

# Victorian Budget submission

by Karl Fitzgerald

## Introduction

Prosper Australia is an NGO advocating for an efficient taxation system by transferring taxes off the productive sector and onto the economic rents of land and land-like assets.

Successive Victorian governments have been proactive in the extensive re-zoning of landholdings. Significant expansions of the Urban Growth Boundary were justified by the urgent need for affordable housing. However, the continued land boom has provided a poor return for the community. Investor dominance has pushed First Home Owners (FHO) to record lows. A review of land and housing policy is vital for the financial sustainability of citizens and the state.

## Priorities

The Victorian government budget is currently well placed thanks to Stamp Duty revenues delivered by a booming property market. This healthy financial position offers the new administration time and space to engage in property and taxation reform.

We advocate the following policy reforms:

1. remove the First Home Owners Stamp Duty discount
2. reduce the Land Tax threshold
3. flatten the Land Tax rate
4. broaden Land Taxes to replace Stamp Duty
5. abolish the First Home Owners Grant
6. replace Developer Charges with a Value Capture system
7. return the Local Council rating base to Site Value
8. monitor the role of Speculative Vacancies in the housing supply crisis

## Remove the First Home Owners Stamp Duty discount

The Stamp Duty (SD) discount introduced July 2011 has delivered no discernible effect on housing prices, as economic theory would suggest and Figure 1 demonstrates.

The alleged saving in SD discounts were invariably bid away in higher house (read land) prices.

The SD discount has seen the loss in government revenue simply transferred to vendor and banking profits. The abolition of the FHO SD discount will return \$70m to the budget and have few market implications.

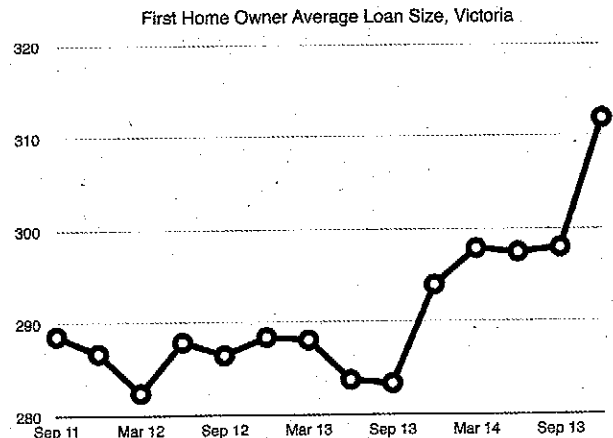


Figure 1

## Reduce the Land Tax threshold

From 2001 to 2008, the State government increased the Land Tax (LT) threshold from \$85,000 to \$250,000. This curtailed LT's effectiveness as a counterweight to land price inflation, encouraging land price appreciation.

In 2014, the owner of a \$330,000 site paid \$435 in LT while enjoying some \$60,000 in capital gains. This low LT charge provides little incentive to put land to productive use. This is compounded by Melbourne's median rents flatlining at \$18,000. This is less than one third of current capital gains. Under today's taxation regime, the incentives to hoard land for speculative gain outweigh renting out or developing a location.

The LT threshold must decrease over time.

Reducing the Land Tax threshold to zero on the \$330,000 site increases the holding cost of land to a still low \$660. However, this charge would come off the capitalisation rate, placing some downward pressure on land prices.

Whilst a minimal reform with limited budgetary significance, this market signal is important. It says that lazy land use will be penalised. An effective Land Tax system is an important tool for government: it politely insists land be put to its best and highest use.

## Flatten the Land Tax rate

The current progressive Land Tax regime is deeply flawed. A progressive LT rate leaves the government open to 'wealth envy' critiques.

By flattening the Land Tax rate, government acknowledges locational values do differ. Land in Toorak is more valuable than Melton. Land Taxes are a percentage charge on the land value. Higher land values in Toorak ensure a landowner naturally pays a higher amount under a flat rate LT system. A higher percentage is not necessary.

If the State government was to flatten the Land Tax rate, it would also address the Henry Tax Review concerns on agglomeration. The strength of this reform is that all land owners pay the same percentage. Locational values account for the varying privilege accorded by nature, infrastructure and culture. Choosing to occupy land is a deliberate decision, evidence of capacity to pay.

