



University of Technology, Sydney

A Review of Rating Residential Land in Randwick Local Government Area 2013

Prepared for:

Randwick City Council

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Vince is author of the text 'Land Tax in Australia' and has published widely on land and property taxation. During 2010 he was a visiting fellow at the Australian School of Taxation (Atax) UNSW and a visiting researcher at the School of Real Estate and Surveying, Aalto University, Helsinki. He has reviewed rating and taxing systems internationally including those in Denmark, Finland, Sweden and Estonia. During 2012 he met with leading tax economists and local government experts at OECD World Headquarters Paris, in reviewing the re-emerging importance of recurrent land taxation for sub-national government in Europe, following the Global Financial Crisis.

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Acronyms

AFTS	Australia's Future Tax System 2009 (Henry Review)
GDP	Gross Domestic Product
CIV	Capital Improved Value
LGA	Local Government Area
LV	Land Value
OECD	Organisation for Economic Co-operation and Development
RCC	Randwick City Council
SV	Site Value

Definitions

Ad-valorem:	Rate revenue derived from the Land Value component of a rating structure as determined by the NSW Valuer-General.
Base amount:	The amount (being the same amount) that may be levied per property in addition to the land value component.
High density housing:	High density housing includes flats and apartments in 3 storey and larger blocks.
Minimum rate:	A minimum amount which can be levied on each property within a rating category rather than paying the lower ad valorem rate.
Separate housing:	All free-standing dwellings separated from neighbouring dwellings by a gap of at least half a metre.
Medium density housing:	Medium density (includes all semi-detached, row, terrace, townhouses and villa units, plus flats and apartments in blocks of 1 or 2 storeys, and flats attached to houses)
Rates / rating:	Is a local government tax imposed on property (land value).

Report Structure

This report commences with a brief overview of recurrent land taxation in Australia and its emerging direction resulting from the recommendations of the 2009 review of Australia's Future Tax System. The report provides an overview of Randwick City Council (RCC) and sets out the emerging housing trend and disparity in the source of rate revenue identified by RCC across its diverse housing types.

RCC's existing rating structure is reviewed followed by a number of models that are being considered in the restructure of its residential rating. These models are reviewed under a précis of the overriding principles of taxation. In conclusion, the report comments on the proposed changes and makes recommendations under the existing basis of Land Value used to assess the ad valorem component of rates, as well as a number of further reforms which may be considered subject to further research and modelling.

Introduction and Objectives

Randwick City Council (RCC) has engaged the Research and Innovation Office, University of Technology, Sydney to provide preliminary advice as to the adequacy of rating options and provisions within the NSW Local Government Act 1993, in assessing its existing revenue raising capacity and mix of residential property within their local government area (LGA).

Randwick City Council advises that 49 per cent of dwellings within its local government area comprise apartment housing. In turn, apartment housing accommodates 44 per cent of residents within its LGA. It is observed by RCC that an increase in disparity is emerging in the relativity between land value and improved value of standalone single dwelling houses in contrast to apartment housing within its LGA.

It is highlighted that the land value component of apartments on which rates are assessed, is disproportionately lower to the total value of property compared with standalone housing and lower density unit housing in the Randwick LGA. The disparity in this relativity is impacting on the imposition of the rating structure and is predicted to increase as further unit development of different scale and size continues across the LGA.

Within the context of capacity-to-pay and benefits-received, RCC have sought advice as to how existing rating revenue may be more evenly imposed across property within its LGA. In summary RCC have sought:

1. An outline of the issues; and
2. Possible recommendations that may be considered for reform including:
 - a. Introduction of base rating with an ad-valorem component;
 - b. The introduction of a maximum rate; and
 - c. Options and alternatives for reforming local government rating.

Recurrent Land Taxation in Australia

Recurrent land taxation commenced in South Australia in 1884. At the time of Federation, this tax was imposed by all three levels of government in some States. New South Wales vacated taxing land in 1906, strengthening local government's opportunity to collect this tax in conjunction with the Commonwealth, now known as council rates.¹ In 1942 the Commonwealth removed the States powers to collect income taxes and ceased imposing land tax in 1952, allowing the States to resume collection of land tax in conjunction with local government.² A dual State and local government structure of recurrent land tax exists today across the six States. Northern Territory imposes council rates but does not impose a Territory land tax.

In contrast to many OECD countries, where recurrent land taxation predominantly operates as a local government tax, in Australia it operates at the local and state government level on a variety of different bases. The dual imposition of this tax by state and local government in Australia has advantages over its sole imposition by local government in other countries, where the evolving rationale has become a perceived quid pro quo tax for services provided. While a taxpayer rationale exists for rates and services at the local level, no such rationale exists for state land tax in Australia, which is more aptly viewed as a consolidated revenue tax.

In contrast to state land tax, which expends revenue through exemptions to the principle place of residence, primary production land and provides a threshold in each State, council rates are imposed on all property with very few exceptions. At present in NSW, the imposition of rate pegging impacts the rate revenue collected by local government. This restriction must be reviewed prior to the expansion of recurrent property tax revenue in order for local government to meet its full tax effort potential. This is an important factor in the development of the current fiscal position of local government, particularly in New South Wales. While warranting mention, rate pegging is beyond the scope of this research.

