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Mr John Alexander OAM MP
Chair
Standing Committee on Infrastructure, Transport and Cities
PO Box 6021
Parliament House
CANBERRA ACT 2600
6 December 2019

Via email: ITC.reps@aph.gov.au

Dear Chair,

Inquiry into options for financing faster rail

The Property Council of Australia is pleased to provide a submission to the inquiry into options for financing faster rail (the Inquiry).

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion plus investment industry. Our industry employs 1.4 million Australians.

Our members are long-term shapers of, and investors in, Australia's cities. They understand that the provision of public rail infrastructure is essential for the productivity, sustainability and liveability of our growing cities.

The government's infrastructure investment and transport scoping is welcome

The Property Council has welcomed the federal government's $100 billion commitment to fund infrastructure over the next decade given Australia's real infrastructure shortfall and supports the Inquiry's broad terms of reference *"inquire into options for financing faster rail"* that will allow it to review funding mechanisms, noting that 'financing' *per se* is readily available for Australian infrastructure projects.

We also welcome the Government's efforts on scoping fast rail between capital and regional cities. The results of this scoping will be crucial to future decision making on the viability of the various options and should of course involve Infrastructure Australia.

Nonetheless, it is to be expected that a number of these will present positive opportunities even when evaluated next to other projects on Infrastructure Australia's list, which remains Australia's best hope of merit-based national project selection.

The most efficient and effective ways for governments to fund transport infrastructure is through efficient broad-based taxes, productive state debt, asset-recycling or user-charges. While there is generally some form of development contribution for new projects where there is a significant up-zoning in association with a major transport investment, the revenues associated with such levies will only ever be a small proportion of the capital needed to fund major transport infrastructure.

Parliament should be 'clear eyed' about the limitations of value capture taxes

Financing public urban infrastructure such as fast rail is possible and it is reasonable that with uplift arising from a considerable rezoning, tax might be applied.

However, we encourage the committee to be 'clear eyed' about the limits of value capture as a funding mechanism for high capital cost infrastructure like fast rail.

Key considerations when taxing rezoned uplift for transport

1. The **purpose of transport infrastructure is to support quality of life** and opportunity.
2. It is important that we plan our cities around our infrastructure and that projects are accompanied by the appropriate **planning that facilitates the housing and economic needs of future communities.**
3. **Any value capture taxes must not be set at a rate that prevents or distorts the urban change that the infrastructure is supposed to be facilitating.** Rather they should be transparent, consistent, clearly mapped and limited.
4. **These taxes won't deliver much of the total cost of a new rail project,** especially in less densely developed areas.

Further principles for designing least-harm value taxes are expanded on in the paper.

Further taxing local property and business for significant transport is rarely optimal

Compelling reasons remain for the committee to be careful around additional value sharing or value capture tax on people's property.

1. **Property is already highly taxed.** Property taxation constitutes between a third and up to a half of state budgets before local government charges are factored in. Government taxes already comprise 25% of the expense of new homes across Australia.
2. **Uplift is already captured.** Much property value including any uplift or appreciation is already 'shared' through capital gains tax, land tax, stamp duties, insurance levies, lease variation charges, developer contributions, GST and income taxes to name a few.
3. **The required density is almost never delivered.** Value sharing taxes generally rely on or anticipate density of development in cities that state and local politicians historically can't or won't deliver.

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4. **Potential negative financial impacts at the local level.** Value sharing taxes tend to hit local owners, local businesses and local tenants in a politically designed hardship zone. Thus, value sharing taxes can create perverse incentives and bad outcomes in terms of settlement patterns around the taxation 'ground zero.'
5. **More harmful in the implementation.** Recent history shows the implementation of new large-scale tax is more damaging to business than governments promise, despite good intentions.

The harmful business experience of new taxes

Business and communities are rightly wary of the introduction of new federal or state taxes.

Failures to eliminate stamp duties and other inefficient taxes as promised by governments at the time of the introduction of the GST are one example.

Another is the very damaging recent experience of the ACT government's increased taxation of commercial property despite a promise to replace stamp duty with a broad-based land tax. Gallingly, both taxes are now implemented together and business and tenants are suffering the additional, unheralded tax burden directly.

In 2012, the ACT began a 20-year tax reform process to abolish stamp duty and replace this with a single land tax style property tax (combining their previous land tax regime with general rates). Total stamp duty revenue has remained little changed over this 'reform' period, falling by just 1% in nominal terms from $268m in 2011/12 to a budgeted $265m in 2019/20. By comparison, total broad-based property tax revenues have more than doubled over this time, increasing from $324m to $750m.

