The Case Against a Windfall Gains Tax

by Emily Sims (Research and Policy Manager, Prosper Australia)

> *Rezoning* ***windfall gains can be ploughed back into public infrastructure.*** *When rezoning revenue is used to fund transport, schools and parks near newly rezoned land it enables* ***liveable, higher density neighbourhoods****. By doing this, the government feeds a* ***virtuous cycle of investment*** *and land rent collection.*

Prosper has been a vocal advocate for value capture and rezoning windfalls taxation for decades.

This year, as for many years prior, we made our submission to the Victorian budget, urging a tax on the planning minister's golden pentick.

Our surprise at being heeded by Treasurer Pallas has been proportional to the industry's shock at being ignored.

The response from the industry peak bodies has been dismay, disappointment, and occasionally, howling rage.

I was recently invited to join a panel presentation to the Planning Institute of Australia on Victoria's proposed Rezoning Windfall Gains Tax.

My task was to present the case being made against the rezoning windfall gains tax, and to provide commentary and rebuttal.

I lifted 'points against' from public documents published by the Property Council of Australia, and the Urban Development Institute. I did not do this to be provocative, but rather to engage directly with the concerns of the peak bodies.

Rezoning windfalls are not unearned

> ...The term 'Windfall Gain' is misleading and disingenuous and does not appropriately recognise the investment in the development process which culminates in a rezoning...

> ...It is being portrayed as a "free kick" to landowners, without acknowledging that *most rezonings are proponent-led*, at significant cost and risk, and over extended time periods...

Here the industry contends that the tax misunderstands the nature of rezoning windfall gains.

They claim that most rezonings are proponent-led. Anecdotally 'proponent-led rezonings' are unusual, but perhaps not. There is no easily collated, publicly available data on proponent-led rezonings.

In their briefing note to members, The UDIA acknowledge that "unilateral" or "government-led" rezonings, or (significant) public works which increase values, are scenarios in which "genuine value capture can occur".

But not proponent-led rezonings. Those entail a 'value add.'

It is true is that proponent-led rezonings are super expensive, risky and uncertain undertakings.

Do they add much value to the planning process? This is something for the planning profession to digest. For many consultant planning firms this kind of work is their bread and butter.

To my mind, the disincentive to proponent-led rezonings is one of the benefits of the rezoning windfall gains tax.

A key rationale for taxing rezoning windfalls is to remove a private incentive to undermine public confidence in the strategic planning process (as was the case in the City of Casey and the John Woodman corruption saga).

Land will be rezoned by planning authorities when and where there is strategic justification.

The Greens, and other members of the Victorian cross-bench, have long been supportive of taxing rezoning gains in part due to experiences in local government where a council-led strategic process that culminated in a decision not to rezone a particular precinct was subsequently "called-in" by the Minister.

Planners often debate the merits of Ministerial powers to grant a rezone without notice. At least with a rezoning windfalls tax we'll remove an obvious, corrosive incentive to lobby.

That shifts the parameters of such a debate.

Vendor expectations must be met or there will be no development sites

...Many of the historical landowners of [infill sites] do not have the requisite skills to navigate the contamination issues and rezoning, but *understandably* they want to secure the value uplift....

...[the proposed rezoning tax] completely ignores vendor psychology or competition (it is based in theory, with no concept of real world market dynamics)...

Vendors expect big windfalls. If they don't get the prices they want (because they have to pay a tax to the government), they will not sell.

The PCA provide the case of a farming family who decides not to enter into an options contract with a developer (who would pursue a planning scheme amendment) because of uncertainty around the rezoning windfall. They decide to keep farming for the time being.

To my mind, this does not undermine the case for a rezoning windfalls tax, which rests partly on the 'the beneficiary pays principle'. This is simply a statement that the beneficiary does not want to pay. Which the PCA claim is understandable.

We know that markets and their participants can often be irrational. It is likely that vendors will hold out if their expectations are unrealistic. This is a real problem caused by the monopolistic character of property markets.

Maybe we must accept that markets and vendors will need time to adjust their expectations, and the rate of development may ease in the short term.

Alternatively, we could broaden the base of land taxes, remove exemptions for homeowners and primary producers, and provide a little nudge in the form of holding charges. They are doing this in the ACT and will be doing it soon it NSW as they phase out stamp duties.

We could dabble with new, deliberative models for greyfields regeneration such as those proposed by Peter Newton and colleagues at Swinburne University.

We could make better use of government development authorities and their powers of compulsory acquisition - not only for assembly but forvalue capture.

These options are all better than “giveaway valuable property rights” to overcome market failure.

Rezoning windfalls tax will be passed through to homebuyers

This is a really scary scenario for a millennial like myself. Because if houses get more expensive, I’ll have to keep renting from my mum.

All over Australia, houses are getting more expensive to build these days. Construction costs are up. But usually when we speak about housing affordability we are really talking about land. Which is also up monstrously everywhere.

The best explanation for current house price inflation is that we can all take out bigger mortgages. Not supply constraints or taxes. We have less people than we did 12 months ago.

The key thing to remember is that developers and vendors are already charging the highest price the market will bear.

Land vendors are not discounting housing because they get free property rights with a rezone. If they did, the lucky discount buyer could just flip and sell at the market rate.

