16th June 2023

Property Council Submission – CoA Draft 2023-24 Business Plan and Budget

Dear Lord Mayor,

The Property Council thanks the Adelaide City Council for this opportunity to make a submission on behalf of its South Australian members in relation to the Draft 2023-24 Business Plan and Budget.

We also take this opportunity to express our appreciation to the Lord Mayor for recently providing a hearing to representatives of our membership who have landlord and tenancy interests within the Adelaide City Council area and for whom this issue is particularly critical.

As outlined in those meetings and re-emphasized in this submission, the Property Council is *fundamentally concerned with the timing* of the Council's proposals to pursue budget repair through raising rates and reinstating charges.

Throughout the pandemic, landlords and tenants within the Adelaide City Council have borne significant economic pain to "keep the lights on" in the CBD. This pain was felt extensively in the hospitality sector.

The pandemic was a "black swan event" that sent shockwaves through the business community and fundamentally changed long held assumptions about how CBDs operate. A significant proportion of impacted businesses are still in recovery.

With the Adelaide City Council and State Government, The Property Council shares the common objective of creating a vibrant CBD where people increasingly choose to live. To support this proposition will require a thriving small business community who can trade confidently.

Whilst pleased that the Council has proposed not to raise the rate in the dollar, we still hold concerns that combined with the inflationary impacts of sharp increases in costs such as energy, insurance, tax, and stock, an increase in rates will feed foreclosure rates and exacerbate the antithesis of our collective desire for Adelaide - streetscapes filled with empty spaces accompanied by 'for lease' signs.

We ask Council to consider the impacts of this budget at this time and request that the Council do all it can, to widen the rateable base, diminish or smooth any increases and create operational and project savings rather than add to the cost burden of the businesses that give life to our city.

Bruce Djite
SA Executive Director, Property Council

Budget repair – not the same as economic repair

The Property Council notes that the narrative justifying the budget is one of "budget repair."

In recent discussions with the Lord Mayor, it was suggested that the city is in "gentile decline" and therefore this budget is positioned as one which initiates a reversal and rescue of that trend.

However, our members would argue that elements of this budget cement decline rather prevent it.

Budget repair does not necessarily equate to economic repair.

This submission outlines the rationale for our members opposition to the increase of rates at this time, given the undeniable impacts of economic pain experienced during and post-pandemic in the Adelaide CBD.

Our members note recent comments by the Chief Executive Office of Adelaide City Council such as:

"After supporting ratepayers through the COVID-19 pandemic, including waived fees and charges, on top of nine years of freezing the rate in the dollar, Council has made some tough financial decisions and we want to hear our community's views on these decisions."

Whilst appreciative of the efforts of the City of Adelaide in supporting initiatives that helped to sustain ratepayers through the pandemic, we would disagree that the decisions taken in this budget are tough. Rather they are rudimentary and predictable. They simply grow revenue but do not grow the economy.

The Property Council would suggest that now is the time for bold thinking and for those charged with constructing the Budget to support the economy through stimulus measures that activate and grow the economy. It is also important to support the direction the State Government has taken in attracting events and fixtures that will improve the tone of the CBD and put the spotlight on Adelaide as an attractive destination to invest, work, live and play.

Recent history – the pandemic and its legacy

Rental Index – drivers from previous 2.5 years

	31/12/2019	30/06/2020	30/06/2021	30/06/2022
Face Rent	100	100	104	105
COVID and/or other general waivers /abatements	2	31	17	11
COVID deferrals	0	24	11	6
Arrears write-offs %	4	7	17	8
Incentives on new leases	17%	47.5%	44%	40%
Average lease term for new lease	5.2	3.1	3.4	4.4
Portfolio vacancy percentage	7%	16%	19%	13%
Average vacancy period	63 Days	127 Days	134 Days	94 Days

Throughout the pandemic, landlords and tenants within the Adelaide City Council have borne significant economic pain to "keep the lights on" in the CBD. This statement is not merely emotive, it is supported by numbers.

