

Australian Property Institute Limited

SUBMISSION

INQUIRY INTO COMMERCIAL RATES

RESPONSE TO THE CHAIR OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

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Contacts Cathy Sirel
Member Services Manager - ACT
Email csirel@api.org.au
Phone 02 6282 5541

INTRODUCTION

About the API

The Australian Property Institute (API) is the leading membership organisation for property professionals. It is impartial, objective and independent. With more than 8,000 members, API represents a wide range of property professionals who have a significant impact on the wider property industry.

API sets and maintains the highest standards of professional practice, education, ethics and professional conduct for our members. In turn, the work of the Institute raises the bar for the entire property profession.

API membership requires minimum qualifications and experience and ongoing professional development and education, ensuring a highly qualified, highly skilled profession.

API members can be found across all sectors of the property profession, including private practice, public sector and academia. This broad base of qualified and skilled professionals is unique to the Australian Property Institute. The Institute is committed to building and maintaining a strong base for the future of the property profession through broadening the expertise and knowledge of membership.

In response to the call for comment, the API has provided feedback on three of the Key Issues raised in the Consultation Paper, where we believe our members can provide professional direction based on their expertise in those areas.

Background

API members are employed by ACT Government to assess Unimproved Values in the Territory which then form the basis on which rates are calculated, API members are also contracted by various private and corporate entities to review these valuations and challenge these figures should they be deemed not to be representative of fair market value (under the Rates Act).

The current system of determining commercial rates has a number of inconsistencies and areas of unfairness which need to be addressed by ACT Government. These include:

1. Calculation of Unimproved Values.
2. Annual reviews of Unimproved Values.
3. Effect of Lease Variation Charges on Unimproved Values.
4. Retrospective charges for rates after a Lease Variation Charges.
5. Charging commercial rates for a property assessed on a residential basis.
6. Apportionment of Rates for mixed use sites
7. The cost of appealing/objecting to rating values.
8. Effect of increasing rates on the value of a property.

To assist the Standing Committee, we set out the areas of concern against each of these individual points below:

1. Calculation of Unimproved Values

In order to assess an Unimproved Value of a parcel of land for rating purposes in the ACT, the Rates Act 2004 specifies the criteria that needs to be considered including the following assumptions:

- Improvements on the site are to be disregarded with the exception of improvements (if any) by way of clearing, filling grading, draining, leveling or excavating;
- New 99 year lease over the land;
- A nominal rent (5 cents per annum) is payable under the lease.

At the date of assessment if there are vacant land sales in the immediate vicinity, then the analysis, comparison and assessment of value for the subject site is comparatively straightforward and transparent (as long as any nuances with sales are known and taken into consideration such as premium paid by an adjoining landowner etc).

However in the majority of instances in established locations, there is a paucity of such sales. Valuers are then forced to consider the sales of improved properties which can be subjective in the analysis, especially when all the facts of the sale including the full details of improvements on the site is not known. E.g. improved commercial properties with a number of leases in place, buildings on the site which may be in various state of repair or refurbishment not known to the valuer. Without all the information in the analysis, the valuer may make a number of assumptions to derive the underlying land value.

Thus it is not an exact science and given the subjective nature of the analysis ACT government valuers and private valuers very often do not agree in the approach adopted or can vary in their assumptions depending on the information they have at hand with regard to the sales they are considering. Discussions were held between the parties and informal working groups between government and private valuers have previously made very limited progress toward a solution of this problem. The API recommends that these discussions be reinstated between the parties to resolve this impasse.

2. Annual reviews of Unimproved Values

Currently Unimproved Values are reassessed annually as at 1 January. It is not possible for ACT Government valuers to consider each individual property and reassess its value and whether it has increased or decreased. Instead the ACT Government valuers undertake a mass appraisal approach by analysing a 'basket' of sales to determine if values have increased or decreased. Then a percentage value is adopted across similar properties to provide new Unimproved Values.

The accuracy of this methodology is dependent on the reliability of the analysis of the sales evidence being adopted by the valuer. Given it is mass appraisal, it is also important that the previous values of all

properties being indexed are accurate. If not, the inaccuracies are magnified each year the value is indexed. Additionally, when no sales of a particular class of property have occurred during the previous year, there is no indication to support whether a property has increased or decreased in value.

For these reasons, a responsive and straightforward objection process is important for land owners when mass appraisal is being used to ensure that individual property values can be reviewed if it is considered that they are not reflective of market level.

3. Effect of Lease Variation Charges on Unimproved Values

As a general rule, the addition of uses to a lease purpose clause increases the value of the Crown Lease. This is set out in the V2 After Value compared to the V1 Before Value. The agreed After Value should be taken into consideration when reassessing the new Unimproved Value for the Site.

We note though that ACT Government valuers often do not have regard to the published Unimproved Values that they have assessed when calculating values for a Lease Variation Charge Valuation. Their comment is that the Unimproved Value is not a true representation of market value but a figure arrived upon by statistical analysis. Members of the public are often confused as to how a property can have an Unimproved Value and assessed Lease Variation Charge Value that differ. In order for the adoption of these values to work, the ACT Government should not rely upon two differing values for the same site.

4. Retrospective Charges for Rates after a Lease Variation Charge

Recently ACT Government has issued rates notices for back rates for periods of up to 5 years after a Lease Variation Charge has been approved where the Government has decided that it did not take the increased Unimproved Value into account. On appeal to ACAT it was determined that (i) this approach was permitted under the Rates ACT and; (ii) the crown lessee had the responsibility to inform the Government of the lease variation.