In many cases it is already the property industry that is the main contributor to state and territory budget revenue.For example, in Victoria the property sector accounts for 48 cents in every dollar of state revenue through land tax, rates, stamp duty, fire services, building permits levies, property and car parking levies among other imposts.

The Property Council welcomes the discussion on how best to finance faster rail infrastructure.

Equally, it is important that the Federal Government firmly rules out new taxes that seek to cloak themselves as 'value sharing' mechanisms. As a nation we should not put the economic value generated by new infrastructure at risk through inequitable taxation.

Please contact me if you would like to discuss any of these matters further.

Yours sincerely,

Mike Zorbas

Group Executive, Advocacy

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Inquiry into options for financing faster rail

December 2019

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Let property grow the economy

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

Property is the nation's largest industry, employing more than mining and manufacturing combined, and creates prosperity, jobs and strong communities.

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**

About the Property Council

The Property Council champions the interests of more than 2300 city-shaping companies that represent the full spectrum of the industry, including those who invest, own, manage and develop across all asset classes.

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Growing cities create an ongoing demand for infrastructure

Cities are the engine rooms of Australia's economic prosperity, generating more than 80 per cent of our gross domestic product. They are home to more than 80% of our population, the location of our most productive businesses and the generators of the vast bulk of our wealth.

As one of the world's most urbanized nations, funding the next generation of major land-use transport infrastructure to lift liveability and sustainability of our cities, and in-turn boosting productivity and growth, is a key policy challenge.

Australia's highly urbanised society has a strong economic dimension - proximity is a big driver of productivity in the knowledge economy. Seventy-five per cent of Australia's population growth over the next 20 years is forecast to occur in just our four largest cities.

Value uplift is captured by existing taxes

Any assessment of value capture taxes needs to first consider how the existing tax structure contributes to the capacity of government to fund infrastructure. Consideration of value capture mechanisms must take into consideration the already significant burden placed on property, particularly new development.

The property industry is highly taxed - contributing 16 per cent of the nation's tax base and pays over $72 billion in revenue to federal, state and local governments.

These include:

- $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 see 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.

These existing taxes capture uplift, both in land and from economic activity. The concept of value capture runs the real risk of states and territories imposing a raft of new taxes and levies above those that are already paid. Ultimately, for a value capture mechanism not to be considered as “just another tax”, it must be appreciated that taxes based on valuation already capture significant value across the country.

Any assessment of value capture taxes needs to first recognise

- how the existing tax system already contributes capacity 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

‘Value capture’ gone wrong

In contemplating value capture taxes to fund faster rail infrastructure, as we do in ensuing pages, we urge the committee to one variation of the model that has 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 by unlocking sites across our CBDs, urban renewal precincts and greenfield land and helping forward fund critical infrastructure.

However, they have since been distorted into a revenue raising mechanism 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 VPA reality:

- 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.

Funding infrastructure: proven mechanisms

The challenge of funding faster rail infrastructure is acute and there is no doubt that constrained balanced sheets across all tiers of government mean that innovative solutions need to be found.

There needs to be caution applied to value capture consideration and clearer policy objectives established.

Value capture is only appropriate in certain circumstances and these approaches will not, and cannot, fully fund the cost of infrastructure. The Federal Government has a significant opportunity to drive State and Local Government to implement these reforms by making its financial contributions conditional on the appropriate application of value capture mechanisms and other reforms.

No 'silver bullet'

Value capture taxes are often venerated as a universal solution to address infrastructure funding gaps. Infrastructure Australia has recognized that this is not the case and strongly cautioned that, although a useful source of incremental funding, governments must be realistic about expected tax outcomes.

It should be acknowledged and understood that value capture mechanisms are not applicable to all infrastructure projects. Value capture may have a place in the funding mix, but it won't supersede the need for governments to continue to pursue user charges, asset recycling and other initiatives to generate the funds needed to pay for our infrastructure.

Asset recycling and private financing

All governments are constrained by their balance sheets, but some are leveraging this constraint 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.

It is questionable whether governments that fail to effectively manage their own balance sheets through the most efficient methods should be encouraged to apply additional complex taxes even if it could deliver faster rail infrastructure.

Tax Increment Financing

Tax increment financing (TIF) is a method of funding infrastructure used commonly in the US and UK – and should be trialed in Australia to fund faster rail infrastructure.

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 have 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

TIF involves governments issuing bonds to pay for infrastructure and recapitalising them through the tax revenues arising from economic growth that follows.

The TIF process:

- 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.

TIF is often referred to as a financing technique. However, infrastructure investment that leads to an above business-as- usual economic activity will provides a legitimate revenue stream to fund infrastructure.

