15 March 2021

Hon. Dominic Perrottet MP
Treasurer
52 Martin Place
Sydney NSW 2000

Via email: TaxReformTaskforce@treasury.nsw.gov.au

UDIA NSW Submission on Property Tax Reform

Dear Treasurer,

The Urban Development Institute of Australia NSW (UDIA) is the leading industry body representing the interests of the urban development sector and has over 500 member companies in NSW. UDIA NSW advocates for the creation of liveable, affordable, and connected smart cities.

UDIA welcomes the Treasurer's appetite for reform in the property sector and we believe that the Property Tax reform has the potential to deliver significant long terms benefits for the economy and the people of NSW. At a high level, removing Stamp Duty, which is a regressive tax, should benefit residential markets, reduce acquisition costs, improve mobility and unlock greater productivity and market capacity.

The backdrop to this reform is a crucial period of economic recovery due to the COVID Pandemic, where governments have recognised the development industry as essential and a key economic bridge to maintaining jobs and driving growth. This response provides our detailed thoughts on a range of aspects of the reform.

Developer and Consumer Choice

The reform has been explained to the broader public on the basis that people buying their own home will have the choice as to whether they pay Stamp Duty (as now) or opt-in to the Property Tax. Once a property switches to the Property Tax, it will continue to be subject to a Property Tax indefinitely. We are strongly of the opinion that it would help speed up the transition to Property Tax if developers were able to opt-in their developments, transitioning many properties in one go. To make this a practicable option, thresholds need to be set at an appropriate level. We believe that this should not be less than $60m.

We recognise that this will remove the opt-in choice from consumers on some properties. However, as more and more properties transition, this will inevitably be the case anyway.

Recommendation 1 – Allow developers to opt-in to Property Tax and set a high threshold for property developments to opt-in to Property Tax of no less than $60m.

Greenfield Development

Greenfield development is currently growing strongly, thanks to low interest rates, the Homebuilder stimulus scheme, the desire for increased living space because of COVID and the greater acceptance of working from home. Property tax is a long-term reform and needs to be able to work throughout the economic cycle. There are several issues to be considered in this reform for the greenfield development sector:

- Consumers often purchase land and then build the house separately. Consequently, they pay Stamp Duty on the land purchase only, reducing their Stamp Duty costs compared to existing properties. This reduces the incentive to opt-out of Stamp Duty and so may slow the transition to Property Tax.

- Many greenfield purchasers are first home buyers, with sensitive household expenses. An annual Property Tax may be less attractive than a one-off upfront stamp duty charge included in their mortgage repayments (there may be some advantage to quarterly rather than annual payments).

- The improvement in the relative position of existing or higher density properties could shift relative demand away from greenfield development and create unintended economic consequences with a knock-on impact to jobs and the economy.

- Annually, new house sales make up approximately 1% of all housing stock and 20% of all house sales in NSW generating substantial Stamp Duty revenues. However, as the transition to property tax takes place, the direct Government revenues from new houses will decrease until it makes up only around 1% of revenues from property tax. This should provide the Government with scope to consider other incentives to opt-in, if required.

- Because Property Tax is on the unimproved land value, low density homes will pay significantly more Property Tax than higher density homes in similar locations. This is likely to encourage the construction of more medium density properties. It will be important for planning policies to support this shift, to maintain affordability.

- Property Development Agreements (PDAs) are a pathway for owners of large land parcels to work with developers to develop greenfield sites. PDAs bring a number of benefits that support greenfield development, particularly today where unzoned and englobo land values are so high. The developer brings the expertise to achieve a rezoning and to masterplan the site with government authorities. During this period the landowner holds the land, and the sale occurs at a later date. This has significant benefits to development cashflow given the major expense of land purchase is sometimes deferred and / or staged, and stamp duty obligations may not arise. If the reform impacts on PDAs, there is a danger that the greenfield pipeline will be further squeezed with significant impacts on new housing delivery, affordability and jobs.

Recommendation 2 – Maintain a watching brief in the first 6 to 12 months of implementation on the level of opt-in to Property Tax from new greenfield housing and consider other incentives to opt-in, if required.

Recommendation 3 – Ensure planning policies allow medium density in greenfield locations.

