

## SUBMISSION TO IPART – 13 MAY 2016: REVIEW OF THE LOCAL GOVERNMENT RATING SYSTEM

The Shopping Centre Council of Australia (SCCA) represents Australia’s major owners, managers and developers of shopping centres (refer to [www.scca.org.au](http://www.scca.org.au)).

This submission on the review of the *Local Government Rating System* summarises the critical issues we believe IPART needs to consider in forming recommendations to the NSW Government regarding reform of the local government rating system. It also highlights some key omissions from the Issues Paper, and also areas where we believe IPART’s understanding and/or explanation of relevant issues, including valuation processes and tax principles, needs development. This submission respectfully seeks to assist fill these gaps.

The local government rating system does not need major reform. However, the current system can seriously fail shopping centres and their retailers.

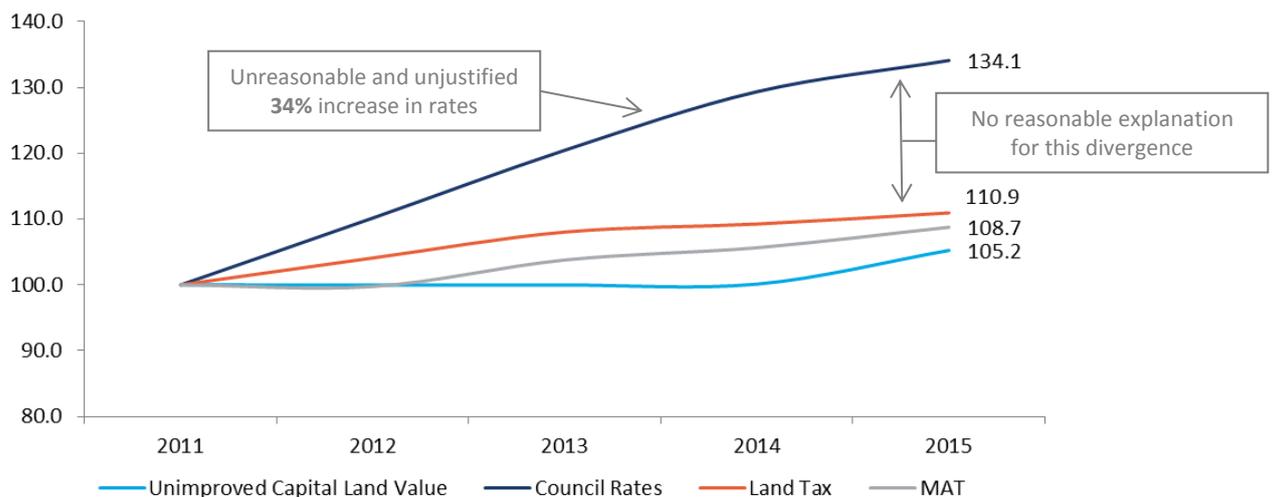
There are a number of important safeguards which should be implemented via amendments to the *Local Government Act 1993* to protect shopping centres and their retailers from disproportionate rates and volatile rate increases. A failure to introduce safeguards will see shopping centres and their retailers remain open to flagrant abuse and increased costs.

Fundamental change to the current statutory land valuation system – the base of the NSW rating system - is also not required. Change in this regard would be costly and disruptive for the NSW Government and councils, and confusing for rate payers, particularly those which also attract a Land Tax and/or a pending Emergency Services Property Levy liability. Any change would also undermine the credibility and existing governance arrangements of the Office of the NSW Valuer General which have, in recent years, been thoroughly reviewed and validated via a NSW Parliamentary inquiry.

### 1 A GROWING, UNJUSTIFIED AND VOLATILE RATE BURDEN ON SHOPPING CENTRES

Over the last five years (2011-15), the rate burden carried by shopping centres and their retailers has outstripped growth in underlying unimproved land value and centre Moving Annual Turnover (MAT). The growth in rates also makes the otherwise disproportionate growth in land tax look moderate in comparison. Put simply, councils are having their cake and eating it too with regard to their rating policies.