Despite the imposition of dual recurrent land tax in Australia, the tax revenue collected from both state and local government is low in contrast to other OECD countries including New Zealand, United States, Canada and United Kingdom,³ as per Table 1. The fiscal benchmarks of tax revenue as a percentage of GDP and revenue as a percentage of total tax collected, highlights that recurrent land tax is low in Australia. The recommendation by Australia's Future Tax System (AFTS 2010) also known as the Henry Review, suggests that recurrent property taxes are an important tax for sub-national government with scope for further expansion in revenue collection.

Prior to adopting the recommendations of AFTS (2010) to expand revenue from land tax, a structure is needed in managing any proposed changes. This includes defining which level of government (state, local or both) should be the beneficiaries of additional revenue

¹ Simpson & Figgis, 1998, Land Tax in New South Wales.

² Smith, S. 2005, Land Tax: An Update

³ OECD 2010, Recurrent land tax and property tax statistics.

collected, how it should be raised, including the base on which it assessed and most importantly an articulated framework for defining and determining the taxpayer's capacity-to-pay.

Table 1: Recurrent property tax as a percentage of total tax and of GDP

	Percentage of total tax			Percentage of GDP			Rank in OECD countries
	1965	2010	% change	1965	2010	% change	
Denmark	4.9	2.9	-41%	1.5	1.4	-6.2%	10
Australia	6.8	5.5	-18.5%	1.4	1.42	1.1%	9
Iceland	1.7	5.2	212%	0.4	1.9	320%	8
New Zealand	8.3	6.6	-20.9%	2.0	2.1	4.4%	7
Japan	5.2	7.7	49.3	0.9	2.1	131.6%	6
Israel	-	7.2	...	-	2.3	...	5
France	1.9	5.7	200%	0.7	2.5	268%	4
United States	13.7	12.2	-11%	3.4	3.0	-10.4%	3
Canada	11.9	10.1	-15.5%	3.0	3.1	2.1%	2
United Kingdom	11.2	9.8	-13%	3.4	3.4	-0.4%	1
<i>Unweighted average</i>							
OECD-Total	3.8	3.25	-15.4%	0.95	1.05	9.9%	Ranking

N.B. Australia's figures are combined State land tax and local government rates

Council rating and principles of 'Good Tax Design'

The two principles identified under this review are benefits received and capacity-to-pay, and have been provided as the rationale for the potential transition from the existing to the proposed rating structure for Randwick's residential property. A number of broader principles co-exist with these in the design of recurrent property taxes, in which the key points of each principle follows.

Efficiency

Economic efficiency is an important and overriding principle in the levying of recurrent land taxation. This may be more specifically broken down into three factors, the first being the inelasticity factor, the second is the neutrality factor and the third is the immovability factor.

Neutrality: The primary strength of land over other bases of value is that it cannot be distorted by improvements of varying scale, types, age or structures that exist across locations of similarly zoned land, which are not highest and best use or maximally productive. To this end, the primary strength of land over other bases of value is its neutrality.

Immovability: The immovability of land makes it impossible to hide and removes any potential inconsistencies of taxpayer self-assessment, as the assessment of value is undertaken by independent and qualified property valuers. Once ownership is established, the valuation and assessment process is undertaken in a simple and transparent manner.

Inelasticity: Land is the preferable base for the assessment of this tax as it has traditionally been viewed as inelastic in supply. The inelasticity factor of land was particularly relevant where it was used for primary production and lower density single, two or three story developments. To this end, inelasticity of land uses worked well while the focus of its use was primarily horizontal. The progressive increase in high rise re-development has challenged the strict inelasticity paradigm, particularly as more land is redeveloped for higher density development, thus increasing the vertical utility of land.

Simplicity and Transparency

Simplicity may be applied from either a taxpayer or government perspective, or both. Council rates are simple for taxpayers to comply with and difficult to avoid.⁴ Accurate property ownership details and land descriptions result in land being a simple base on which to assess rates. In contrast, valuations which underpin the ad valorem component of rates impact on the transparency of this tax, particularly from a ratepayer perspective.⁵ The Valuer-General values each parcel of land in NSW annually and issues these to Office of State Revenue for the assessment of land tax where applicable.

The annual land values undertaken by the Valuer-General are issued to local governments every 3-4 years in NSW. Council uses these values in determining an ad valorem for each rating category for each financial year within the valuation cycle. This part of assessing council rates is not always simple and the determination of land values used to assess the ad valorem component of rates is not always clear or transparent to the rate and land tax payers⁶. Reforms and improvements in transparency have been made since 2005 in the assessment of land values.⁷

Benefits received

The benefits received principle is respected in most tax systems however, it is tended with difficulty as it attempts to rationalise a relationship between rates paid and services provided by local government. It is even more tenuous when attempting to draw a relationship with rates against services actually used by ratepayers, of which there is little research to support a proportional connection. It is more commonly aligned and better correlated with user pay charges in which a more direct link can be made between the two.⁸ It is further highlighted that unimproved site value (UVS) also known as land value, is a better indicator of benefits received, which is more closely aligned with the location of the property to services and benefits received.⁹ However, in the case of apartment blocks, this correlation is diluted by the proportional allocation of land value to each lot and increases significantly in the case of high rise apartment blocks. While benefits received, is within the

⁴ Comrie, Smiri & Sody, Rating Policies – an ad hoc or principled balancing act? Unpublished paper, 10.

