ACT Government

Review of the Lease Variation Charge

Chief Minister, Treasury and Economic Development Directorate

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ABOUT THE REVIEW

The ACT Government has commenced a review of the Lease Variation Charge (LVC). This review is intended to inform the Government on how reforms made to the LVC framework in recent years are flowing through to community and development outcomes, and whether further improvements to the framework are warranted.

The scope of the review is based on the motion passed by the Legislative Assembly on 26 October 2017.[1] The Review will also consider other matters which are related to those addressed by the Assembly motion.

Broadly, the review will consider:

> LVC and remissions as they apply to residential and mixed use developments;
> Simplifying LVC charges and increasing consistency across lease types;
> The combined impact of LVC and zoning or planning rules on the financial viability of redevelopment, particularly in relation to the codified charges updated in 2017;
> Aligning LVC with housing affordability, housing supply and planning objectives;
> Simplifying residential schedules and extending application of codified charges.

The review will consider whether further improvements can be made to the LVC framework to ensure it continues to achieve the objective of seeing the Canberra community share in the benefit of land value uplift while aligning with the Government's urban renewal and housing supply priorities. The Government intends that any potential future reforms will be achieved in a revenue neutral way.

The review is being led by ACT Treasury, with this discussion paper forming the first step of the process. The Government will consider all of the evidence and input provided through submissions to inform potential reforms ahead of the 2019-20 Budget.

Interested stakeholders and members of the Canberra community are invited to make written submissions to the review by **17 October 2018**.

Further information on the implementation of the review and submissions received will be published online at https://www.yoursay.act.gov.au.

[1] See Appendix for the text of the motion.

LEASE VARIATION CHARGE

The LVC is the current form of a betterment tax which has been in place in the Territory since 1971.

The LVC replaced the Change of Use Charge (CUC) which was put in place following the abolition of land rents and implementation of the current leasehold system. The CUC was modified a number of times over the years following its introduction in 1971, and was regarded as having become complex and difficult to administer, contributing to uncertainties and delays in development approvals. The Government responded to these concerns by replacing the CUC with the LVC in 2011.

The principle underlying the LVC (and other forms of betterment tax) is that the community should share the benefit from any increase in the value of the land lease arising from changes to the original lease granted by the government. If this benefit is not recovered, it provides an unearned windfall from the community to private entities. The LVC compensates the community for the loss of revenue that would have been raised if the government had originally sold the lease with the higher valued lease conditions in place.

The LVC is currently set at the rate of 75 per cent of the uplift in value of the lease.[2] This allows the government to retain a significant proportion of the increased value for the community's benefit, while providing an incentive for leaseholders to vary leases for more appropriate purposes as the city develops.

In the ACT, lease conditions were originally determined to specify the type of development allowed on a site. As the ACT has grown, many original lease conditions are no longer in line with desired planning objectives and lease variations are required to meet desired outcomes. However, as they also cause significant uplift in the value of land lease, LVC is payable. The price paid for a lease reflects the current market value, which accounts for the development allowed under the lease conditions at the time of sale. As such, where a land lease is sold with varied lease arrangements in place the full market value is paid, which includes the value of the lease variation. Only approximately 20 per cent of development projects require a lease variation in order to proceed.

As the LVC isolates and taxes the additional value of a lease that is solely due to increased development rights, it should have a minimal impact on production and consumption decisions. In other words, a project will be viable (or not) regardless of whether LVC is payable, as the business case should take into account the full cost of the land lease including the necessary development rights. In general, development will occur in locations where the best returns can be made.

The CUC, the earlier form of betterment tax which preceded the LVC until 2011, was perceived to have become arbitrary, complex, inefficient and inequitable over the course of forty years. It also resulted in large transfers of unearned windfall gains to lease holders. The development of LVC was informed by this experience, especially in the use of codified charges, to avoid the shortcomings of the previous system and make it easier to use and administer.

In 2018, the Government implemented a deferred payment scheme to give project proponents more flexibility in aligning the payment of LVC with cash flows associated with a development[3]. Where LVC of more than $100,000 is payable, project proponents can pay this at the end of the development process, instead of at the time a lease is first varied so that building work can commence. Under the scheme, builders and lease holders can defer LVC payments for up to four years or the completion of development, whichever is earlier. The interest charged on deferred[4] LVC payments is set at a rate significantly lower than commercial interest rates and costs generally charged by financial lenders for construction and building projects.

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[2] Information on how the LVC is calculated is available on http://www.planning.act.gov.au/topics/design-and-build/fees/change_of_use_charge_-_lease_variation_charge

[3] https://www.revenue.act.gov.au/lvc/lvc-deferrals

[4] A deferral is compulsory if the LVC payable includes a remission for Environmental Sustainability, even if the LVC payable is under $100,000. This is to ensure the completed developments meets the remission requirements.

