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Mr David Nicol
Under Treasurer
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Review of the Lease Variation Charge

Thank you for the opportunity to comment on the Review of the Lease Variation Charge prepared by the Chief Minister, Treasury and Economic Development Directorate, September 2018.

The Housing Industry Association (HIA) is Australia's national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

The residential building industry includes land development, detached home construction, home renovations, low/medium-density housing, high-rise apartment buildings and building product manufacturing. Along with providing a range of services to members, HIA develops and advocates policy on behalf of the industry to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population.

The Housing Industry Association (HIA) fundamentally opposes taxes on development such as the Lease Variation Charge (LVC) and the predecessor to this scheme the Change of Use Charge (CUC), and does not support the proposition that the LVC has a 'neutral' impact on investment decisions with respect to development.

Regardless of the rationale of the ACT Government with respect to the LVC, it is nonetheless a disincentive to development and job creation, and impacts negatively on housing affordability.

Housing Affordability

After Sydney and Melbourne, Canberra is Australia's third most challenging capital city in terms of housing affordability.[1] What's more, while affordability in the two former cities has started to improve, affordability in Canberra continues to deteriorate. In the September 2018 quarter, affordability deteriorated by 1.1% to also be 1.1% cent less favourable than a year earlier.

Post the Global Financial Crisis (GFC), housing affordability in the ACT reached its most favourable position during the June 2015 quarter. Since then, the HIA Housing Affordability Index has declined from 92.1 to 86.2, equivalent to a deterioration of 6.3%. The change in affordability in the ACT over the

[1] Housing Affordability Report, Housing Industry Association, October 2018.

past year is largely the result of significant growth in dwelling prices. During the September 2018 quarter, the median dwelling price was an estimated $552,611, an increase of 2.4% on the same period a year earlier when the median price was an estimated $539,434.

The relatively restricted financial state of the federal government and the prevalence of low inflation generally have constrained earnings growth in the ACT. Average earnings are estimated to have risen by 2.0% over the year to the September 2018 quarter. Affordability conditions will continue to deteriorate if dwelling price growth continues to outpace earnings.

As the charge is levied prior to the settlement of a new dwelling contract, it will attract the Goods and Services Tax (GST), effectively creating a ‘tax on a tax’. It is also worth noting Stamp Duty will be levied on the total contract price, including the impact of the LVC.

It is also worth noting that inflationary development taxes such as the Lease Variation Charge, where passed onto first home buyers will also have implications for the Loan to Value Ratio (LVR), and therefore the level of Lenders Mortgage Insurance (LMI) potentially charged to borrowers.

Taxation on Housing

In 2011 HIA commissioned an independent report into taxation on new housing from the Centre for International Economics (CIE). Information on all the taxes that contribute to the final price of a new home were collated, with figures then verified with many residential building businesses.

When all taxes are included (direct and indirect), the taxation on a new house and land package in Sydney is an estimated 44% of the purchase price, for Melbourne the figure is 38% and for Brisbane the figure is 36%. The level of taxation of apartments was found to be comparable by CIE, being Sydney 35%, Melbourne 33% and Brisbane 34%. These figures have since been replicated in a further study conducted by CIE, which focused on smaller capital cities and regional centres.

The burden of tax falling on the housing sector is considerably higher than the average for all other sectors. New housing is inequitably taxed, accounting for around 1.2% of value added in the economy while contributing 2.8% of government taxation revenues. The average tax burden on the new housing sector is estimated at 31% of the value of output compared with an economy-wide average of 24.4%. This percentage for new housing makes it the second most heavily taxed large industrial sector in the Australian economy.

Consequently, the taxation system influences the stock of dwellings available for occupation and the extent to which new housing is added to the stock. Appropriate tax policy settings will be crucial to ensuring that the nation’s housing meets the current and future needs of the population.

Several the taxes imposed on the housing sector, and on new housing are inefficient. The Australia’s Future Tax System report , commonly referred to as the ‘Henry Tax Review’ found that among the vast array of taxes paid by the housing sector, about half of them were highly inefficient.

Impact on development activity

The attached table (Appendix I) contains the last 10 years of LVC/CUC revenue from past budget papers. The LVC has consistently failed to achieve revenue targets, and more optimistic forecasts have regularly been wound back.

From the modest levels projected in the original CUC of around $5 million per annum in the 2010-11 budget, revenue projections steadily increased over the forward estimates and were projected to reach nearly $27 million by 2014-15. This figure was progressively downgraded in the estimates before eventually achieving a much more modest $14,165 million.

In fact, the highest level of LVC that has been achieved so far is $22.38 million in 2011-12. A similar trend of downgraded forecasts can be observed in the 2015-16, 2015-16 and 2016-17 budgets.

It is acknowledged that it is difficult to draw strong conclusions from these figures, and the generally underperformance of the revenue stream against projections could relate to the methodology or other forecasting issues. Equally, with concessional arrangements in place during the early years of the charge, changes to rates over time, and now a deferral scheme, the evidence asked for in the discussion paper can be difficult to quantify.