⁵ Mangioni, V. 2011, Transparency in the valuation of land for land tax purposes in NSW. eJournal of tax research, UNSW.

⁶ Walton, J. 1999 Inquiry into operation of the Valuation of Land Act, NSW.

⁷ Ibid.

⁸ Ibid.

⁹ Ibid. 20

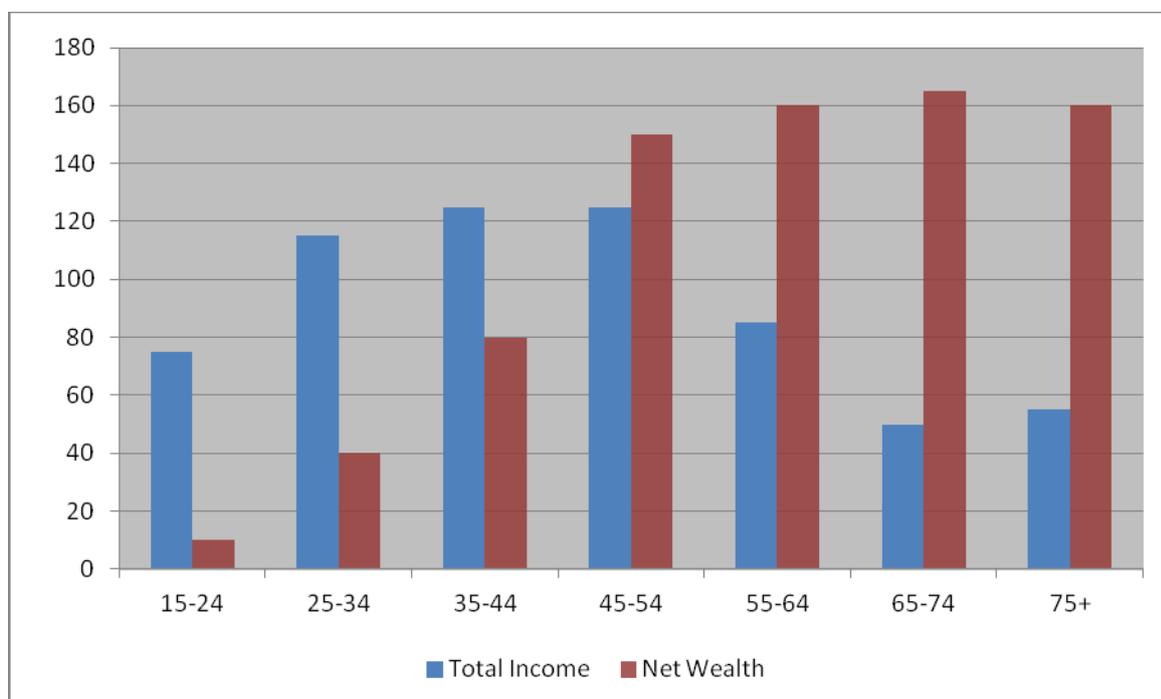
rationale for this review, it is less relevant to and sometimes at odds with the principle of capacity-to-pay.

Capacity to pay

Capacity to pay principle stands in contrast to the benefits received principle. Its measurability may be either determined on wealth or income. In the case of rating, it is determined on the value of property which reflects wealth, rather than the actual income of the ratepayer. It is highlighted that over the lifetime of a taxpayer, the relativity between income and wealth may vary significantly.¹⁰ As highlighted in Figure 1, in the age bracket of 15-24 income is high relative to wealth, which changes in the mid-life bracket of 45-54 where net wealth exceeds income for the first time. In contrast, in the later age brackets of 65-74 and 75+, income is low relative to net wealth where mortgage debt on property has reduced or has been paid off and income reduces in retirement.

Local Government have statutory provisions for discounting rates to address the high net wealth versus low income issue in the later years of the lifecycle for approved applicants on government pensions. While some correlation exists between income of ratepayers and the value of property, the determination of rates on either value or income alone may be better addressed using a combination of these two measures. In progressing local government rating into the future and improving local government tax effort from property, formulation of a capacity to pay determined on a combination of value and income of the owner warrants further research.