Recommendation 4 – Ensure that the reform supports the continuing use of Property Development Agreements.

Apartments

The apartment market is going through a major slump in NSW, with approvals down 63% from their peak and construction down over 40%. If things do not improve quickly, we are likely to see sizeable skilled job losses and significant affordability challenges when post-COVID household formation rates normalise, and immigration and overseas students return. The Homebuilder program largely bypassed the Sydney apartment market and shifted demand to the greenfield sector where eligibility hurdles could be met. We need further stimulus to protect against further skilled job losses and to restore supply. The Property Tax reform can help support the apartment sector in several ways:

- The purchasers of apartments will benefit from the reform by not paying Stamp Duty upfront and because Property Tax is calculated on the unimproved land value and apartments require less land, they will pay significantly less Property Tax. This is likely to increase relative demand for apartments.

- One of the key drivers behind the slump in the apartment market has been the significant four-year reduction in foreign investors, mostly due to the increases in foreign investor surcharges. If foreign investors can opt-in to Property Tax, removing the need to pay Stamp Duty could reduce a barrier to them investing, supporting the apartment market. This would be further enhanced if existing foreign investor surcharges can be either remover entirely or incorporated into Property Tax without undue complexity.

- For domestic investors, the impact will depend on how long investors intend to hold the property for and the rate they will have to pay. Currently, for purchasers off the plan, Stamp Duty is paid 3 months from sale, well before any opportunity to earn off-setting income. Removing this impost is a positive. However, it will not provide much improvement if the Property Tax needs to be paid before the investor can earn income. Therefore, even if the election date to opt-in to Property Tax is the same as when Stamp Duty is due, it is essential Property Tax does not become payable by an off the plan purchaser until at least the settlement date.

- Currently, first time buyers of apartments often do not pay Stamp Duty due to concessions. The compensation that the Government is proposing to pay if they opt-in to Property Tax, could allow these buyers to put the money saved towards a deposit, lowering barriers to them getting onto the property ladder and helping to restore apartment demand. However, this could have a knock-on impact on the amount that the banks are willing to allow first time buyers to borrow due to their increased expenditure from property tax. In addition, the cashflow impacts for first time buyers may cause them not to opt-in to property tax. In these cases, providing the option for first time buyers to defer property tax payments up to the equivalent amount could be appealing. This would also have the benefit of reducing the short-term revenue loss to the Government.

- For apartment developers, given the relatively shorter time that they often hold the land, they will usually favour Property Tax. If they are not given the option to opt in, such as through low thresholds, compared to today they will favour buying land that has already gone into the Property Tax regime. This will distort the locations where apartments are built, potentially in an undesirable way.

Recommendation 5 – Allow domestic and foreign investors to opt-in to Property Tax at the owner occupier rate.

Recommendation 6 – Review whether foreign investor surcharges can be eliminated or incorporated into Property Tax.

Recommendation 7 – For new residential buyers the liability date for Property Tax to start should be at settlement to ensure the purchaser has an asset to expense it too.

Recommendation 8 – Maintain the existing proposals for first home buyer compensation and ensure the payment can be used as part of a finance agreement.

Recommendation 9 – Consider giving the option to first time buyers to defer property tax payments.

Recommendation 10 – Consider providing additional short-term support to the apartment sector.

Transition period - Retrospective

If, and when the Treasurer announces that the NSW Government will proceed with the Property Tax reform, there will be a gap between announcement and the date that the reform comes into force. This gap could create uncertainty and create a debilitating pause in the property market with significant negative consequences for developers, jobs and the economy. Therefore, it is critical that the ability to opt-in to Property Tax commences immediately from announcement. We recognise that this creates a risk for the Government. However, we believe that this is small compared to the damage created by stopping the property market for four to five months.

In addition, the reform has the potential to generate misinformation. This could have significant market impacts. To minimise the risk of this occurring, at the time of announcement, the Government needs to provide communication materials for estate agents and developers to provide to clients and online tools that allow the public to model the financial implications of opting into Property Tax compared to paying Stamp Duty.

Recommendation 11 – Allow the ability to opt-in to Property Tax from the date of the announcement that the Government will proceed with the reform.