**Land Value vs. Council Rates, Land Tax & Retail MAT**  
New South Wales Index of Total Value 2011 to 2015



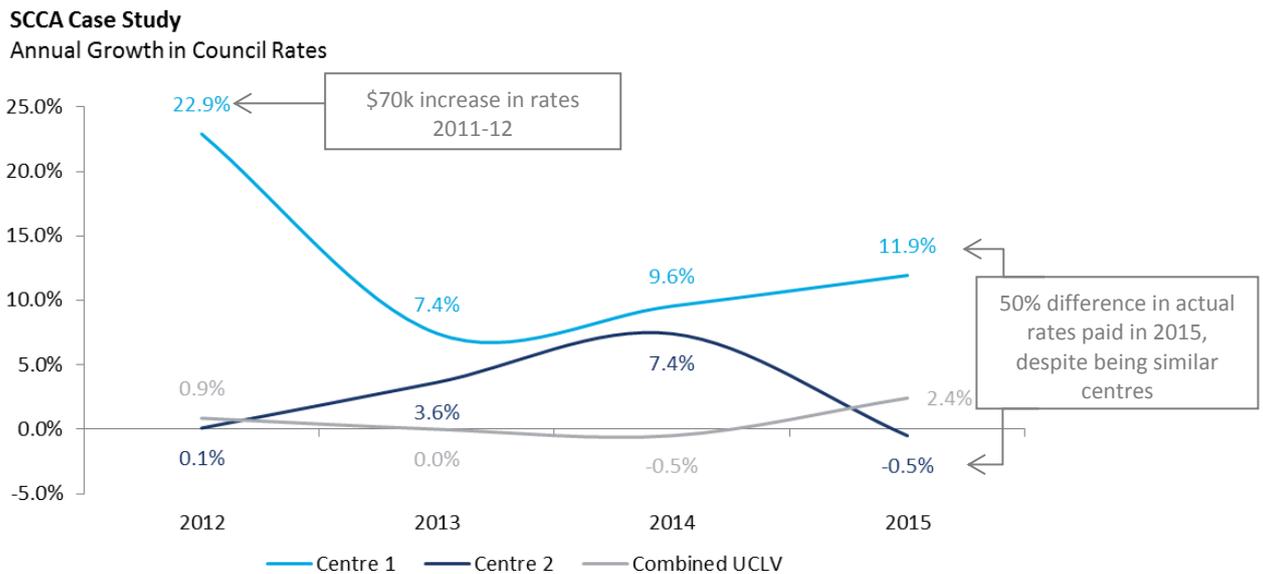
Source: SCCA Research

This rate burden is facilitated by the current system which enables councils to apportion the rate burden under the rate cap and special rate variations, and also create shopping centre specific sub-categories without any justification or analysis of the service and infrastructure ‘benefits’ which will result. There is also no requirement for commensurate safeguards to be implemented to ensure that rates are not increased – without justification - over time.