## Broaden the Land Tax to replace Stamp Duty

Stamp Duty is arguably the most inefficient tax levied. It is currently a \$36,000 impost on a Victorian household for moving closer to their work.

A broad based Land Tax on all Victorian land could be set at a low rate in the dollar to replace all of

Victoria's property taxes. In 2013-14, \$7.468bn was raised by Victoria's various property taxes. As of June 2014, Victorian land values were \$1,109.1bn. A 0.00674 rate in the dollar is capable of replacing SD, LT, the Growth Areas Infrastructure Charge (GAIC), the Fire Services Levy, the Congestion Levy and the Metropolitan Improvement Levy.

This would be a nation leading reform and result in a number of benefits:

- Cheaper housing
- Lower future debt
- Improved efficiencies (lower deadweight costs)
- Better for the local economy - more money spent locally
- Improved turnover in housing, leading to more suitable housing relevant to need
- Less congestion due to more moving closer to work.

A number of implementation strategies are possible.

## Monitor the role of Speculative Vacancies in the Housing Supply Crisis

For seven years we have conducted a yearly investigation into the number of vacant properties in Melbourne. We analyse abnormally low water consumption levels as a proxy for vacancy.

Prosper Australia's most recent report found 64,386 vacant properties, adding 3.4 per cent to SQM Research's conservative 2.5 per cent market vacancy rate. Our speculative vacancy rate looks at the entire housing stock. Vacancy statistics have typically analysed a smaller subset - those properties advertised available and vacant for three weeks or more. With investors running at 50 per cent of buyers and significant capital gains now so prominent, the import of letting out a property drops with each rise in property prices.

Many of the Speculative Vacancies identified could be subdivided as part of the Intensifying Melbourne agenda. An effective State Land Tax is essential to drive better outcomes.

The yearly Speculative Vacancies report continually reveals very high vacancy rates in Southbank, Docklands, Carlton South and the CBD. However, this hoarded supply is ignored in the Housing Supply Crisis meme.

Of note is the 23.2 per cent Speculative Vacancy rate in commercial land holdings. Massive sunk capital in this sector is undermining Victoria's business competitiveness.

We request the State government assist in our data monitoring and incorporate these findings into their land supply calculations.

## Return Local Councils to Site Value Rating

The Andrews government cap on local council rates may be good politics but it will lead to poor economic outcomes. The State government should encourage local council financial autonomy (especially in light of the trends announced in the Commission of Audit). This could be done by providing incentives for a return to Site Value Rating. This would do more to assist long term affordability and council efficiency than the rating cap severely undermining many NSW councils. Such rating caps have further centralised power. The continual under-utilisation of economic rents as a revenue source at both the local and state government level cede further centralisation of power to the federal tax base.

Capital Improved Valuation (CIV) rating ensures the family home pays more in council rates than the neighbouring land banker. Taxpayers should not be penalised for improving their homes via renovation (or installation of solar, water tanks). Under CIV (or NAV) rating, such improvements result in a higher rating burden. This subtle subsidy for land bankers adds pressure to our already sprawling city.

Further confusing the information available to FHBs on the macro level is the manner in which the 'housing supply crisis' meme has deflected attention away from the dominance of demand over supply. Melbourne's apartment market is a prime example. With record apartment supplies entering the market, FHBs have been forced to rationalise their price assessments into accepting that the best possible outcome is for the price of 2 bedroom apartments to remain flat.

However, both wage growth and inflation are flatlining. The conclusion must be that under the current taxation system, the housing market is incapable of meeting housing demand.

Instead, speculative demand takes priority in a world where mobile capital is scouring the globe for lightly taxed profits.

## Conclusion

There are substantial first-mover advantages available to any Australian state willing to step outside the conventional wisdom that high land costs are evidence of economic success.

High land prices stifle entrepreneurialism, transfer wealth from young to old and from low income earners to financiers. Such inequality slows the rate of growth.

As we have demonstrated, both the demand and supply side of the land market are working against affordable housing outcomes. Public policy must act as a counterweight to the natural advantages land owners enjoy over time.

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