Nor are they empowered to simply pass through taxes and charges to the buyer. That’s not the way a competitive market operates. They can instead, pass some costs backwards because the tax base is the residual value of land. This is what happens with Stamp Duty for example, and other land based taxes.

At any rate, a well-designed rezoning windfall gains tax should fall on the vendor of a development site, and should have very little impact on the final cost of housing for new development.

If it did, the market might just prefer to buy land in areas that are already zoned for development. Of which there are heaps. DEWLPs Urban Development Program reports a supply of 235k zoned broadacre lots. If zoned retail lots are being drip-fed to market the problem resides with land bankers.

However, the rezoning windfalls tax is a new tax. Not everyone with projects on the go are coming into the market to find a development site. People have irons in the fire. Which leads us to transition issues.

Rezoning windfalls tax is unfair to speculative land bankers

Developers have bought land on the basis of some areas to be rezoned (designated in the corridor plans as future developable however still in Farming Zone or Rural Conservation Zone).

The purchase amounts already have a price that is reflective of it being UGZ (i.e. developable) - hence the supposed uplift to the vendor has also been recognised.

How will this be calculated and/or fair to developers who take the risk and little reward to begin with?

What if you've bought a site 'as if' it was already rezoned, and 'as if' up until last month there was no such thing as a rezoning windfall gains tax?

In this scenario, the beneficiary has already been paid. The rezoning uplift was pocketed in the speculative 'run up'. If your feasibility is based on the 'already rezoned' residual, it is likely that your project is no longer viable. You might lose your shirt.

There are some reasonable mitigating factors:

Prices are skyrocketing in many markets, so your outlook might be more optimistic than you thought. In some senses, with the market going crazy, it's probably a good time to make this transition.

We have a year to get the transition right, and Treasury is consulting with industry and civil society.

If a project becomes unviable, a rational developer will on-sell the site to another developer to cut their losses. Land speculation may move to other states, but the land itself stays in Victoria.

Over time, the market will adjust to the new rezoning windfall tax reality. Again, this is one of the benefits of the tax. It's based on a pure economic rent. It is less distortionary relative to other taxes.

To an extent, we can design our way out of real transition unfairness. Potentials include a long phase-in, grandfathering, exemptions in certain precincts perhaps. These are not recommendations so much as spitballing.

The point is designing a fairer transition is preferable to giving away rezoning rights and encouraging speculation in the path of development.

Rezoning windfalls tax will sterilise infill development sites

...The WGT would...actively discourage development and investment in the Government's own identified priority precincts e.g. Arden

...the new tax will drastically reduce the industry's ability to activate and deliver new housing, retail, office and mixed-use development which would maximise the Government's infrastructure investment in [Suburban Rail Loop Stage 1] suburban locations.

Finally, there is some contention that an unintended consequence of the tax will be to make GAIC areas more attractive vis-a-vis urban infill.

This is not caused by the rezoning windfall tax but by the exemption of the GAIC areas. And by the existing challenges to infill development: slimmer margins, riskier, and more capital intensive projects, heterogeneity of infill sites and their relative scarcity etc.

Many planners are united with industry in their concern that the objectives of Plan Melbourne may be undermined unintentionally. Will Melbourne again become a sprawling donut?

I do not think the answer lies in continuing to give away rezoning rights.

For starters, we cannot have any confidence that by giving away rezoning rights we are improving infill feasibility. We may simply be giving away rezoning rights to landholders whose "business" is flipping strategic, scarce and heterogenous development sites.

We recently released a report on Fishermans Bend. In it, there's a paradigmatic case:
320 Plummer Street.

- Bought for an indexed value of $2.2m three years before the rezone,
- Received a development permit issued in 2015 for a 500+ apartment mixed-use development,
- Flipped in the same year to a developer for $11m.

I estimated the rezoning windfall at an adjusted value of $7.7m. Under the proposed rezoning tax, $3.85m of that would have gone to consolidated revenue to help pay for the transport links we need in Fishermans Bend.

I'll accept that by getting their development approval, the flipping landholder de-risked the purchase. But how much value do we suppose that adds? And should we be pinning our hopes for sustainable urban renewal on the crapshoot of private sector land speculation?

Again, I think we must look to more empowered public sector development authorities to resolve some of the challenges of infill development. We may need to increase the volume of land zoned for development in inner and middle ring suburbs.

The case against taxing rezoning windfalls comes down to fear. Vested interests would like us to believe that the risk of land market disruption outweighs the benefits of the reform. It is true that any tax or regulatory intervention in a complex system, like markets, risks unintended consequences. There are always unknown unknowns with this kind of reform.
The known risks are manageable, but rely on getting the design and the transition detail right.

Initially, those against it argued that the tax had no merit. Now they are arguing that it should be reframed as a 'contribution' and instituted on all developments across the state. Initially they argued that the tax would hit homebuyers. Now they want the tax to distinguish between a genuine developer and land speculators. So we have discovered what is truly to fear in this reform: a tax that calls a windfall a windfall.

Read Emily's report on The Rezoning Honeypot: Evidence from Fisherman's Bend
https://tinyurl.com/3hc8krwd