Figure 1: Changing relativity between income and net wealth over taxpayer's lifecycle



Source: Kelly 2003 (cited by South Australian Centre for Economic Studies, 8)

¹⁰ The South Australian Centre for Economic Studies, 2004. The correlation between income and home values, 2-3

Sutton Principle

This principle is applicable to council rating and evolved from the premise that council rating comprises an ad valorem component in New South Wales.¹¹

A review of the minimum rates paid by the applicant show that each of their General Rate, Water Rate, Local Sewerage Rate and Library Rate in the 1976 & 77 year comprised a minimum rate with no application of an ad valorem component. The percentage of ratepayers in Sutton paying the minimum rates ranged from 76.2% to 97.1%. The Court did not give any specific indication of what would be an acceptable "cut-off" point.

In upholding the objection of the ratepayer, Holland, J. stated:

“The problem in the point of view that I have expressed is not in saying that the minimum rating power is limited but in postulating where the limit lies. I think that the answer to this problem is that it is a matter of degree in which some cases will be considered to be clearly below and some clearly above the line and that there would be an area of boarder line cases which would be difficult to decide and on which minds might differ” 66.

Of importance in the application of this principle in determining council rates, is that rates comprise an ad valorem component and that the relativity of the ad valorem component to either the minimum rate or base amount has a context and is supported by a sound rationale.

Randwick Local Government Area: The Emerging Disparity

A review of the rate revenue by local government is an important part of its ongoing fiscal alignment in monitoring its tax effort. In reviewing its revenue, RCC has examined its existing rate revenue structure against its emerging housing profile. This section commences with an overview of RCC which provides context for the observed emerging disparity in its rating structure.

Randwick City is located in the eastern suburbs of the Sydney metropolitan area bounded by Centennial Park in the north, to the East by the Pacific Ocean, and to the south by Botany Bay. It has an area of 37.42 square kilometres and contains thirteen different suburbs with housing density highest in Randwick, Coogee and Kingsford.

¹¹ Sutton v. Blue Mountains City Council (1977) 40 LGRA 51, It was argued in the relevant case that “council set their minimum rates so high and their ad valorem rate in the dollar so low, that all ratepayers paid the minimum and the ad valorem applied to no one.”⁵¹.

Randwick City has extensive parkland and open space areas including Centennial Park, Heffron Park and Botany Bay National Park; 29 kilometres of coastline; education and medical facilities including the University of NSW, four major hospitals and associated research and related services; a strong artistic and cultural focus; regionally significant recreational facilities and proximity to the Sydney Central Business District, Sydney Airport and Port Botany.

At the 2011 census, Randwick City had a resident population of 128,989 which represents an increase from 2006 of 9,137 people (7.6 per cent) with an average household size of 2.4 people. 42.5 per cent of the population rent their homes. The population, especially in the northern suburbs, tends to be transient in nature, with 44 per cent of the population residing in their home for less than 5 years. The population is ageing and household occupancy is decreasing (i.e. there are fewer people per household). These factors are expected to influence the types of dwellings that are constructed in the future.

As cities evolve and continue to urbanise, local government rating and its structure must also evolve in meeting the needs of government and its community. As identified in the introduction, 49 per cent of housing within Randwick City Council's LGA comprises unit dwellings which accommodate 44 per cent of its residents. Meetings with rating managers at RCC, have indicated that further demand exists for medium and high rise residential housing within the Randwick LGA.

Randwick City Council has identified an emerging disparity in the rate revenue raised across residential housing within its local Government area. This has emerged from two primary factors, the first being the transformation of housing type with increased high density housing in the Randwick LGA. The second factor is the increasing differential between LV used to assess council rates of separate housing compared with higher density housing. The two factors are now each addressed in turn.

In reviewing the transformation of dwelling types, Table 2 highlights that between the last two census dates of 2006 and 2011, high density housing increased by 3,374 dwellings, or approximately 16 per cent in Randwick LGA. Further, as at the 2011 census date, Randwick hosted more than double the high density housing compared with the Greater Sydney Metropolitan Area. In contrast to increases in the number of high density housing, a decrease is noted between 2006 and 2011 in medium density and in particular separate dwelling housing.

Randwick is progressively transitioning from a low to higher residential density LGA, in which transitioning is occurring faster than the rest of the Greater Sydney Metropolitan Area. The demand for housing in Randwick LGA is further supported in Table 2, in which the net increase in private dwelling stock has increased by 2,387 dwellings or approximately 4.5 per cent. It is further highlighted that Randwick is targeted to accommodate 8,400 new dwellings between 2004 and 2013 under the Draft Sydney Subregional Strategy (2007).

Table 2: Randwick City dwelling structure change between 2006 & 2011

Randwick City	2011			2006			Change
Dwelling type	Number	%	Greater Sydney	Number	%	Greater Sydney	2006 to 2011
Separate house	16,180	29.2	58.9	16,769	31.6	60.9	-589
Medium density	14,278	25.8	19.7	14,556	27.4	19.1	-278
High density	24,635	44.5	20.7	21,261	40.1	19.2	+3,374
Caravans, cabin, houseboat	7	0.0	0.2	16	0.0	0.3	-9
Other	247	0.4	0.4	362	0.7	0.4	-115
Not stated	74	0.1	0.1	70	0.1	0.1	+4
Total Private Dwellings	55,421	100	100	53,034	100	100	+2,387

Source: Australian Bureau of Statistics, Census of Population and Housing 2006 and 2011.