In a submission to the State Government in 2022, the Property Council developed the above rental index by working with a selection of its members whose holdings represent a diverse range of commercial, industrial and retail asset classes (retail, food and beverage, shopping centres, hotels, warehousing, industrial and bulky goods) in both inner and outer metropolitan Adelaide as well as regional South Australia.

The above index yields a high-fidelity image of the true landscape landlords managed in good faith with their tenants from the onset of the pandemic.

Analysis of the above reveals that whilst on an index level face rents remained somewhat stable, other factors such as incentives on new leases, lease terms, portfolio vacancy percentages and average vacancy periods were negatively impacted and substantially reduced the effective rent collected over the period and yields across portfolios.

The above is supplied by way of providing strong evidentiary context from recent history for the Property Council's current opposition to the proposed increases to rates.

Heeding the history books – will rate increases help Adelaide prosper?

With the above index clearly illustrating the impact of the pandemic on depressing effective rents and their subsequent recovery in Adelaide, the echoes of history and their application to the present deserve attention.

In renowned land economist Fred Harrison's seminal work, *The Power In the Land,* he provides a valid and eerie warning on the negative impact rate increases had on the local economy leading into the 1980s recession in Britain.

Harrison describes how in the late 1970's commercial rents began to recover towards 1973/74 highs. However, he argues, the figures do not give a full picture of industry and commerce or take account of the effect of rates.

Prior to the Second World War, rates in Britain were low and constant. However, following this period rates began to contribute causally to the business cycle.

Speaking of the economics of the landlord/tenant dynamic Harrison states that although rate increases "are offset against rent demands in negotiations between landlords and tenants…an accelerated increase in rates falls on the entrepreneurs who occupy business premises", and that "although rents are the major cost, a sudden increase in the growth of rates can in the short term impose a non-transferrable burden of dangerous proportions in a time of economic instability."

By the 1980s Harrison writes, "Profits (excluding North Sea oil activities) sank to around two to three per cent, and the rates burden (taken in conjunction with the level of rents) were isolated as a deterrent to the formation of new businesses, especially small firms."[1]

As outlined previously, the Property Council is *fundamentally concerned with the timing* of the Adelaide City Council's proposals to pursue so called budget repair through raising rates and reinstating charges.

Accompanied with the above warning from history, our position is that sudden increases to rates during the current post-pandemic economic conditions could act as a disincentive to the formation of new businesses and an unbearable burden to existing ones.

This outcome would be at odds with the stated intentions of the City of Adelaide to nurture the conditions for a Council area where business can flourish and provide the goods and services that attract people, investment, culture and vibrancy.

Indeed, the Draft Budget (page 3) states that it has a priority to:

"Focus on financially sustainable decision-making and strategic partnerships which enable future investment, jobs and growth in the City."

The Property Council would opine that raising rates at this time will undermine this stated strategic objective.

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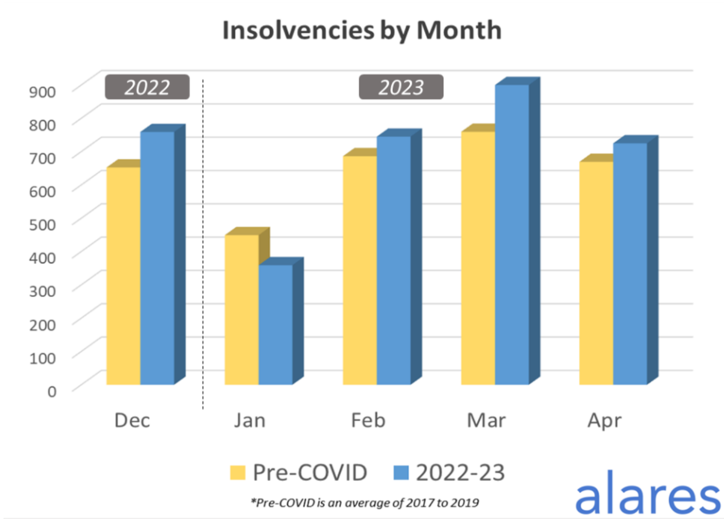
[1] Harrison, Fred: The Power in the Land, An Inquiry into unemployment, the Profits Crisis and Land Speculation (Shepard-Walwyn 1983), pp. 249-250

