9/10/2018

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REVIEW OF THE LEASE VARIATION CHARGE

As an Architect and Developer, LVC among other add on charges are integral to viability of projects. There are many reasons that Treasury have maintained their position of the ACT being entitled to Value Capture and I agree that there is a strong argument to support that. The issue is primarily the level that the charge is set at. The industry has long argued that it is too high and rather than being a benefit to the ACT it is an impediment to development going forward and actually reduces the potential return that could be delivered from a lower rate being set.

Treasury argues that Developers are making significant returns on the uplift benefits of adding additional dwellings to existing properties and the ACT should be entitled to a share. To some extent that is true but it is a very simplistic argument to an incredibly complex issue.

Project returns vary considerably from very profitable to marginal or poor. At the upper end LVC has less impact as it can be absorbed into the project or passed on but at the lower end any additional charge has a massive impact. The high return projects are few and far between and tend to be on the larger scale available to a limited market. The bulk of the market operates on minimal return set by the banks to approve funding. That rate is 15% with 110% of debt coverage in cash or presales. Treasury in the past has argued that a lower rate is appropriate for an expected return but that has no basis in reality other than final returns being less than the anticipated feasibility due to unanticipated costs.

Competition is extremely tight and viable land is rare. Developable blocks are dependent on tree issues, mandatory consolidation issues, block shape, block orientation, zoning and location. The value of those blocks is high due to their location and the already anticipated value to developers. The reality is that those blocks are rarely worth more to a developer than a single home buyer due to the returns that have to be made. Any additional cost has to be passed on one way or another. A developer will either have to force the price down on the land or lift the sale price of the end product. Competition for land means that the land price can rarely be pushed down so for a project to be feasible all add on costs like LVC must be increase the sale price. At this point there is a market tolerance driven by demand that sets the maximum price of sale. If the add on costs can't be passed on then the project doesn't go ahead and the land isn't sold. The ACT misses out on the potential LVC, Stamp Duty, Rates and GST associated with the sales. Lack of supply in the market puts upward pressure on sale prices putting constant pressure on affordability. I would argue that the long term loss from a project not going forward far outweighs the short term gain derived from LVC.

For many years the redevelopment market happily moved along searching out the "Residential Lease" blocks rather than "Single Residential Lease" blocks where Codified charges were minimal adding in the order of $5,000 to each additional property after the first three as opposed to $40,000 to $60,000 for the alternative. The industry argued that the high Codified rates were not viable at the time of introduction and the evidence of the lack of development would support that. Now that the Codified rate for all blocks has been set at $30,000 the industry has argued that this is still too high. Development is still progressing and it is short sighted by Treasury to argue that the current rate works. The truth is that while development continues the viable pie has gotten smaller and less projects are feasible. The ones on the margin that go ahead do so by lifting the sale price and or decreasing quality and build costs. There is extreme pressure to drive down or short pay for trades and materials. Unscrupulous operators are establishing practices that will result in problems through the life of these buildings. Evidence of this is seen and well documented through the recent quality studies that have been undertaken.

Treasury asks for evidence of LVC having a negative impact on the industry and the housing market and it is difficult to provide. The impact is up front in the decisions that are made to proceed with land purchases. Those that go ahead showed enough profit to pay the charges and move on. The irony is that the charge puts more money in the developers pocket by having to make a minimum of 15% return on the LVC charge. Those that don't rarely have any documentation retained to be analysed.

The industry has long argued that an additional charge in the order of $10,000 per unit was a reasonable amount that could be absorbed without too much disruption. A reasonable jump up from $5,000 that would make a far greater range of properties available on the market that were attractive to developers. This in turn would bring a lot more end product to market and introduce competition that could slow price growth and help to supply demand. The ACT would receive a reasonable share of the uplift from increased development rights, a return from Stamp Duty and increase the Rates pool in the long term. GST revenue would increase. The pressure on urban sprawl would be decreased.

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A greater range of blocks being viable brings suburban core areas on line that would otherwise be overlooked. With greater turnover in our suburbs there would be an increased range of appropriate choice available to promote churn in our suburbs. Elderly residents would have the opportunity to relocate within their communities to more appropriate housing freeing up the larger outer ring properties for new families that feed the existing social and transport infrastructure. Churn is healthy for the long term benefit of our city and the ACT Government could promote this with appropriate policy supporting the redevelopment industry rather than penalties that constrain and discourage investment in Canberra.

A lesser, more affordable view of Value Capture taxing that enabled the ACT to realise the benefit of so many lost opportunities for the future of our city is not only appropriate but a necessity. The ACT government needs to take a much longer term view of supporting development rather than strangling it through taxation at every opportunity.

An example of a recent development purchase in the Inner North that achieves the marginal return of 15% bank requirement before detailed design and costing looks like this:

Block 1 purchased for $1.4M. This increased the number of dwellings by 3 to a total of 4. The purchase value was the same as the value for a single house buyer. LVC of $90,000 was factored in. The uplift return to the developer is $0

Block 2 next door was purchased for $1.5M to be consolidated with the first block. It is larger and the rate per m2 is similar. A premium of $100,000 was paid for the second block which again was increased by 3 dwellings. The anticipated return is just over 15% on the total development. The uplift in value to the developer is realised by the land seller of $100,000. It could be argued that the developer is making 15% return on this uplift. $15,000. The LVC charged on this block was $90,000. This is $10,000 less than the uplift value and $75,000 more than the profit that the developer realises from the increased development rights.

Block 3 was purchased for $1.7M to be consolidated with the other two. The area is close to the first. A premium of $300,000 was paid for the third block which again was increased by 3 dwellings. The anticipated return is just over 16% on the total development. The uplift in value to the developer is realised by the land seller of $300,000. It could be argued that the developer is making 16% return on this uplift. $48,000. The LVC charged on this block was $90,000. This is $210,000 less than the uplift value and $42,000 more than the profit that the developer realises from the increased development rights.

The total profit from the increased land value is $63,000 for an increase of 9 dwellings over the original 3. This is a value of $7,000 per dwelling. If the ACT was to take a

50% share if this profit being an equal share it would equate to $3,500 per dwelling. The amount paid at $30,000 per dwelling totalling $270,000 is incredibly hard to justify. The total uplift value was $400,000. $270,000 is still more than half the value that was realised by the sellers and all of the $270,000 will be passed on to the end purchasers and incur Stamp Duty and GST.

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HIA President

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MBA National Medium Density Development Over 5 Dwellings 2016
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