The second factor resulting in increasing differentials in rate revenue derived from residential property across Randwick LGA is set out in Table 3a. Residential property comprises 96 per cent of all property in Randwick and generates 79.5 per cent of the rate revenue. Within the residential category alone, 25,464 residential properties, representing 53 per cent are paying the minimum rate of \$653.27 p.a. accounting for 27.4 per cent of total rate revenue. This is further articulated in Table 3b in which residential property rate revenue is considered in isolation. Table 3b shows the disparity in which 34.4 per cent of residential rate revenue is derived from 53.1 per cent of property, while 65.6 per cent of residential rates are derived from 46.9 per cent of residential properties across the LGA.

Table 3a: Total Rate Revenue Distribution by Property Category 2012-13

Ordinary rate description	Rate	No. of properties	% of properties	Rate revenue	Rate revenue %
Residential ad valorem	\$0.00193290 x land value	22,509	45	\$31,705,484	52.1%
Residential minimum	\$653.27	25,464	51	\$16,635,037	27.4%
Business ad valorem	\$0.00637410 x land value	1,401	2.8	\$11,809,419	19.4%
Business minimum	\$1,052.72	624	1.2	\$657,434	1.1%
TOTAL		49,998	100	\$60,807,374	100

N.B. Differences in dwelling numbers in this table and the 2011 census are due to Department of Housing dwellings and differing periods.

Table 3b: Residential Rate Revenue Distribution

Ordinary rate description	Rate 2012-13	No. of properties	% of properties	Rate revenue	Rate revenue %
Residential ad valorem	\$0.00193290 x land value	22,509	46.9	\$31,705,484	65.6%
Residential minimum	\$653.27	25,464	53.1	\$16,635,037	34.4%
TOTAL		47,973	100	\$48,340,521	100

RCC have provided examples of the disparity that exists primarily between detached, low density and high density housing across the LGA,¹² which is set out in Table 4.¹³ As the density of the housing structure increases, so does the relativity between the CIV and LV increase.

Table 4 highlights the changing relativity between the CIV and LV followed by the corresponding difference in rates paid on all three properties. The renovated semi house and modern penthouse have the same CIV, with the LV of the penthouse being 36.5 per cent of the semi house, resulting in the rates of the penthouse being approximately 51 per cent (minimum rate) of the semi house.

In the case of the relativity between the penthouse and high density unit, the LV of the high density unit is 15.4 per cent of the penthouse apartment with each attracting the same minimum rate. From a valuation perspective, as land is developed more intensely, the LV is likely to be lower as a proportion of the CIV per dwelling, where both are highest and best use. However from a rating perspective, where the land use and relativity between LV and CIV becomes so disparate, the question as to which is the more relevant rating base must be asked.

The example provided in Table 4, further casts the question as to whether the provisions of the statutory ratio¹⁴ and relativity between base amount and ad valorem component were designed to account for such disparity.

Table 4: Relativity of rates between houses, low and high density unit housing 2012-13

Housing Category	Location	CIV	LV	LV % of CIV	Council Rates
Semi detached house 4 B/R	Clovelly	\$2,000,000*	\$743,000	37.15	\$1,280
Apartment 4 B/R Penthouse unit	Coogee	\$2,000,000*	\$271,150	13.55	\$653.27 (min rate)
High density unit	Maroubra Junction	\$630,000	\$41,790	6.63	\$653.27 (min rate)

Source: Randwick City Council *denotes approximate CIV, with rates provided by council.

¹² Commentary provided by RCC. 'a primarily and predominantly ad valorem rating structure does not fairly rate strata apartments because the land value apportioned to the property is so low with no relevance to the actual market value of the property or the owner's capacity to pay. For example, the rateable land value of a 285m2 four bedroom penthouse apartment in Coogee with ocean views is \$271,150. The property attracts the minimum rate, despite a market value of almost \$2m. A 240m2 four bedroom semi in Clovelly also valued at \$2m is charged double the minimum rate due to its \$743,000 land value.' The land value apportioned to apartments in high rise buildings is very low resulting in very low rates under an ad valorem system. Two bedroom apartments in a new high rise building located in Maroubra Junction have only been apportioned a rateable land value of \$41,790, despite their market values being in excess of \$630,000 each.

¹³ It is recognised that Table 4 is not a statistically representative sample of Randwick LGA however provides an important starting point for further analysis.

¹⁴ ss499 and 500 Local Government Act 1993

Précis of options and rating reforms for Randwick City Council

As set out in the introduction, a number of rating options are being considered by RCC in a review of their residential rating structure. The previous section highlighted the disparity emerging in rate revenue collected across the Randwick LGA, resulting from increasing high rise density housing under the current method of assessing the ad-valorem component of rates based on land value and limitations on the number of assessments permitted on the minimum rate.

