ACT LEGISLATIVE ASSEMBLY PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO THE METHODOLOGY FOR DETERMINING RATES AND LAND TAX FOR STRATA RESIDENCES

SUBMISSION BY THE OWNERS CORPORATION OF LANDMARK APARTMENTS, BARTON – UNITS PLAN 2413

Introduction

Landmark Apartments is a large complex on a large block of land in Barton. As explained in this submission, because its land value is high, the impact of the change in methodology the subject of the Committee's inquiry is especially great. Landmark apartments cover a wide range of values. The largest are comparatively expensive, although nowhere near as expensive as the most valuable apartments in Kingston Foreshore complexes or many other complexes throughout Canberra. There are many one-bedroom apartments, and many of those (as well as larger apartments) are tenanted.

The impact of the changed methodology is greatest on the smallest and lowest-valued apartments.

This submission:

- provides examples of the impacts of the change in methodology;
- explains how the change in methodology creates the impacts it does;
- sets out the resulting inequities; and
- compares the impacts to the stated rationale for the changes.

Brief examples of the impact of the change in methodology

First, we present examples of the rate increases this year for three actual apartments in the Landmark multi-unit complex in Barton:

- A small one-bedroom apartment suffered a rates increase from 2016-17 to 2017-18 of 24.8% with an increase in the valuation-based component of 118.3%;
- A two-bedroom apartment suffered a rates increase of 31.5% with an increase in the valuation-based component of 102.0%; and
- A large three-bedroom apartment suffered a rates increase of 28.6% with an increase in the valuation-based component of 41.1%.

Meanwhile, increases for households on individual residential blocks have been relatively modest. There has been a massive redistribution of the rates burden onto the owners of apartments (or townhouses) in multi-unit complexes from those on individual blocks. Within that redistribution there has been an even more massive redistribution of the burden onto the smallest and least valuable apartments, as demonstrated by the examples above.

These anomalous increases cannot possibly be consistent with any notion of equity. To understand what has happened, it is necessary to examine the change in methodology for levying rates in the ACT.

The change in methodology explained

Until the 2017-18 year, the methodology for calculating the rates of multi-unit dwellings and for houses was essentially the same. In each case a Valuation Based Charge was calculated on the Average Unimproved Value (AUV) of the property:

- in the case of a house, on the unimproved value of the land which it occupies; or
- in the case of an apartment in a multi-unit complex, on that apartment's share of the unimproved value of the land occupied by the complex.

An apartment's (or townhouse's) share is given by its unit entitlement, ie its proportion of the total number of units for the complex. At Landmark, which is a large multi-unit complex, unit entitlements range from 0.21% to 1.14%.

The methodology was relatively uncontroversial.

In addition to the Valuation Based Charge, for all residential rate-payers there was (and still is) a Fixed Charge, uniform across rate-payers, ie not varying with the value of the property. A further fixed Fire and Emergency Services Levy and a Safer Families Levy are also added. The Fixed Charge ($765) and the Safer Families Levy ($30) are unchanged from 2016-17 to 2017-18. The Fire and Emergency Services Levy increased from $252 in 2016-17 to $294 in 2017-18. Finally, in 2017-18 there is a one-off rebate of $100 for strata properties.

The Valuation Based Charge is a smaller proportion of the overall rates bill for an apartment (or any residential property) with a low valuation than for one with a high valuation. For high value properties, the Valuation Based Charge greatly outweighs the sum of the fixed charges.

For 2017-18, the methodology for calculating the Valuation Based Charge was changed. An overall Valuation Based Charge is now calculated for the whole multi-unit complex, and apportioned between the apartments (or townhouses) in the complex in accordance with the unit entitlements.

The impact of the changed methodology

To understand the impact of this change it is necessary to note that the Valuation Based Charge is levied using a progressive tax scale, as follows for 2017-18:

Residential Average Unimproved Value (AUV)		Tax rate	Tax on Tranche	Cumulative Total
$0	to $150,000	0.2960%	$444.00	$444.00
$150,001	to $300,000	0.4088%	$613.20	$1,057.20
$300,001	to $450,000	0.5130%	$769.50	$1,826.70
$450,001	to $600,000	0.5603%	$840.45	$2,667.15
$600,001	& over	0.6013%		

These rates have increased in 2017-18, as they generally do each year, but that has had only a minor effect compared with the impact of the changed methodology.