The API suggests that this approach is problematic and requires review given the following:

- (i) The ACT Government has the opportunity to reassess Unimproved Values annually, and each Crown Lease holder receives a notice from the ACT Government noting that fact. Also landowners, both large and small need to prepare operating budgets of annual expenditure that they can rely on based upon projected operating costs, a major component of which is rates. It is reasonable to assume that a statutory organisation such as ACT Government would have systems in place to assure this is, in effect, what happens. When back rates are issued for an extended period, owners would likely not have budgeted for this and therefore may not have cash reserves to pay, causing undo financial stress. Alternatively, if left to reassess for a period, in the event a Tenant of the site being responsible for paying statutory outgoings, the lease may have expired and tenant vacated with the owner not be able to recover these outgoings.

- (ii) Given the ACT Government is the approving authority for LVC Variations, the API recommends that there is a mechanism in place to trigger reassessment of an Unimproved Value at the time a variation is approved rather than putting the onus onto the property owner.

5. Charging commercial rates for a property assessed on a residential basis

Legislation states that Unimproved Values be based upon highest and best use of the Crown Lease assuming the site is vacant i.e. disregarding existing buildings on the site. There are many examples where properties in the inner suburbs of Canberra may have ‘residential’ as a permitted use in their Crown Lease, and in recent years this use has been determined as the “highest and best” value of the site. Thus the Unimproved Value has been reassessed accordingly. This is despite the fact that some sites may have been developed a number of years ago with commercial building and are currently being used for commercial purposes (given this was the highest and best use back at the time the site was developed).

An owner will ultimately redevelop a site for its highest and best use to benefit from the higher returns but may be constrained in doing so for years for a number of reasons e.g. existing leases on the Property which would stop redevelopment, or the cost of demolition etc.

However the crown lessee is charged rates on a higher commercial basis though the property is valued as the higher use of residential. This produces very inequitable figures; for example, based upon a UV of \$2,000,000 (assessed as Residential) at 1 January 2018:

Commercial Calculation	Rates	\$116,651.78
Residential Calculation	Rates	\$11,853.65
	Land Tax	\$21,333.00
	Total	\$33,186.65
<i>Difference</i>		\$83,465.13

The difference is significant and could be higher than the income the property is currently generating. If a property is to be assessed on a residential basis as its highest and best use, it is only right that the rate be levied on that basis as well otherwise it could be regarded as “double dipping”. In the example above the same site if it was to be assessed as commercial its Unimproved Value may have only been \$1,100,000.

6. Apportionment of Rates for mixed use sites

The API recommends that the application of rates on a mixed use site is reviewed and an approach similar to that adopted in NSW is applied.

As an example, a site under its Crown Lease may be permitted to be developed with 1,000 sqm of Commercial and 5,000 sqm of residential use. The Unimproved Value of the site would be assessed accordingly. However currently in ACT the site would be rated applying the commercial calculation to the full value.

The API considers that this approach is inequitable and discourages mixed use development. Instead the API recommends that the rates calculation, as they do in NSW, should be apportioned taking into account the pro rata of use of the site.

Under this amended approach in the above example 16.67% of the value of the site (being 1,000 sqm/6000 sqm) would be rated as commercial and the balance as residential, instead of the current approach used in the ACT whereby the full site would be rated as commercial.

7. The Cost of Appealing/Objecting to Rating Values

The current system of challenging an Unimproved Value is for a notice to be lodged with ACT Government within 60 day of the notice being issued. There is no charge for this appeal. Should a crown lessee be unhappy with the result of the appeal, currently the matter may proceed to ACAT. For a matter to have an ACAT hearing, the cost for the applicant can range from \$50,000 to in excess of \$100,000 with no guaranteed outcome. According to anecdotal evidence from members, this amount is well above the means of all but the largest landowners and these costs have been the reason that many landowners have not proceeded with an objection to their Unimproved Value or have been forced to sell their property that has been the home of their business for many years.

The API suggests that objections could, in the first instance, be reviewed by an independent expert panel as an interim step prior to a formal appeal to ACAT. The API would welcome the opportunity to discuss this in more detail.

8. Effect of increasing rates on the value of a property

The annual increase in rates has a negative effect on a property's Unimproved Value and consequently the amount of Stamp Duty that the ACT Government will receive once a property is sold.

The most common methodology of purchasing a commercial property is by calculating the potential net rental income the property could generate. Net rental income is calculated by subtracting the annual estimated operating costs of the asset (rates, insurance, electricity etc.) from the rental paid by the tenants. Any increase in rates lowers the net income in direct proportion and therefore the amount a purchaser may pay for the premises.

The reduced potential purchase price for an asset the results in reduced Stamp Duty payable by the purchaser that will have an overall effect upon the ACT Governments financial position over time.

SUMMARY

The Australian Property Institute has considered the terms of reference for the Inquiry into Commercial Rates and has made a number of suggestions set out in the text of this submission. These can be summarised as follows:

1. Reinstigate discussions with ACT Government and private valuers to determine a methodology for analysing sales evidence.
2. Align Unimproved Values and Lease Variation Charge Values.
3. Implement a system that captures increases in land values after Lease Variation at the next assessment of Unimproved Values.
4. Charge residential rates for properties whose Unimproved Value on a highest and best use is assessed as residential, not commercial rates for residential values.
5. Establish an intermediate process for appealing rating values that is cost effective and transparent for both parties.

The API is pleased to be able to provide this commentary and are available to discuss the responses and suggestions in more detail should it be required.