In 2008, the Property Council commissioned research and modelling with PwC on the potential application of TIF 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 would urge the Parliament to explore how it can deploy its own tax base to support tax increment financing to fund faster rail infrastructure.

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

Principles and tests for less harmful value capture implementation

Contemplating any new model to fund fast rail infrastructure requires rigor to ensure that it is integrated, rather than adding to the tax burden.

There are several principles and tests that should inform any such consideration:

- The existence of independent, clearly justified and long-term infrastructure plans, noting that, before financing can be considered, a clear business case for the investment in infrastructure, including the economic benefits expected, must be developed
- The policy objectives of any value capture mechanism and the degree to which it can be achieved on a given project, noting -
    - 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 simply an additional, new revenue stream for governments
- The integration of any new model with existing infrastructure charges and property taxes, noting 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, noting -
    - 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, noting 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, noting -
    - 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 perceived value is real, noting -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

Infrastructure funding options and their economic impact

Value capture and innovative financing approaches for funding faster rail should not be contemplated for the provision of infrastructure that does not provide significant uplift to the broader community.

Where faster rail is funded there will be a variety of different taxation options. Some will be very harmful and should be avoided.

Government grant funding

Infrastructure investments funded from general taxation, sometimes supplemented through user charges, as the benefits are directly or indirectly shared across beneficiaries.

Rationale

The capacity to fund infrastructure through grants raised via the existing tax structure including valuation-based taxes levied on the property sector. Although the constraints on both State and Federal Government's balance sheets is recognised, governments must be realistic about the expected outcomes.

Value capture mechanisms will never cover the cost of new or significantly upgraded infrastructure in its entirety. The costs of infrastructure are beyond any one sub-set of society to pay for. Any contribution made by value capture is likely to be incremental, and there is a practical limit on how much funding value capture can and should raise.

Property Council position

Grant funding is supported as current practice for infrastructure funding and it is recognised that value capture can only ever be considered as part of a funding mix. Where there is capacity, consideration should be given to the appropriate use of productive public debt to fund initial investments in infrastructure, with gains from economic activity being reinvested into further projects.

Asset recycling

The leasing or sale, in whole or part, of infrastructure which can be more effectively operated and managed by the private sector, where proceeds are reinvested into infrastructure.

Rationale

Strong, positive examples of asset recycling include the Commonwealth Asset Recycling Fund, providing incentive payments to states who do so as well as the disposal of state-owned ports across several jurisdictions. However, in some states asset recycling has halted for purely ideological reasons. It is highly questionable whether Governments that fail to actively manage their own balance sheets for reinvestment should be able to resort to new taxes to resolve funding constraints.

Property Council position

Asset recycling is supported as it has been deployed successfully. The Commonwealth is urged to reinstate the Asset Recycling Fund. Consideration could also be given to a program of audits and recycling of the Commonwealth's own surplus and underutilized assets, with the proceeds reinvested in the Asset Recycling Fund.

User charges

The creation of a revenue stream funded by the direct users over the lifecycle of the infrastructure.

Rationale

User charges are considered the norm in many public infrastructure sectors (including electricity, gas, telecommunications, water, ports, airports, and public transport). Well-designed and efficient user charges are likely to be superior to taxpayer funding of infrastructure in many situations. Efficient user charges are an effective means to reveal willingness to pay for new infrastructure and to improve the use and augmentation of existing infrastructure.

Property Council position

Well-designed user charges provide a long term, sustainable funding base for major transport infrastructure and should be used to the fullest extent that can be economically justified. However, governments still have to fund some projects and clearly address any equity issues.

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Networkwide fare-box surcharges

Users of the broader network benefit from major system upgrades due to infrastructure investment.

Rationale

All users of the infrastructure, specifically public transport, benefit when the broader system is upgraded and, given that fare box revenues only cover 20-30 per cent of operating costs, there is an opportunity to introduce a fare box surcharge. This approach to value capture may meet community resistance and must be modestly applied to ensure that the demand is not impacted.

Property Council position

This approach is supported as it ensures that those benefiting from the improved infrastructure contribute to the operating cost over the lifecycle of the asset.

Betterment tax levied annually

Captures a portion of the estimated value uplift on land (residential, commercial or both) within an infrastructure catchment area, calculated on above market increases in land values, levied annually.

Rationale

In theory infrastructure investments often provide local households and businesses with improved accessibility or amenity. These benefits are reflected in the value of the land or property.

This uplift however can only be accessed once the property is sold and therefore, the tax is on future earnings, irrespective of the final value of the land or property upon disposal.

