting inter-generational equity.*"[6]

Councils should sensibly use debt to finance infrastructure rather than consistently relying upon hikes in rates.

Conclusion

The Property Council commends the Committee for examining this policy area. In summary, we believe that rate-capping should be examined in the context of local Government reform that examines efficacy, efficiency and transparency. South Australia's economy is underperforming and we are in a competition globally for attracting talent and capital to this State.

South Australian property owners are overtaxed and overgoverned compared to other jurisdictions – reform is desperately needed. Unfortunately, many Councils have failed to self-regulate in this area, often implementing rate increases that are way out of line with inflation or CPI.

In terms of rate-capping regimes elsewhere in Australia, there are important lessons to be learned from the rate-capping experience in New South Wales in terms of potential deferred infrastructure investment. More broadly, Councils need to seriously consider how they modernise their funding and delivery of infrastructure to ensure they are meeting the present and future needs of the community.

[5] Government Finance Statistics, Australian Bureau of Statistics, 5512.0

[6] Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, April 2008.

Appendix: What is the Property Council of Australia?

The Property Council of Australia is the national peak industry body representing property developers, property investors and businesses that provide professional services to the property industry in Australia. We have offices in every state and territory of Australia.

The Property Council of Australia's vision for South Australia is a thriving, modern economy supporting prosperity, jobs and strong communities.

Contribution of the property sector to our state's economy

In respect to the overall State economy, the property industry is the largest private sector employer in South Australia and overall it is the third largest private industry sector by economic output. Investment in property also represents the major assets of individuals, families and business, through direct ownership, superannuation funds, savings and investments.

The property sector has a larger footprint on the South Australian economy than any other industry.

- It directly contributed $10.5 billion to Gross State Product (GSP) in 2013-14 (10.8%), and is estimated to have contributed a further $16.3 billion to South Australia's GSP through flow-on demand for goods and services (16.8 % of GSP).

- It also directly employed 73,325 full time equivalent (FTE) employees in 2013-14 (10.5 % of South Australia's total), and supported some 95,011 FTE jobs through flow-on activity (13.6 % of South Australia's total).

- It directly paid approximately $4.4 billion in wages and salaries to South Australian workers (9.8% of South Australia's total wages and salaries paid), and a further $7.2 billion to South Australian workers through flow-on activity (16.0% of South Australia's total).

- The property sector contributed approximately $3.6 billion in combined South Australian Government tax revenues and South Australian local Government rates, fees and charges revenue in 2013-14. This equates to 56.6% of total State taxes and local Government rates, fees and charges revenues in 2013-14.

- Residential property ownership is not the only way every day Australians participate in the property sector; 1.29 million South Australian residents have a financial stake in the property industry through their super funds.