The effect of a progressive tax scale is that the Valuation Based Charge for a higher AUV is not only higher than for a lower AUV, but a higher proportion of the AUV. For example, the Fixed Valuation Based Charge for an AUV of $140,000 is 0.2960% of $140,000; that is, $414.40.

The Valuation Based Charge for an AUV of $550,000 is the sum of:

- the tax on the first tranche of $150,000, namely 0.2960% of $150,000, which is $444.00; and
- the tax on the next tranche of $150,000 ($300,000 minus $150,000), namely 0.4088% of $150,000, which is $613.20; and
- the tax on the next tranche of $150,000 ($450,000 minus $300,000), namely 0.5130% of $150,000, which is $769.50; and
- the tax on the final tranche of $100,000 ($550,000 minus $450,000), namely 0.5603% of $100,000, which is $560.30.

This sum is $2,387.00.

Thus, the Valuation Based Charge for an AUV of $140,000 represents 0.2960% of the AUV, while the Valuation Based Charge for an AUV of $550,000 represents 0.4340% of the AUV; that is, a 46.6% higher rate of tax. This is the nature of progressive taxes, like the income tax.

Returning to the change in methodology in 2017-18, the impact is that all the apartments in a multi-unit complex are now levied a Valuation Based Charge at the far higher rate applying to the AUV of the whole of complex, as if it was owned by a single person. Until 2017-18, each apartment paid the Valuation Based Charge (correctly) applying to that apartment's share of the overall AUV.

A small, one-bedroom unit in a multi-unit complex now pays a Valuation Based Charge calculated at exactly the same rate as for a penthouse in the same complex. Moreover, virtually every medium to large multi-unit complex will have an overall AUV above the threshold of $600,000 for the top marginal tax rate for the Valuation Based Charge. Indeed, even a relatively modest set of townhouses can have an AUV of several million dollars. That means that all the unit-holders in such complexes now pay a Valuation Based Charge at close to the top marginal rate, even if they were previously at the lowest marginal rate.

Resulting inequities

Obviously, the increases in the Valuation Based Charge for the least valuable apartments are proportionately the highest, and the increases for the most valuable apartments are proportionately the lowest (although the amount of the Valuation Based Charge remains, of course, much higher for the most valuable apartments).

What was a progressive tax is now, within a given complex, no longer progressive. The change is consequently regressive.

The Landmark complex in Barton has an AUV of $51,609,965, reflecting its size and location. However, it also has a large number of apartments: 282. The smallest of these apartments have a share of less than a quarter of one per cent of the overall value of the complex, and of its AUV for rating purposes. That is, they are entitled to less than one four-hundredth of the total value. Thus, their share of the total AUV is less than $130,000. Until this year, they paid rates based on that AUV of less than $150,000.

Now, by contrast, they pay rates based on the consolidated AUV for the complex which, under the new calculation methodology, means that every apartment pays the Valuation Based Charge at a rate of 0.6% (0.5995%). This mean that if the unit entitlement of this small apartment was 0.23%, the AUV would be $118,702, which under the previous methodology would have given rise to a Valuation Based Charge of $351.36, as for an individual block with that AUV. Instead, under the new methodology, the Valuation Based Charge would be $711.60. A single dwelling would have to have an AUV of around $215,460, over 80% more, to be liable for the same Valuation Based Charge of $711.60.

The two-bedroom apartment given as an example above has a share in Landmark's overall AUV of $185,795, corresponding to a unit entitlement of 0.36%. But it must pay a Valuation Based Charge of $1,113.80, which would be paid by a single dwelling only when its AUV was $311,033, 67% greater.

The three-bedroom apartment with a unit entitlement of 1.14% has an AUV of $588,353 and is liable to a Valuation Based Charge of $3,527.05 which would be paid by a single dwelling only when its AUV was $743,002, 26% greater.

Because of the vagaries of the combination of a valuation-based charge with various fixed charges, the increases in the total rates bill vary across apartments in a counter-intuitive fashion. As shown in the examples at the beginning, the greatest percentage increases in total rates occur for those apartments in the middle of the range of apartment values. The peak increase in the Valuation Based Charge is about 106% (a more than doubling) for the lowest-valued apartments. The peak increase in total rates bill is around 35% for an apartment with a unit entitlement of around 0.58%.

It is impossible to see any logic in this pattern.