Property Council position

Betterment taxes are not supported as the degree of value uplift attributable to infrastructure investment is not easily determined. This process is very complex, often lacks transparency and is costly to administer.

Any betterment taxes must take account of the value uplift capture from other valuation-based taxes such as land tax, stamp duty, capital gains tax and council rates.

Rate surcharge on residence

A surcharge on residential property set at a low rate would provide a revenue stream to borrow against to contribute to funding infrastructure.

Rationale

A broad based low rate surcharge set at a low rate, hypothecated to funding infrastructure, geographically bounded and set for a period of time is a fair and efficient approach. Such taxes are applied irrespective of land value and so are less costly to administer than betterment taxes.

Property Council position

A low rate surcharge on owner-occupied dwellings that would provide a revenue stream to underpin infrastructure project funding is supported. However, removing the exemptions to make a broad-based land tax change would be contentious and governments would have to provide a compelling narrative for change.

Given the political challenges of this approach, even with the significant opportunity to efficiently and equitably raise funding for infrastructure, it could only be attempted as part of a package of significant tax reform measures to boost productivity and growth.

Rate surcharge on businesses

A surcharge on businesses set at a low rate would provide a revenue stream to borrow against to contribute to funding infrastructure.

Rationale

A broad based low rate surcharge set at a low rate, hypothecated to funding infrastructure, geographically bounded and set for a period of time is a fair and efficient approach is applied to businesses. Any taxes would be applied irrespective of land value, raising equity challenges.

Property Council position

Value capture mechanisms are already incorporated into businesses taxes and it would be ill-advised to add additional taxes that will stifle investment. Businesses are subject to land tax, council rates and fire and emergency services levies at very high rates. Any uplift in land value as a result of infrastructure investment will be captured by these mechanisms.

Further, any increase in economic activity attributable to the infrastructure investment will be further taxed through capital gains tax, company tax and GST payments.

Intensify development around new infrastructure

The Australian Government places stronger conditions on funding, or a central pool of additional incentives, to drive more efficient use of re-zoning and integrated planning.

Rationale

Maximising population density and economic activity around major infrastructure is needed to support growing cities. This delivers the much sought after productivity outcomes from associated agglomeration benefits, which flow through to government tax revenue.

This approach to value capture is highly appropriate for government owned land or air rights around major infrastructure. Governments can realise 100 per cent of the value uplift when the infrastructure project is accompanied by an integrated land use plan that increases density.

Property Council position

This is sensible public policy and is supported. This approach boosts transport network efficiency by focusing demand on specific corridors, reducing the need for future infrastructure funding additional multimodal transport systems. This approach requires strong reinforcement with different levels of governments to coordinate rezoning and integrated planning provisions to meet the desired densities.

Poor coordination between infrastructure provision and land use plans has often resulted in suboptimal densities around new and existing infrastructure, and many growth corridors and economic centers remain under serviced.

Voluntary funding of infrastructure by developer

A developer agrees to contribute funding to infrastructure as one-off payment where a nexus between the development and the infrastructure can be demonstrated.

Rationale

When appropriately designed, a levy is paid by developers as part of the planning and approval process to fund infrastructure. This approach to value capture gives developers discretion around funding infrastructure that creates value and unlocks development.

Property Council position

The variation of charges existing across jurisdictions creates uncertainty and requires navigation of complex approvals and charges, which undermines its effectiveness as a funding mechanism.

This approach to value capture would be supported by industry if it was truly developer-sponsored, not simply a condition to receiving an approval.

However, voluntary funding of infrastructure must be accompanied by safeguards to ensure that it does not incentive governments to under-zone growth areas to leverage additional funding above legislated levels.

Additional development levies when accompanied by rezoning

An additional development levy is applied to developments when the provision of new infrastructure is accompanied by a significant rezoning to increase density and change-of-use.

Rationale

Major new infrastructure investments and rezoning will unlock substantial new development capacity and growth. Intensifying development opportunities will ensure that land surrounding the investment is deployed for the highest and best use.

Property Council position

It is appropriate that this type of tax is used to fund new infrastructure investment if certain safeguards are in operation:

- The new infrastructure investment meets threshold tests around scale and significance.
- Rezoning and change-of-use must deliver superior planning outcomes to stimulate development- particularly in infill locations.
- The value of the development levy must be established early to provide certainty to developers.
- The levy must meet the principles and tests that inform consideration of value capture.
- Recognition that this charge may not be appropriate in all circumstances.

The ACT Lease Variation Charge demonstrates where this approach to value capture acts as a disincentive to intensifying development under normal market conditions.

To operate fairly and efficiently, a development levy must replace the myriad of infrastructure charges imposed on developers by the different levels of government during the development process.

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