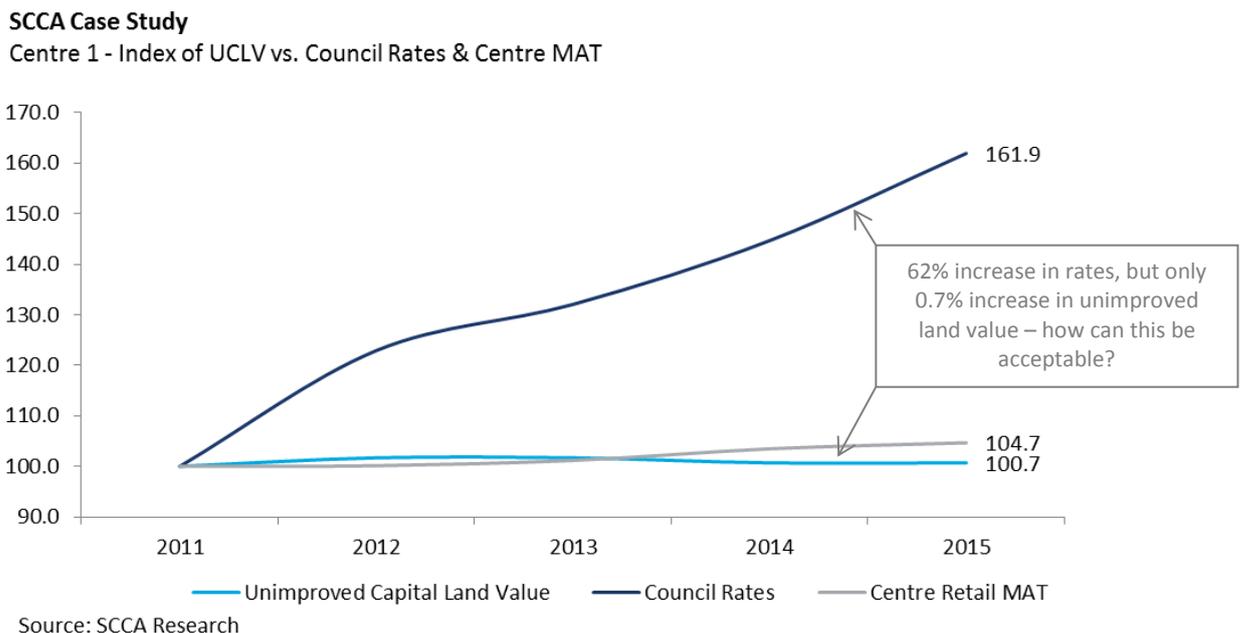
It is also typical for shopping centres to experience significant volatility in the application of rates, with large year-on-year increases being very common. This volatility makes it extremely difficult for shopping centre owners, and their retailers, to prepare annual budgets with certainty.

There is observable volatility between shopping centres in different local government areas, despite the fact that the service and infrastructure 'benefits' which would accrue to each centre would be reasonably similar. This suggests that some councils are not basing their rate policies on a reasonable apportionment of costs or demand assessments but, rather, opportunistically so as to shift the rate cost burden to commercial property.

The below illustrates the year-on-year volatility in the continued growth in council rates on two typical, large shopping centres in NSW. It also illustrates the divergence between the rate increases experienced by the two centres – *Centre 1* and *Centre 2* – that are reasonably similar in size, MAT, number of retailers and visitation, but are in different local government areas.



The following illustrates the growth over time in council rates payable by *Centre 1*. Between 2011 and 2015, *Centre 1's* council rates increased by almost 62%, while the centre turnover and land value only increased by 4.7% and 0.7% respectively. In the absence of appropriate safeguards, this clearly demonstrates that the rating system is failing shopping centres.



**TEN CRITICAL ISSUES**

We respectfully request that IPART consider the following critical issues in its ongoing review of the local government rating system:

**VALUATION**

- #1: **The rate valuation base must remain 'unimproved land value'**
- #2: **Shopping centres are a specialised valuation class; a centralised valuation process is critical**
- #3: **Important Parliamentary processes and Government policy announcements must be acknowledged to avoid duplication and confusion.**

**RATES SYSTEM**

- #4: **Extreme caution is needed regarding any reform to further 'relax' the rate peg to avoid rate blow-outs and cost shifts to shopping centres and their retailers**
- #5: **Rating sub-categories which impact one asset, or a small number of assets, must be stopped**
- #6: **If retained, rate increases on a sub-category must be justified, and safeguards imposed to stop unjustified increases in costs**
- #7: **Infrastructure and service costs need greater transparency to stop runaway, unjustified rate increases**

**OTHER**

- #8: **'Capacity to pay' is not a credible principle of taxation and penalises commercial property**
- #9: **Shopping centre retailers also carry the burden of increasing and volatile rates**
- #10: **There are related risks, including so-called 'value-capture' infrastructure funding, that need to be considered**

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**VALUATION****#1: The rate valuation base must remain 'unimproved land value'**

There is no justification for a move to an improved base for valuation for the purpose of council rates. IPART should abandon its consideration of shifting the valuation base from 'unimproved land value' to 'capital improved value' or 'annual rental value', or allowing councils the discretion to decide.