A further anomaly needs to be considered. Consider two multi-unit complexes: one a large complex with 200 apartments and an overall AUV of $60 million, and a dual occupancy with an AUV of $600,000.

An apartment with a unit entitlement of 0.5% and a corresponding share of $300,000 in the AUV of the first complex would pay a Valuation Based Charge of 0.5% of the Valuation Based Charge for the whole complex, ie $1,799. If each of the units in the dual occupancy has 50% share, then each would pay a Valuation Based Charge of $1,329,53. Thus, the Valuation Based Charge for the apartment in the large complex would be 35% higher. But such a dual occupancy might well have a value greater than the apartment in the 200-apartment complex.

Thus, the change in methodology produces inequitable changes in rates liability:

- within multi-unit complexes;
- between residents of large complexes and residents of small complexes; and
- between residents of complexes and residents of stand-alone dwellings.

Stated rationale for the change in methodology

That raises the issue of what the policy motivation was for the change in methodology. The following rationale has been given

> "The intention of this change is to ensure that rates and land tax on units are better aligned with rates on freestanding homes with equivalent market values, as previously unit holders have generally paid significantly less in many cases.
>
> In the ACT, general rates do not only pay for municipal services such as roads and rubbish. Because of our unique single level of government, rates also help to pay for the ACT's schools, hospitals, public transport and many other 'state government'

services that all Canberrans access. This is why it is important that everyone in our community contributes fairly.

The general rates and land tax calculations for multi-unit dwellings are now based on the total Average Unimproved Value of the land rather than the AUV of the individual unit. This change is being phased in over the next two years. As a result, general rates and land tax for units are increasing at a higher rate than for freestanding properties during this time as the change takes effect.

Under the previous methodology, someone with a $500,000 unit in the City paid about $400 a year *less* in rates than someone with a freestanding home worth the same amount in Charnwood. We do not believe that was fair or equitable.

Even after the methodology change average rates on units are significantly lower at $1,352 per year, compared with $2,295 a year on average for freestanding homes."[1]

Assessment of the rationale for change

As mentioned above, several forms of "realignment" are at work in the new methodology. One is between rates on freestanding homes and apartments with equivalent market values. Another is within multi-unit complexes, with the least valuable apartments suffering the greatest increase in the Valuation Based Charge and the most valuable experiencing the lowest increase. A third is between larger and more valuable complexes and smaller, less valuable complexes.

It is obvious that if, as is demonstrably the case, apartments within a multi-unit complex are experiencing increases in the Valuation Based Charge in inverse relation to their value, then there can be no general "better alignment" with rates on freestanding homes.

More fundamental is the question what "alignment" ought to consist of. The clear assumption is that rates ought to be more reflective of the market value of residences, not the unimproved value of the land on which they stand. Those with high-valued apartments ought to pay as much as those with equivalently valued houses.

But that represents a huge change in the historical basis for levying rates in Australia. Moreover, even under the new methodology, the actual structure of rates flies in the face of the claimed norm based on market values. Most fundamentally, the rationale appeals to some notions of equity that are not spelt out and can be seen to be incoherent.

First, if the objective is to equate rates payable for homes of equal market value, why not simply use market value in place of unimproved value of land?

We do not advocate that approach, but merely point out that it would follow as night follows day from the objective that is presented as the basis for the methodology change. The change in methodology is not merely an imperfect way of achieving a market-based rate structure; it cannot begin to achieve it and instead has perverse results.

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[1] Email dated 18 February 2018 to a member of the Executive Committee of the Owners Corporation of Landmark Apartments from Dr Jennifer Rayner, Director of Budget & Economic Policy, Office of Andrew Barr MLA, Chief Minister and Treasurer.

Secondly, the current rates structure contains a significant fixed component of $1,089 for 2017-18 (setting aside the one-off rebate on the basis that it is not intended to be a permanent feature of the rates structure). Indeed, the fixed component accounts for far more than half of total rates payable by smaller apartments even under the new methodology, where the Valuation Based Charge has more than doubled. It is a correspondingly high proportion of the rates for stand-alone dwellings on land with relatively low unimproved value.

What is the rationale for the fixed component? Two possibilities suggest themselves. The cost of providing services to households is obviously unrelated – at least in any reasonably direct way – to the value of either the land or the homes of those households. Although the cost is far from uniform across households, there is some attraction in simply apportioning the cost equally across households.