Recommendation 12 – Provide communication materials and online tools to avoid misinformation.

Interaction with Developer Contributions and Value Capture

This reform will have an interaction with the reforms proposed by the Productivity Commissions review of Developer Contributions final report in December 2020. For example, where a new piece of transport infrastructure is being constructed that will increase land values, a developer in Property Tax could potentially be asked to pay more through a higher Property Tax and also be hit with higher developer contributions or a separate value capture charge. UDIA NSW would not support double dipping in this way and we will need to work through these scenarios as part of the developer contributions reforms being undertaken.

Recommendation 13 – Ensure that developer contributions and Property Tax reform work harmoniously together.

Property Prices

Over time the reform is expected to assist housing supply and put downward pressure on property prices. However, this will be minor in comparison with the other forces driving property prices. Therefore, it is critical that the Government undertakes other measures to put downward pressure on property prices to increase affordability, especially around removing supply constraints.

Recommendation 14 – The NSW Government continues to review and remove barriers to increasing housing supply.

Build to Rent (BtR)

UDIA NSW wants the nascent BtR sector to succeed in NSW and has actively supported policy development in line with Build to Sell (BtS) apartments, with some incentives like the 50% reduction in Land Tax normalising this position, rather than creating an advantage. This means that any change to the BtR tax regime should not disadvantage it compared to where we are today. This means that BtR should pay a residential investor rate of Property Tax and not a commercial rate. The difference between BtS per unit payment and BtR units in one-line requires further analysis. It should be noted that the boost to BtS apartments from the move to Property Tax (discussed above) may make it harder for BtR to get off the ground.

Recommendation 15 – Ensure that BtR is subject to a Property Tax at residential investor rates and provide further clarity about the Property Tax treatment.

Retirement Living

As the NSW population ages, retirement living is more important to deliver the aging in place and community benefits we desire. Retirement Living is struggling to grow in NSW, as other residential development is mostly a higher and better use. The Property Tax reform has no clear pathway for Loan-Lease villages for the most popular tenure in NSW as there is no transaction to pass on the expense of Property Tax.

Property tax may impact adversely on new retirement living developments for properties that have previously elected to opt-in, as it may increase the annual expense payable by residents.

Recommendation 16 – Undertake a review of the challenges facing retirement living to ensure this form of residential living is sustained as the population ages.

Commercial, Retail and Industrial Property

The viable development of these types of property is essential to the creation of the 30-minute city and liveable mixed-use neighbourhoods. Under existing policies, these property types are less attractive developments than residential uses. Under a Property Tax regime recoverability from occupiers will become important for commercial, retail and industrial development feasibilities and there is some variability to be considered for each asset class. The impact on net income will have a significant impact on asset valuations and clearly tenants will need to consider their total occupancy costs.

Recommendation 17 – Consider the recoverability from occupiers for commercial assets such as office, industrial and retail to ensure consistent feasibility and sustainable markets.

Rates and Increases

The potential Property Tax rates in the consultation document provide an incentive to opt-in under most scenarios. If the reform it to be successful in the long-term, we believe that incentive needs to be maintained.

The method of calculating increases in the amount a taxpayer will pay in Property Tax has the potential to be complicated and could be beyond the understanding of the average person. However, we believe that the need to limit the volatility in payments is essential for the long-term success of the policy. If many individual households face significant successive increases in Property Tax for several years in a row, the political pressure for reform of the system will become acute. Any proposed formula needs to moderate increases sufficiently to avoid this problem.

Recommendation 18 – Maintain the existing potential rates.

Recommendation 19 – Review what Property Tax increases would have been in the past decade in key geographical areas and whether these would have been sustainable from a political perspective.

Foreign Developers

Foreign developers are an important part of the development and investment markets and are critical to the supply of housing. Generally, policy positions should continue with the current settings and avoid exacerbating the current disincentives to investment. However, we note that there is an existing anomaly where foreign developers need to finish selling projects by June 2021 that should be resolved.

Recommendation 20 – Foreign Developers should not be penalised, and Property Tax reform should maintain existing housing affordability settings and deal with the existing anomaly where foreign developers need to finish selling projects by June 2021.