Our observation from the 26 April public hearing is that councils are driving reform in this regard to shift the rate burden to high valued properties, such as shopping centres. We are also conscious of a related 'Trojan Horse' whereby a shift to a capital improved basis - which may initially be met with appropriate safeguards for highly valued commercial property - could eventually be met with demands from councils to extract untold additional rate revenue from properties with high value improvements.

The current land valuation system in NSW is credible, well understood and simple to administer.

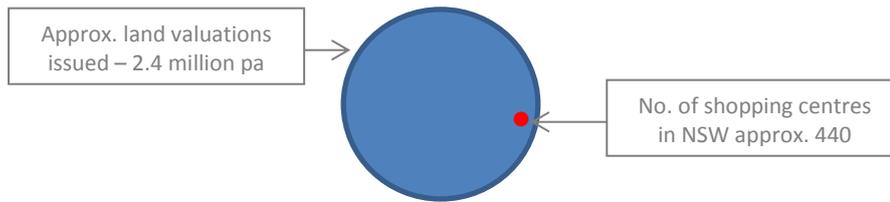
Improved rating bases require a series of hypothetical assumptions to ensure the statutory valuation only assesses the value of land and physical improvements to ensure that a ratepayers intangible improvements are not captured.

If NSW adopted an improved rating base, it would add substantial complexity and cost over and above the existing land value system. As noted by the Valuer General at the 26 April public hearing, it would cost in the "...many tens of millions..." to capture the data necessary to set up an alternative valuation base.

**#2: Shopping centres are a specialised valuation class; a centralised valuation process is critical**

The valuation services provided by the NSW Office of the Valuer General should continue to be required to be used by local councils in NSW.

Value and valuation isn't a simplistic concept for shopping centres principally as a result of the fact that there are relatively few shopping centres across NSW and that they transact infrequently. There is also only a small number of shopping centres in any given area (e.g. any given LGA). In this regard, the general or mass valuation approach of residential property cannot be applied to shopping centres, particularly large shopping centres.



For this reason, shopping centres are generally treated as a specialised asset classe for statutory valuation purposes, which involve additional review processes to ensure that valuations, particularly for larger shopping centres, are consistent and accurate across the state. Maintaining a centralised approach to valuation will ensure that the integrity of shopping centre valuations, which largely exists as a function of the engagement of the Office of the Valuer General, is maintained.

Although there is no evidence of the like in the Issues Paper, we would suspect that a cost/benefit analysis of moving away from a centralised approach would conclusively demonstrate that the status quo should prevail.

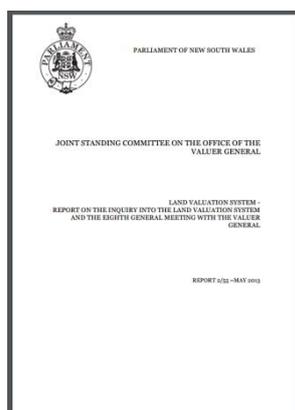
**#3 Important Parliamentary processes and Government policy announcements must be acknowledged to avoid duplication and confusion**

The Issues Paper omits a number of highly relevant policy inquiries and announcements which should be highly instructive to IPART in preparing its recommendations to Government.

In 2013, the Joint Standing Committee on the Office of the Valuer General undertook an inquiry into the *Land Valuation System*. This inquiry, chaired by the current Parliamentary Secretary for Treasury, Matt Kean, conclusively found “...that land value is the appropriate basis for valuation for rating and taxing purposes”.

This inquiry also comprehensively considered a range of highly relevant issues, including procedural fairness, avenues for appeal and transparency of and access to data, all of which are fundamental to the integrity of the NSW rating system.