RCC currently determine their residential rates using an ad-valorem amount subject to a minimum rate.¹⁵ They apply a minimum rate of \$653.27 for the 2013 financial year, as set out in Table 3b. RCC are now exploring the option of determining residential rates on a base amount in addition to an ad valorem amount.¹⁶ The current basis on which the ad-valorem component of council rates is assessed in New South Wales is Land Value.¹⁷

Two of the three options being considered by RCC are outside the existing statutory limits of the Act, to which a submission may be made to lobby for changes.

In a review of the relativity of rate revenue collected across all residential property in the Randwick LGA, using base amount and ad valorem component, three models are considered which comprise:

1. 50 per cent base rate / 50 per cent ad valorem with no maximum rate cap;
2. 70 per cent base rate / 30 per cent ad valorem with a six times cap on the upper limit relative to the base rate; and
3. 70 per cent base rate / 30 per cent ad valorem with no maximum / upper limit cap

Précis of options

Option 1

50 per cent base rate with no maximum cap is within the existing rating provisions of the Local Government Act 1993.¹⁸ Under this option the Council would raise 50 per cent of its residential rate revenue off the same base rate per residential property across its LGA. The remaining 50 per cent would be raised from the ad valorem component which comprises a rate in the dollar as determined by RCC and applied to all residential property across the LGA.

Option 2

This option raises 70 per cent of its residential rate revenue from a base amount with 30 per cent of the rate revenue derived from the ad valorem component. An additional provision

¹⁵ s497(a) Local Government Act 1993.

¹⁶ s497(b) Local Government Act 1993.

¹⁷ s6A Valuation of Land Act NSW 1916.

¹⁸ s497 Local Government Act 1993.

exists which applies an upper cap limit on rates relative to the base rate in the LGA. This option adopts a higher base amount than is permitted under the Act,¹⁹ which is coupled with a proposed cap that limits the amount of rates paid by rate payers at the upper end of the land value range.

Option 3

This option is the same as option 2, and raises 70 per cent from a base amount with no maximum / upper limit cap and hence adopts a higher base amount than is permitted under the Act.²⁰ This option is the most appropriate for Randwick LGA based on its fast emerging multi-housing profile, particularly with its increasing high density housing in Maroubra Junction and the precinct along the Anzac Parade housing corridor.

Summary of options

Option 1: It is highlighted by RCC that under this model that 8,880 properties which have a land value below \$144,758 will pay rates below the current minimum rate. This would increase disparity across the current diverse value ranges compared with the minimum rate structure and ad valorem approach currently used by RCC.

Options 2 and 3: As set out above, options 2 and 3 are similar with option 2 applying an upper cap limit on rates relative to the base rate in the LGA. These models apply a consistent, simple and transparent approach to the rating of residential property across Randwick LGA. These options better addresses the increasing hiatus between LV and CIV across the diversity of housing types.

Option 2, based on initial modelling, at this stage is the option preferred by Randwick Council. Randwick Council states that a rating system that would allow a greater base rate and the option to set a maximum rate would enable a Council to establish its rating structure based on the LGA's residential mix. Option 3 maintains a more consistent ad valorem component, which under both options 2 and 3 comprises 30 per cent across the range of residential property of the LGA.

At this point none of the above options articulates capacity-to-pay by reference to ratepayer's income, as was highlighted in Figure 1 and the preceding commentary. This principle is one requiring further consideration in the current review of local government in NSW²¹ and would assist Councils similar to Randwick that have few properties with land values higher than the majority of properties in their LGA. A method of testing capacity to pay beyond the value of the property itself and by reference to income (owner / household) warrants further analysis and consideration.

¹⁹ s499 & 500 Local Government Act 1993.

²⁰ Ibid.

²¹ Better, Stronger Local Government – The case for Sustainable Change.

Sutton Principle and the rationale for change

A review of the Sutton Principle and comments resulting from the case underpinning the principle was set out earlier under the Principles of 'Good Tax Design.' It is stated that there is no specific weighting for determination of the ad valorem component in the rating of property however it was clear in the Sutton case, that the objective was to remove as far as possible any reference to the use of an ad valorem component by Blue Mountains City Council. In contrast, it is not the rationale of RCC to introduce a base amount of 70 per cent to remove or minimize the use of the ad valorem component to its residential rating structure.

The rationale for RCC's change has been articulated under the previous section and again addressed in the précis of the options in this section. In summary, the primary objective for adopting a base amount higher than the statutory limit is to address the emerging disparity in its rating structure resulting from the increasing diversity of residential housing within Randwick's LGA. Table 1 further set's out the key factors which differentiate RCC's proposed changes to their rating structure against the provisions of the Local Government Act and the circumstances that existed in the Sutton Case.

Designing change and recommendations

In addressing the needs of local government and their communities across New South Wales, greater diversity and flexibility is needed in the structure of rating options and the revenue raising powers of local government.

In NSW council rates and indeed land tax are both determined on land value²², hence New South Wales and Queensland have the narrowest single base option for assessing it's recurrent property taxes of all six States, see Table 2. In order for local government rating to develop in NSW, it is important that options, including other bases of value, are available for the assessment of local government rates. The diversity of urban form across and within the 152 local government areas of NSW require a diversity of rating options as well as diversity of bases of value on which the ad valorem component of the tax is assessed.