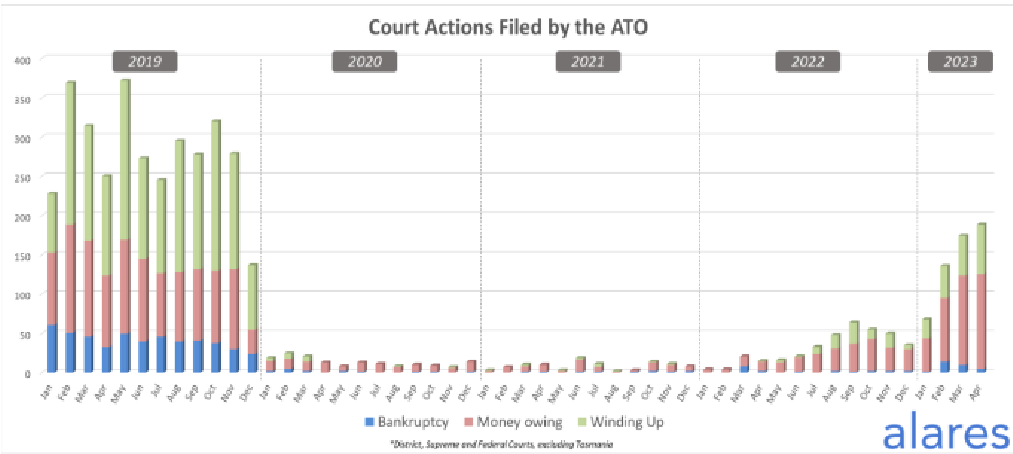
A tipping point

If the annals of history are not sufficiently persuasive, then the Property Council would urge those charged with establishing the budget to consider current data.

Monthly credit risk data provided by Alares reveals that monthly insolvencies are on the rise and well above pre-COVID averages. Their most recent newsletter describes April as a "typically slow month, however insolvencies continue to track above historical levels."[2]



In the same report, the data clearly outlines that "Court Actions Filed by the ATO" appear to be in an upward trend. As the ATO steps up collection activities this has the potential to cause significant business failure. Whilst this data is not specific to Adelaide, one must assume that the local situation is somewhat correlated with the national trend.



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[2] https://alares.com.au/insights/01-05-2023

The question of rates and fairness

Page 55 of the Draft Budget outlines that the rating structure is developed in accordance with the requirements of the *Local Government Act 1999*, and that key considerations include:

> *"The taxation principles of equity, benefit, ability-to-pay, efficiency and simplicity have been identified and applied as guiding principles to our Rating Policy."*

In addition, the document puts forward:

> *"We are committed to maintaining a transparent and equitable rating system. Accordingly, we undertake to manage the Rating Policy to ensure the greatest level of equity for ratepayers by maintaining a non-punitive rating structure."*

With the arguments and data already supplied in this submission the Property Council would suggest that given the current economic climate, an increase in rates may contradict the principle of "ability-to-pay" and quite possibly be viewed as punitive.

With approximately 75 per cent of Adelaide City Council's general revenue sourced from non-residential rates,[3] the majority of the $10.7m rate increase will fall on businesses, which in Adelaide are predominantly SMEs (Small to Medium Enterprises).

The Property Council notes that a significant portion ($7.4m) of the 2023-24 additional expenses are attributed to employee costs that appears to include an additional 28.7 FTEs.