Alternatively, it may be that the fixed component is thought to produce a more politically acceptable outcome by deliberately reducing the progressivity of the rates structure. Without it, a lower proportion of rates would be collected from households with higher valued assets (whether unimproved land values or market values of homes).

Again, we do not advocate removal of the fixed components. Rather we point out that their existence is at odds with any conception of “alignment” of rates based on market values.

Thirdly, it is claimed that in the ACT general rates pay for State-like services as well as municipal services, and that this is why it is important that everyone in our community contributes fairly. This is at best highly misleading, as well as begging the question of what rates structure constitutes fairness.

In fact, residential general rates account for only 5.9% of total general government sector revenue in the 2018 ACT budget.[2]

The ACT Government’s own-source taxation accounts for 32.8% of its total revenue, and residential general rates account for only 18.0% of that. The largest component of own-source revenue at 26.8% is payroll tax, accounting for 8.8% of total revenue. It might be noted that payroll tax is a tax levied by the States, not by municipal authorities.

Other components of total revenue that are larger than residential general rates are sales of goods and services such as regulatory fees (9.7% of total revenue) and dividends and income tax equivalents from government-owned enterprises (7.6% of total revenue).

By far the largest component of ACT Government revenue is grants from the Commonwealth, comprising the ACT’s share of GST revenue plus various other forms of general and specific purpose assistance. Together these account for just over 40% of revenue. This is the main source of funding for the ACT’s State-like services. The GST revenue is distributed among the States and Territories in accordance with decisions by the Commonwealth Grants Commission, taking account of the ACT’s relative expenditure needs and revenue-raising capacity.

It could therefore be argued that the ACT Government’s State-like expenditure responsibilities are irrelevant to an examination of how it levies residential general rates. In any case, the claimed rationale quoted above provides no basis for the suggestion that equity

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[2] ACT Government, 2017-18 Budget Paper No. 3, pages 222-223, accessed at https://apps.treasury.act.gov.au/__data/assets/pdf_file/0010/1069921/08_BP3-2017-18-Budget-Chapter-6.pdf.

between ratepayers in the rates they pay should depend in some unstated manner on how the ACT Government spends its revenues.

Moreover, there is a respectable argument that the Commonwealth government is responsible for, and best placed to deal with, financial equity between citizens through its taxation and income transfer systems. While we do not advocate the conclusion that could be drawn from such a view – namely, that municipal services ought to be funded by a poll tax – we do question the simplistic view that the ACT Government ought to change its rates structure with the objective of giving it a greater redistributional role.

Market value versus unimproved land value

We note further that it is apparently integral to the rationale quoted above, that "[e]ven after the methodology change average rates on units are significantly lower at $1,352 per year, compared with $2,295 a year on average for freestanding homes." That comparison is utterly meaningless without further context. What are the comparative:

- land values;
- market values; and
- costs of service provision

between multi-unit complexes and freestanding homes?

That anyone should be surprised that rates on units are on average lower than rates on freestanding homes is staggering. How many one-bedroom freestanding homes are there in the ACT?

That anyone should consider that the difference should be corrected, without the slightest analysis, is disturbing.

Claims that basing rates more on market value than on unimproved capital value is automatically fairer need to be subjected to scrutiny.

It is said that a unit in Civic that has a value the same as a house in Charnwood ought (self-evidently) not to pay lower rates. But compared to the Charnwood house, the Civic apartment would:

- have a claim on only a fraction of the land; and
- place less demand on municipal services, due to economies such as a single water and sewerage connection to the Civic apartment complex.

Conclusions

Land rates based on unimproved land values have served the country well. The ACT is not significantly different in relevant ways from other parts of Australia, in particular given the variety of sources of its revenue.

The claimed rationale for changing the methodology does not stand up to scrutiny.

Even if there was merit in some sort of shift towards market value-based rates, the changed methodology as implemented is a shemozzle. It is ill thought-through and gives rise to massive inequities. In particular, subjecting every apartment or townhouse in a multi-unit complex to a Value Based Charge at the same rate; that rate being close to the top marginal rate applying to very highly valued properties, is senseless.

The changes impact disproportionately on those least able to afford them. As a particular case, because tenants are more highly represented in units compared to freestanding homes, they will be particularly hard hit as rate increases are passed through into rents.

At the very least, such a major change in the way the ACT government raises revenue from its residents ought to be properly analysed, explained, subjected to consultation with Territory residents, and approved by a majority.