However, the fact that LVC revenue has generally not performed against its initial targets and overall expectations could suggest that there has been an underestimation in the elasticity of development with respect to projects that attract the LVC, and that a significant increase in tax does actually decrease activity.

Project feasibility is a complex process of which a very important component is to determine a sites economic development potential. The government must be responsible for ensuring the LVC is able to robustly balance elements such as certainty for the development industry, avoiding unnecessary complexities in calculating the LVC and ensuring an accurate calculation can be carried at an appropriate time in the overall development approvals process. Absence of these elements (particularly in the climate of protracted development approval timeframes which are being experienced in the ACT), leads to greater developer holding costs, which negatively impacts upon feasibility. It may be that a lower rate per unit would balance these aims more appropriately.

Alignment with planning policies

The LVC charge runs counter to several well-entrenched ACT Government policies, with respect to urban renewal and infill development. ACT Government strategic planning documents state that for future development *“infill sites for increased density will have been identified for new housing. Increased density will help support more efficient public transport and vibrant neighbourhood centres.”*

The government’s commitment with respect to light rail from both Gungahlin and Woden to the city and associated development along these corridors, reflect this strategy.

The LVC is in direct conflict with this strategy, introducing a significant disincentive to redevelopment in these areas. By definition the LVC is a consequence of infill development rather than greenfield, and it would create a perverse outcome if a charge levied in relation government policy, in fact caused it to fail.

The ACT planning system should create an environment where the private sector can innovate and deliver a range of housing types and styles to the community, within the boundaries set by the government and community’s overall vision for the city. LVC contributes positively to neither. Setting significant and inconsistent price imposts on development will invariably drive development to occur where projects are feasible, rather than where is preferred.

Providing an incentive for better outcomes

HIA is generally supportive of schemes that link incentives with better outcomes, though it is recommended when considering a scheme such as this that it is approached with caution and it is important that the bar set to achieve the incentive is commercially viable for the applicant/developer, reasonable and done in consultation with industry. It is also important that provision be made for the incentive and the better outcome to be adjusted relatively easily to keep pace with modern thinking in terms of design and social need.

Particularly when considering this concept in the context of a betterment tax, HIA recommends clear and transparent formulas and scenarios with minimal to no opportunity for subjectivity as even a slight difference in understanding between a regulator and an applicant could have financial consequences for the applicant/developer and negligible consequences for the regulator. Although providing an incentive for better outcomes can on the surface seem like a win-win this may not always be the case as the applicant/developer will be carrying far greater, but most likely all, of the associated risk.

HIA would welcome the opportunity to meet with you to discuss this further, and I can be contacted on 6285 7300 or g.weller@hia.com.au.

Yours sincerely

Greg Weller
Executive Director, ACT/SNSW

APPENDIX I

Lease Variation Charge / Change of Use Charge Reveune - ACT Budget papers

2017-18 Budget	2017-18 est. outcome	2018-19 Budget	Variation (%)	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate	2013-14 Estimate	2014-15 Estimate	2015-16 Estimate	2016-17 Estimate	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
22,851	8,193	21,482	162%										25,717	27,024	28,405
2016-17 Budget	2016-17 est. outcome	2017-18 Budget	Variation (%)									2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	
17,744	19,906	22,851	15									25,840	26,982	28,181	
2015-16 Budget	2015-16 est. outcome	2016-17 Budget	Variation (%)								2017-18 Estimate	2018-19 Estimate	2019-20 Estimate		
16,290	5,057	17,744	251%								18,454	19,377	20,346		
2014-15 Budget	2014-15 est. outcome	2015-16 Budget	Variation (%)							2016-17 Estimate	2017-18 Estimate	2018-19 Estimate			
14,580	14,165	16,290	15%							17,593	18,174	18,118			
2013-14 Budget	2013-14 est. outcome	2014-15 Budget	Variation (%)						2015-16 Estimate	2016-17 Estimate	2017-18 Estimate				
17,674	15,228	14,580	-4%						16,767	18,112	18,710				
2012-13 Budget	2012-13 est. outcome	2013-14 Budget	Variation (%)					2014-15 Estimate	2015-16 Estimate	2016-17 Estimate					
23,484	17,674	17,674	0%					18,469	19,300	20,169					
2011-12 Budget	2011-12 est. outcome	2012-13 Budget	Variation (%)				2013-14 Estimate	2014-15 Estimate	2015-16 Estimate						
22,382	22,382	23,484	5%				24,641	26,365	28,211						
2010-11 Budget	2010-11 est. outcome	2011-12 Budget	Variation (%)			2012-13 Estimate	2013-14 Estimate	2014-15 Estimate							
14,225	14,225	22,382	57%			25,597	26,821	27,894							
2009-10 Budget	2009-10 est. outcome	2010-11 Budget	Variation (%)		2011-12 Estimate	2012-13 Estimate	2013-14 Estimate								
2,221	5,000	14,225	185%		22,382	25,597	26,821								
2008-09 Budget	2008-09 est. outcome	2009-10 Budget	Variation (%)	2010-11 Estimate	2011-12 Estimate	2012-13 Estimate									
4,697	5,627	2,221	-61%	5,056	5,056	5,056									

Values in $'000