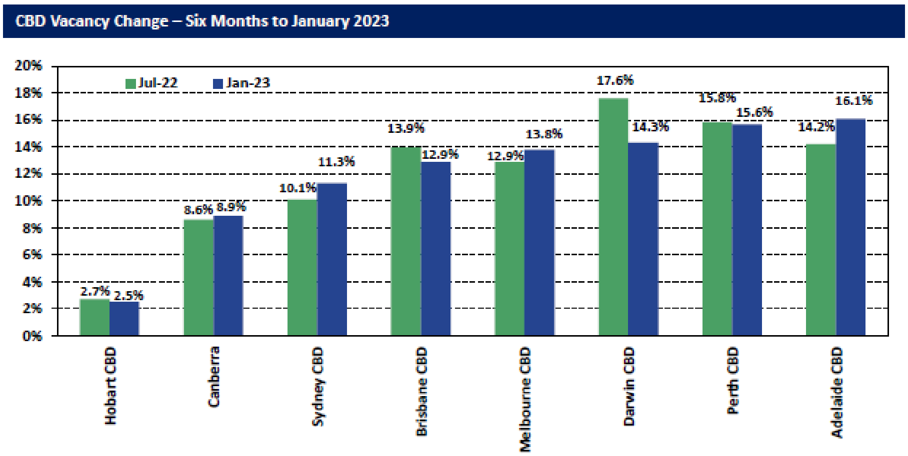
At a time when private sector expansion is hampered by inflation, and recovering from the losses of recent years, it is certainly not lost on members of the Property Council that the Adelaide City Council is planning an expansion funded by rate payers.

The Property Council also take issue with the speed at which the Business Plan and Budget have been released. It is our understanding that members of Council received the Budget on May 17th and that conventionally more time would be given to consideration of the Draft Budget before releasing it to the public for consultation.

[3] City of Adelaide Draft 2023/24 Business Plan and Budget, p. 55

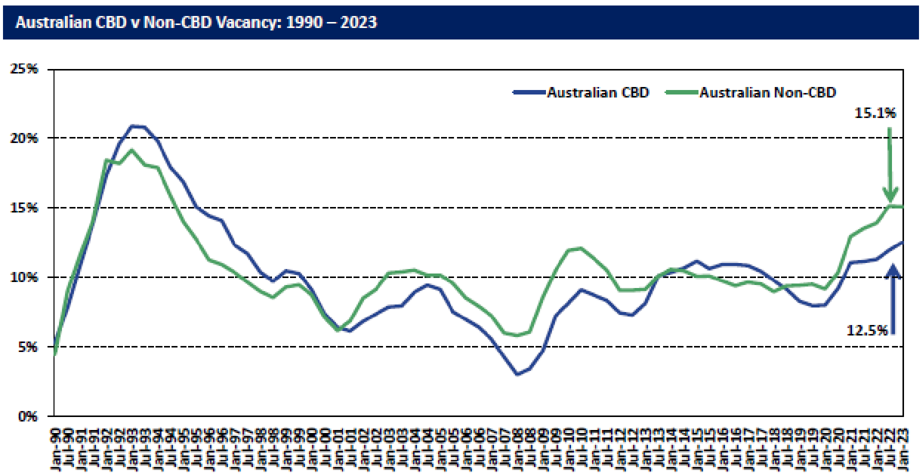
Office Vacancy

In the latest Office Market Report (Jan 2023) Adelaide was listed with the highest office vacancy rate in the country (16.1 per cent). This was also the largest increase in vacancy in CBD markets in Australia.



Half the CBD markets recorded vacancy increases including Adelaide, which now has the highest vacancy rate

It should be noted that across the country vacancy in the CBD markets is increasing while decreasing in non-CBD markets. It is presumed that by further adding to the outgoings of tenants via increasing rates and charges will only further establish this trend.