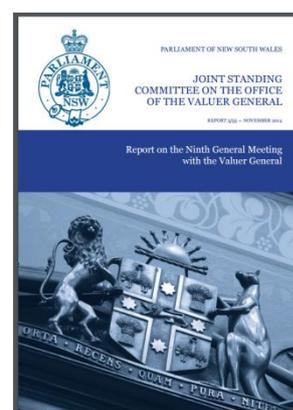
The reforms recommended by this inquiry in May 2013 were considered by the NSW Government and a formal response was issued in November 2013. The Office of the Valuer General continues to implement the improvements that were sought by the Government and the Valuer General regularly reports to Parliament on progress (the ‘Tenth General Meeting with the Valuer General’ with the Standing Committee took place on 13 May).



**May 2013**



**November 2013**



**Ongoing**

The Office of the Valuer General also maintains a Land Valuation Advisory Group, of which the SCCA is a member, to ensure ongoing industry engagement and feedback.

It is also essential that IPART consider the December 2015 announcement by the NSW Government that the Emergency Services Property Levy will be “...based on unimproved land value and will be collected by local government on behalf of the State”. The NSW Treasurer, Gladys Berejiklian, has also announced that the ESPL will be “...paid alongside council rates”.

It would be a ridiculous scenario where a rates notice is issued to property owners with two components - rates and ESPL – and for the two components to have a different valuation base. This would lead to unnecessary confusion, with no benefit.

## RATE SYSTEM

### **#4: Extreme caution is needed regarding any reform to further 'relax' the rate peg to avoid rate blow-outs and cost shifts to shopping centres and their retailers**

IPART should exercise considerable caution and highly caveat any recommendation regarding reform to further 'relax' the rate peg, particularly considering that councils are, generally speaking, monopoly service providers. The current nature of council service provision justifies a degree of regulation and oversight.

Considering the current growing and unjustified growth in council rates paid by shopping centres and their retailers, we have little confidence that councils will reasonably and transparently manage significant changes to the rate peg system, especially in an extreme scenario where the rate peg is 'abolished'. We think this could just open the door to the shift of even more costs to shopping centres.

Our view on this is informed by the already excessive and unjustified rate increases experienced by shopping centre owners under the current framework which allows, generally speaking, council discretion under the rate peg, special rate variations and sub-categorisations.

We cannot overstate how cautious we are about any proposal to significantly reform or 'relax' rate pegging. At the very least, any reform proposal must be met with an assurance that a fiscal responsibility framework, fair rating principles and safeguards to prevent councils from shifting the rate burden to commercial property owners.

### **#5: Rating sub-categories which impact one asset, or a small number of assets, must be stopped**

Councils should be prohibited from creating rate sub-categories which place a higher rate burden on a single property, or a small number of properties (e.g. large shopping centres).

We note, and agree with, the comment in the Issues Paper, at page 23, that "*levying higher rates and charges on more successful centres of activity could only undermine efficiency and competitive neutrality*". This encapsulates why the current abuse of sub-categories by councils needs to be stopped.

Currently, IPART set the rate peg (set at 1.8% for 2016-17) and/or approve a special variation and councils then distribute the total rate base as it chooses. This can include by targeting a small number of property owners under via a rating sub-category.

The existing legislative framework does not require sub-categories (and resultant rate increases) to be justified via, for example, a demonstration of increased service demand or improvement. In our experience, they are informed by a wilful misunderstanding of 'capacity to pay' and the desire to suppress increases in rates for the owners of other property types (e.g residential property) by increasing the rates imposed on commercial property.

Our members have frequently experienced rate increases which are considerably higher than any prevailing 'rate peg' or special rate variation, or the increases in many other reasonable measures (e.g. CPI). Such is the case with regard to *Centres 1 and 2* above.

The ability for councils to distribute the rate burden in such a manner, even in a 'rate pegged' environment, lies at the heart of our concerns with the current rating framework.

By way of current example, we are aware the Hornsby Shire Council is currently considering the implementation of a sub-category under the 'Hornsby CBD Business Rate' called 'Major Retail Shopping Centre'. The sub-category is proposed to have a higher *ad valorem* rate than the prevailing Hornsby CBD Business Rate.