The tools for setting local general rates across Australia vary from State to State, as set out in Table 3. While not the specific focus of this report, these tools provide insight for local government in its reform in NSW and warrant further research for the reform of government local rating in NSW.

One issue of particular relevance to Randwick Council is the rating of the few properties that have land values that are considerably higher than the majority of properties in the LGA. While the Council acknowledges capacity to pay is an important principle of a rating structure, the situation where rates paid far outweighs the benefits and services received needs to be addressed. South Australia has addressed this issue through s158 of the Local Government Act 1999 which states:

²² s6A of the Valuation of Land Act 1916 NSW.

“...Councils may also alter the amount payable for properties that fall within a defined range of valuations. In practice this option is used by councils where:

- A small number of highly valued properties lie within an area otherwise characterised by lesser valued properties, and
- Council fixes a relatively high rate in the dollar that produces an average rate from the majority of low-valued properties, but an exceptionally high amount from the few high-value properties. In these circumstances, an adjustment for specified values would operate in effect, like a cap or limit on the maximum that would otherwise be payable.”

Greater flexibility is needed in rating structures in NSW so that councils can design a system that best fits their LGA. The current limits on minimum rates and base rates, in addition to ad valorem rates based on land values, are too restrictive. This is a rising issue in inner city LGA's where there are a growing number of high rise dwellings and vast disparity in land values.

Further, it was highlighted in the introduction that rate pegging imposed restrictions on increases in local government revenue raised from rating. In line with the current review of Local Government in NSW and the recommendations of AFTS (2010) for increases in revenue recurrent land taxes, rate pegging provisions should be reviewed and provide local government opportunity in improving its tax effort from rates.

In strengthening rating revenue, greater emphasis should be placed on rates as a general purpose local government tax rather than just a fee for service charge in line with the perceived benefits and services received. This is perhaps the greatest challenge confronting the reform of local government rate revenue across Australia. While Randwick Council acknowledges rates are a tax, as discussed above, a solution is needed to address situations where a small number of highly valued properties are attracting exceptionally high rates. A gradual but significant paradigm shift will be required in refocusing local government rating as a tax and in particular the way this tax is assessed.

Conclusion

This report has stressed the re-emerging importance of recurrent property taxation for state and local government in Australia, a point also identified by AFTS (2010). It has highlighted the importance that the ongoing operation and any reforms to this tax continue to accord with the principles of 'good tax design.'

The emerging disparity in the imposition of this tax in Randwick LGA resulting from the emerging diversity in residential housing types, epitomises the complexities confronting local governments in the operation of this tax. A number of options have been modelled by RCC which this report has critiqued, relevant to the circumstances of its LGA.

An option to the existing rating structure currently used by RCC has been recommended and the case for its use argued in exceeding the fixed statutory limits for base rates under the Local Government Act 1993. The report further identifies that in maintaining a consistent ad valorem component to a rating structure by capping rates, does not allow local government the opportunity to further develop rates into a capacity to pay tax.

The precipitating rationale for increasing the base amount in Randwick LGA in light of its changing housing structure brings to light the importance of expanding rating options for local government in NSW. It was identified that NSW in conjunction with Qld has a single rating option and hence no diversity or flexibility in the imposition of rates across a diverse LGA.

Greater flexibility is needed in rating structures in NSW so that councils can design a system that best fits their LGAs. The current limits on maximum rates and base rates, in addition to ad valorem rates based only on land values, are too restrictive. This is a rising issue in inner city LGA's, such as Randwick City, where there are a growing number of high rise dwellings and vast disparity in land values. A choice of rating structure tools without statutory limits and the ability to choose the most appropriate valuation method are essential to ensuring a sound Council rating system.

Qualification

This report is provided to RCC and the recommendations are based on their specific circumstances, although a number of general recommendations made in this research report may be relevant to other local governments. Further, a distinction is made in the rationale between state land tax and local government rating, in which LV or SV remains the most efficient and neutral base for assessing state land tax, as is currently used across all six States of Australia.

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Cases and legislation

- Sutton v. Blue Mountains City Council (1977), 40 LGRA 51.
- Local Government Act 1993 (NSW)
- Valuation of Land Act 1916 (NSW)

Annexure

1. Sutton / Randwick City Council summary
2. National comparison of bases for assessing rates
3. Summary of rate setting tools

Table 1: Comparative analysis and rationale in distinguishing Randwick City Council’s proposed rating re-structure relative to the Sutton Principle