Amalgamations and Partitions

Developers create the future of our cities, often by consolidating properties to form larger sites and Property Tax should help enable this activity. Development sites could be a mixture of Stamp Duty and Property Tax properties which need to be amalgamated. To aid the transition, it makes sense for the entire property to fall under the Property Tax regime if only one part of the property is already in the Property Tax regime. However, it should be noted, that this may provide an incentive to exclude a Property Tax property into an amalgamation to avoid any restriction on thresholds.

A likely scenario is for a purchaser to pay Stamp Duty and then amalgamate with a Property Tax purchase, switching everything over to Property Tax. In this scenario, credits for Stamp Duty already paid should be provided as an offset against future property tax.

Recommendation 21 – Allow an entire property to be in the Property Tax regime, if one property already pays Property Tax.

Recommendation 22 – Create a credits scheme for amalgamation scenarios where Stamp Duty has already been paid.

Primary Production

The current exemption from land tax for land that is used for primary production should be maintained to avoid disruption to land supply. Other exemptions should also continue to apply.

Recommendation 23 – Maintain the existing exemption for land tax, for Property Tax on primary production land.

Treatment & definition of Vacant Land

Where a property is not being used it should be defined as 'vacant land.' It would be unreasonable to penalise any land (including any improvements on it) that is being held in fallow pending a decision (e.g. a DA) within which there is no activity and no income and no certainty on the final use.

Legally no use or activity can permissibly be undertaken within a lot, until it can be legally occupied and used. Therefore, while construction is underway but not yet complete, we believe the property should continue to be considered as vacant land until an Occupancy Certificate is issued or the final lot is registered.

Recommendation 24 - Any property that cannot be lawfully occupied or used and any property that is not being used (e.g. being held in fallow) should default to 'vacant land.'

Treatment and Definition of Mixed Use

There also needs to be some consideration given to a "mixed use" definition given that in more and more situations commercial and residential uses may be combined in the same title.

The definition of "mixed use" has been argued ad infinitum in the NSW Land and Environment Court given that the mixed-use zone (named as 'B4") in NSW makes permissible much of the residential apartments along major roads (via the land use term "shop top housing").

Case law has determined the definition to require ground floor commercial, but the predominant use can be residential. Hence why they can often be found with vacant commercial tenancies on the ground level. This is required (and sacrificed) to give permissibility to the apartment building above. Thus, case law is ahead of the legal definitions in the "Standard Instrument—Principal Local Environmental Plan (2006 EPI 155a)." (NSW legislation website).

Recommendation 25 - Where the zone is mixed use in nature (i.e. 'B4" but also can be town centre zoned such as B3), then the predominant use should be determined. This is relatively easy if there is a DA and intent to develop, and if not, it may be reasonable to make a determination based on the Council LEP vision for the precinct in which the site is located and the nature of surrounding consents. This sounds tedious but the onus could be put on the property owner to demonstrate this.

Valuation processes

Many of our members do not feel that the current land valuation processes are fit for purpose with often large discrepancies between land values that should be similar. The current appeals process is far too expensive (circa $80K) and ties up the Land and Environment court unnecessarily. Given the importance of land values on Property Tax, these processes are going to be more important than they were in the past. The Government should consider alternatives such as the use of a NSW Civil and Administrative Tribunal (NCAT) with a special section with valuation experts. Taxpayers generally have too limited a right of review, and natural justice should be given greater weight.

Recommendation 26 – Undertake a review into the current land valuation processes and appeal mechanisms.

Conclusion

UDIA is supportive of the direction of travel to abolish Stamp Duty and move to a Property Tax. However, there are a lot of issues that need to be worked through to ensure its success. Especially key is the impact that the reform will have on the current housing market. Handled poorly, the reform could bring the housing market to a halt with a significant impact on economic growth, economic confidence and jobs. We would emphasise the importance of our two recommendations above on transition and retrospectivity:

Recommendation 11 – Allow the ability to opt-in to property tax from the announcement that the government will proceed with the reform.

Recommendation 12 – Provide communication materials and online tools to avoid misinformation.

UDIA looks forward to continuing to work with the Government in working through the detail of this important reform for NSW and ensuring good outcomes for the community in housing and development.

Yours sincerely,

Steve Mann
Chief Executive
UDIA NSW