Hornsby Shire Council's *Draft 2016-17 Operational Plan* provides no analysis or justification for the creation of this sub-category beyond generalities regarding the potential for "*significantly higher or lower valuation percentage variation compared to surrounding properties*". There is no evidence to justify the proposed increase based on service or infrastructure demand, or additional benefits that will accrue to the shopping centres impacted (which we understand may be a single centre – Westfield Hornsby).

It is a particular and growing concern to us that Hornsby Shire is just the next in a line of councils which have taken this approach to sub-categorisation.

**#6: If retained, rate increases on a sub-category must be justified, and safeguards imposed to stop unjustified increases in costs**

Sub-categories which target specific properties, or a small number of properties, are able to be implemented without proper or transparent analysis to determine the potential cost impact on the property owners involved - or their tenants - and without any safeguards to ensure that a council cannot, over time, continue to inequitably increase costs.

The current abuse of sub-categories by councils also gives rise to an un-level playing field between retail competitors.

As noted on page 15 of the Issues Paper, the tax principle of 'competitive neutrality' "...requires that businesses competing with each other be treated in a similar way".

Why should a retailer in a shopping centre which happens to be the subject of a sub-category with a higher *ad valorem* rate be placed at a disadvantage relative to a retailer outside of the shopping centre where a lower *ad valorem* rate applies?

If sub-categories applicable to a single or a small number of properties are not ruled-out, IPART should recommend to Government that legislative safeguards be built into the *Local Government Act 1993* to prevent their abuse by councils. This should include consideration of requiring that the highest applicable *ad valorem* rate can be no more than *X* times that the lowest *ad valorem* rate and limiting the year-on-year increase in rates that can be imposed on any individual rate payer (e.g. 5%).

**OTHER**

**#7: Infrastructure and service costs need greater transparency to stop runaway, unjustified rate increases**

We are extremely concerned about the generalised commentary in the Issues Paper regarding the 'demand' generated for council infrastructure and services by different valued properties. We fundamentally disagree with the comment at page 18 of the Issues Paper that "*the market value of a property may better correlate with the benefits received by the owners from the provision of public goods by the council*".

Put simply, value is not a proxy for demand.

If IPART is to make comments and recommendations in this regard, it must be informed by a thorough analysis and quantification of the types and, importantly, the level of service and infrastructure provision that are required by different property types.

This analysis should acknowledge historical and ongoing investments made by property owners to reduce, or equalise, their demand on council services and infrastructure. For example, shopping centres are required to make development contributions to council at the development stage to equalise the additional demand a particular development will have on the surrounding road network. Some shopping centres also have private waste management contractors and manage their own private car parks. It is also an understood principle of infrastructure funding that shopping centres don't generate demand for the provision of public open space or its maintenance.

This type of analysis would also drive greater transparency in, and allow for the justification of, the application of rates to particular rating categories and sub-categories (e.g. IPART could recommend requiring councils to justify rate increases to particular categories or sub-categories with regard to the benefits which are required by, or would accrue, to particular property owners).

**#8: 'Capacity to pay' is not a credible principle of taxation and penalises commercial property**

'Capacity to pay' should not be considered as a principle by IPART when considering their recommendations to Government. Comments in the Issues Paper which suggest property based taxes are equitable and that property value is a proxy for "*wealth and ability to pay*" are ill informed.

'Value' cannot be conflated or confused with income or profit and, as highlighted elsewhere, 'value' isn't a proxy of demand.

(We would also observe that, as far as we are aware, property-based taxes are not generally regarded as equitable, although there is principled agreement that land based property taxes are efficient to the extent that land is immobile and, if based on unimproved value, they do not distort investment decisions).

A shopping centre's Net Operating Income is only a small fraction of the 'value' of the asset. Value also exists at a point of time and cannot be realised until such time as an asset is sold.