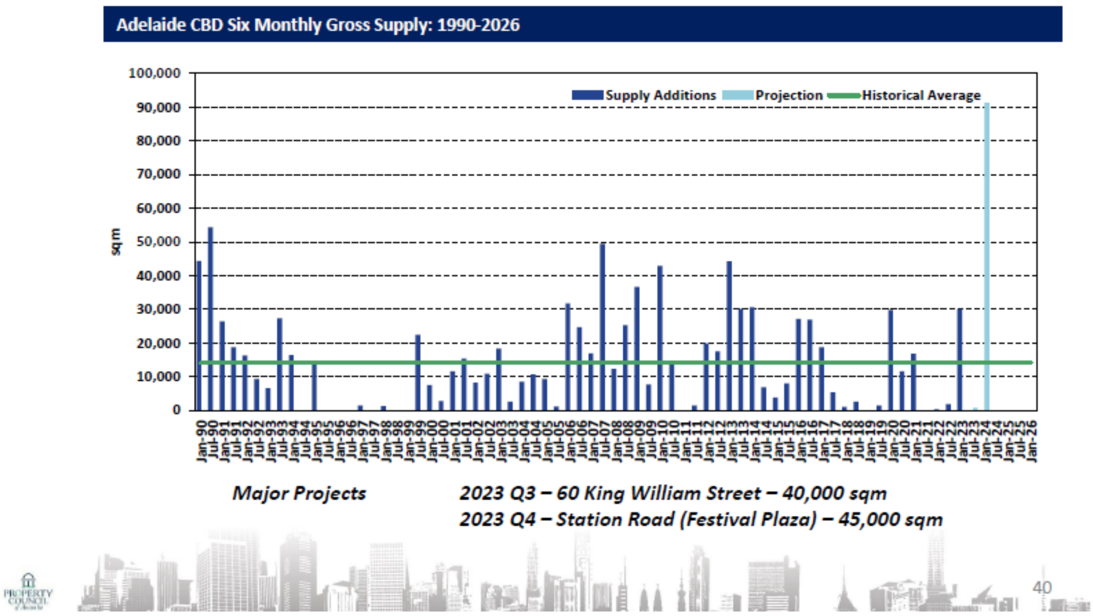
Australian CBD vacancy increased while the Non-CBD vacancy slightly decreased

In Adelaide, higher vacancy is being experienced in C and D grade buildings (lower quality stock) as tenants downsize their demand or move to higher quality stock (A and B grade). An increase in rates lowers valuations for assets and decreases the capacity for landlords to borrow funds that can be utilised to upgrade and refurbish existing stock, which is something the Council has publicly stated it wishes to see happen.

Key market indicators, Adelaide CBD (aggregate)

Grade	Vacancy, Jan 23 (%)	Vacancy, Jul 22 (%)
A	14.8	10.7
B	17.0	18.5
C	20.2	17.3
D	11.9	9.8
Total	16.1	14.2

The Property Council of Australia's January 2023 Office Market Report revealed that the Adelaide CBD recorded net supply of over 23,000 sqm of space – over triple the historical average and the highest in a decade.



Working from Home and CBD populations

In Hays "Salary Guide - See Beyond the Numbers" FY23/24 report, key insights include that "almost two-thirds of desk-based employees will look for a hybrid role when they next job search. This is consistent with last year's 64 per cent. As the market for labour continues to be tight, a continuation of this trend in an "employee market" does not bode well for CBD based small businesses who depend on the spend created by the conglomeration of office workers. Adding cost pressure through rates creates pressure when there is a general reduction in the discretionary spend available to a diminished number of CBD workers makes a hard situation even harder.

Seeking clarification

The Property Council seeks clarification on reports that during the preliminary stages of the valuations process being undertaken by Council that the data received indicates valuation movements for various classes of property in the order of:

- Residential (16,623 properties) 10.2%
- Retail (2,390 properties) 3.1%
- Office (3,710 properties) 5%
- Commercial (2,253 properties) 2.9%

The Property Council also seeks clarification on how the valuations have been arrived at. It is our understanding that to date the valuation reports have not been made available.