	Sutton Case	Local Govt Act NSW	Randwick City Council
Rating structure	76.2 & 97.1 per cent of rate revenue was derived from minimum rates	Sections 499 & 500 allow up to 50 per cent base amount. S548 allows for minimum rates.	Application for 70 per cent base amount and 30 per cent ad valorem
Relevant Date	1976 & 1977	1993	2013
Residential profile	Primarily single dwelling housing	N/a	29.2 per cent separate housing v. 70.3 per cent medium & high density
Taxing rationale	To ensure minimum rates became the rule with ad valorem being the exception.	Create a balance between base and ad valorem rating. N.B. A base and minimum rate cannot exist together (s548(7)).	To even the rate relativity between residential housing types resulting from the diminishing relativity of LV to CIV in Randwick LGA.
Commentary	In challenging the rates over two years 76 & 77, it was determined that the rationale for the rate structure was to remove the ad valorem component for rating property within Blue Mountains City LGA.	The Local Government Act was reviewed in 1993 in which provisions were made to restrict rate revenue derived from a base amount to no more than 50 per cent, with the balance derived from an ad valorem component of no less than 50 per cent.	RCC is seeking to establish a more even imposition of rating across its increasingly diverse housing type. In doing so it seeks to ensure the consistent application of the ad valorem component of its rating at 30 per cent of all property.

Source: Sutton v. Blue Mountains City Council (1977) 40 LGRA 51, & Local Government Act 1993 NSW.

Table 2: National comparison of bases for assessing rates

Property Valuation methods permitted to be applied								
Group^a	Method	NSW	Vic	Qld	WA^b	SA	Tas	NT
A	Assessed Annual Value (AAV)						√	
	Annual value (AV)					√ ^c		√
B	Capital improved value		√					
	Capital value					√	√	
	Improved capital value							√
C	Gross rental value (GRV)				√			
	Net annual value (NAV)		√					
D	Site Value (SV)		√	√		√ ^c		
	Land value (LV)	√					√	
E	Unimproved capital value (UCV)							√
	Unimproved value (UV)				√			

^a Various terms used across jurisdictions to describe methods that are essentially the same and these are grouped together.

^b Two methods are used in Western Australia, but these are restricted by land type: UV for rural only and GRV for non-rural only.

^c The AV and SV methods can be used in South Australia if the council declared rates for that land on that basis for the previous financial year, or if the council declares rates for that land on the basis of capital value for the previous three financial years.

N.B. Qld moved from UCV to SV in 2010

Source: Productivity Commission 2008

Table 3: Tools for setting general rates

State	Fixed charge	Minimum rates	Differential rates
NSW	A 'base amount' may differ according to land use category, but must not collect in excess of 50% of general rate revenue. ²³	A minimum (set by regulation) may be imposed only in respect of an ad valorem rate. ²⁴	<ul style="list-style-type: none"> • Four major categories of land use and multiple sub-categories of land use; • No provision for categories of land location.²⁵
Vic	The 'municipal charge' is limited to 20% of general rate revenue.	No provision.	<ul style="list-style-type: none"> • Multiple categories of land use permitted;²⁶ • No categories of land location.
Qld	No provision.	A number of differential minimums may apply, according to land categories. There is no restriction on the % of properties that may be subject to the minimum. ²⁷	<ul style="list-style-type: none"> • Multiple land use categories permitted at Council's discretion. • It is unclear whether categories of location are permitted.²⁸
Tas	A fixed charge must not exceed 50% of general rates. ²⁹	Minimum rates cannot be used in addition to a fixed charge. ³⁰ No restriction on how high the minimum rate can be.	<ul style="list-style-type: none"> • Eight categories of land use; • No restriction on the categories of land location.³¹
SA	A fixed charge must not exceed 50% of general rates. ³²	Minimum rate may apply to no more than 35% of properties, and cannot be used in addition to a fixed charge. ³³	<ul style="list-style-type: none"> • Nine categories of land use; • A choice of specified location categories; or • Both land use & location
WA	No provision.	Different minimums may apply in different areas of one Council ³⁴ but may not apply to more than 50% of premises, unless the minimum is no more than \$200 ³⁵	Multiple categories of land use/purpose permitted at Councils discretion. ³⁶ Regulations may broaden or narrow the categories (but no regulations have been made. ³⁷

Source: Comrie, Smiri & Sody

²³ NSW LG Act ss499, 500

²⁴ NSW LG Act s548, and Local Govt (General) Regulation 2005 (NSW) r126. This minimum amount is adjusted annually. In 2011, it was set at \$442.

²⁵ NSW LG Act s493 and s529

²⁶ Vic LG Act s161(2)(a)(ii)

²⁷ Local Govt (Finance, Plans and Reporting) Regulation 2010 (Qld) r11 (subsequently cited as Qld LG Regs)

²⁸ Qld Regs r15. The regulation cites as examples only land use categories. Categories based on location are not expressly prohibited, but do not seem to have been envisaged.

²⁹ Tas LG Act s91(2)(b)

³⁰ Tas LG Act s90(4)

³¹ Tas LG Act s107

³² SA LG Act s151(10)

³³ SA LG Act s158(2)

³⁴ WA LG Act s6.35

³⁵ Local Govt (Financial Management) Regulation 1996(WA) rr52,53-Subsequently cited as WA LG Regs.

³⁶ WA LG Act s6.33(1)

³⁷ WA LG Act s6.33(2); see WA Regs.