Adopting an oversimplified view of 'capacity to pay' – whereby high valued assets pay more without reference to service and infrastructure demand – also runs the risk of reducing the value of an asset. By way of explanation, additional or increased taxes – can impact a shopping centre's Net Operating Income and subsequently a shopping centre's asset value. Based on a capitalisation rate of 6.25%, every \$1 million increase in a new tax could result in a \$16 million decrease in asset value. We doubt this would be an intended consequence of any proposed reform to the NSW rating system.

#### **#9: Shopping centre retailers also carry the burden of increasing and volatile rates**

Council rates, like land tax, are statutory costs which are recoverable by landlords from retailers. When rates are increased on a shopping centre owner, a portion of these costs are passed through to retailers. IPART should be aware of this relationship, which is regulated under the *Retail Leases Act 1994*.

The SCCA and the Australian Retailers Association (ARA) have recently finalised a *Retail Sector Tax Policy Position* which presents a united position on the imposition and growth of land based property taxes. This *Policy Position* is available in the SCCA's website.

#### **#10: There are related risks, including so-called 'value-capture' infrastructure funding, that need to be considered**

'Value-capture' funding has been proposed as a so-called 'new' and 'innovative' method to fund infrastructure. While various models exist, we are concerned that 'value-capture' could simply result in yet another land-based property tax which would come on top of Land Tax and council rates.

While the recent public policy debate has been largely driven by the Federal Government's 'cities policy', we are concerned that state governments and local councils may begin to unilaterally progress value-capture proposals which could possibly result in considerable additional costs to shopping centres and their retailers.

By way of example, the Gold Coast Light Rail is commonly referenced as involving a 'value-capture' component which we understand is applied as a surcharge on council rates.

We also have little confidence that 'value-capture' models will appropriately reflect the existing contributions already made by commercial properties (i.e. land tax, rates, infrastructure charges) and may just exacerbate the double and triple dipping which already occurs with regard to land based property taxes.

Although this issue sits beyond Terms of Reference, we think it is critical that IPART give consideration to other live policy debates which may compound the impacts of any recommendations made regarding the local government rating system.

### 3

## **CONCLUSION AND NEXT STEPS**

The SCCA has more detailed information on the *Ten Critical Issues* raised above and would be pleased to discuss them further.

The SCCA respectfully urges IPART to ensure their recommendations to Government are firmly evidence based and not informed by pleas from local government for greater flexibility to impose potentially even higher rates – but with less rigour and transparency. We also urge IPART to remain alert to 'Trojan Horse' policy proposals from local government which, over time, could come at the expense of shopping centres.

The current local government rating system doesn't need full scale reform, but the lack of safeguards for shopping centres means that the current system fails landlords and their retailers. Safeguards should be implemented to protect shopping centres and other commercial property from unjustified and unreasonable rate increases.

IPART should not entertain any change to the rating base for local government rates. The premise of 'unimproved land valuation' is well understood and doesn't distort investment decisions. The valuation services offered by the NSW Valuer General should also be retained for the purposes of local government rates.

We would be pleased to participate in any public hearing process and/or meet IPART to discuss the data in this submission on a confidential basis.

## 4 ABOUT US

The SCCA represents Australia's major shopping centre owners, managers and developers. Our members own and manage shopping centres from the very largest ('super-regional') centres to the smallest ('neighbourhood') centres in cities and towns in every state and territory.

Our members are AMP Capital Investors, Blackstone Group, Brookfield, Charter Hall Retail REIT, DEXUS Property Group, Eureka Funds Management, GPT Group, ISPT, Ipoh Management Services, Jen Retail Properties, JLL, Lancini Group, Lendlease Retail, McConaghy Group, McConaghy Properties, Mirvac, Perron Group, Precision Group, QIC, Savills, SCA Property Group, Scentre Group, Stockland and Vicinity Centres.

## 5 CONTACT

### **Angus Nardi**

Executive Director

Phone: 02 9033 1930

Email: [anardi@scca.org.au](mailto:anardi@scca.org.au)

### **Kristin Pryce**

Senior Adviser

Phone: 02 9033 1941

Email: [kpryce@scca.org.au](mailto:kpryce@scca.org.au)