The revenue received from the LVC can differ significantly from year to year depending on the number of major projects requiring a lease variation. The 2018-19 Budget includes an estimate of LVC revenue of $21.5 million.

Calculation of LVC

The LVC for single purpose residential and commercial developments is codified to make calculation clear and straightforward.

The LVC is calculated using a set rate that is based on the value of additional dwellings or additional commercial Gross Floor Area, depending on the requirements of the development. These set rates are based on location and size of the development, updated according to changes in market value. The charges are set out in Disallowable Instrument *DI2017-208* made under the *Planning and Development Act 2007*.

Example: A proponent intends to construct 10 units on a block in Macquarie. Under the lease the block is currently approved for two dwellings. The LVC to vary the lease to enable the construction of an additional 8 dwellings is $40,000 per dwelling, as specified in Schedule 2 of DI2017-208. The LVC payable in this example is $320,000.

Where a development is more complex – such as mixed use projects which combine residential and commercial elements – and does not fall within the schedules, the LVC is generally based on 75 per cent of the value uplift that has been determined by valuations of the 'before' and 'after' market value (V1 – V2). The before value of the land is based on the existing conditions and takes into account site preparation costs such as demolition and clearance.

Example: A proponent intends to demolish existing commercial offices and construct a mixed-use development of 100 residential units and 5 retail spaces. Prior to demolition, the 'before' market value of the block is $8 million. After variation of the lease to enable the proposed development, the 'after' market value of the block is $15 million. The LVC payable in this example is $5.25 million (75 per cent of the $7 million value uplift.

CONSULTATION QUESTIONS

In making a submission, stakeholders are asked to consider a number of broad questions which align with the scope of this review. Stakeholders are encouraged to include detailed evidence including industry data or project costings in support of the views and arguments provided.

When making a submission, please nominate whether your input can be published online or should be treated confidentially.

Impact on development activity

Betterment taxes are considered to have a minimal impact on the financial viability of developments as they isolate the value attributable to government decisions. However, the indirect cost due to a change in behaviour in response to a tax ('deadweight loss') can be difficult to assess.

It has been suggested that the current LVC framework could lead to less residential redevelopment activity occurring than might have otherwise been undertaken. Development activity in the ACT has been strong in recent years and this is expected to continue with a significant number of projects in the pipeline. However, some commercial stakeholders have suggested that the LVC can have a financial impact on their development costs and impact viability of projects, particularly for medium to high density residential developments.

> **Stakeholders are invited to provide financial data and any other evidence demonstrating the relationship between LVC and project viability. If requested, any such data or evidence provided will be kept confidential.**

Lease value and equity

The 2017-18 Budget increased the LVC codified charge applying to lease variations which increase the number of allowable dwellings on a lease. The charge was increased from $7,500 to $30,000 per dwelling from 1 July 2017, while providing a transition mechanism[5]. This change was made to better reflect the increase in land lease values associated with a lease variation for additional dwellings, and also provide for greater equity between different lease types that do not specify the number of dwellings. These type of leases are located in established suburbs where land values tend to be higher in general. The unit titling charge aligns the land lease cost of developments with sites where leases already enable unit tilted development to occur.

> **Stakeholders are invited to provide evidence and input about the impact, if any, of the change in this codified charge on development activity in established suburbs or property prices.**

> **Stakeholders are invited to discuss how the change in this codified charge may be affecting decisions about the development of any particular dwelling type(s).**

[5] The increased charge will not apply to any development application (DA) submitted for a completeness check before 30 June 2017. It will also not apply to cases where the variation is related to a lease purchased between 1 July 2016 and 30 June 2017, where the DA is submitted before 1 October 2017 and where it is lodged with all documentation required to pass the completeness check before 1 July 2018.

Simplicity and consistency

The development of the LVC, especially in the use of codified charges and use of a valuation method for more complex developments, was informed by the experience of the preceding CUC which was perceived to have become inefficient, arbitrary and complex.

While the current system has been designed to address these shortcomings, feedback is invited on further improvements that could be made to the LVC framework easier to understand and comply with.

> **Stakeholders are invited to provide input on ways that existing documentation (including LVC schedules, statutory instruments and information on ACT Government websites) can be improved to better assist understanding of LVC charges associated with a proposed development.**

> **Stakeholders are invited to provide ideas and suggestions on ways the design of the LVC could be rationalised and streamlined to minimise complexity.**

There are two methods of assessing LVC consisting of codified charges for simpler and smaller single purpose developments, and a 'before' and 'after' valuation approach for more complex and unique developments.

The valuation method is applied where it is not possible to determine a codified charge in advance, for example when consolidating several single dwelling residential blocks to develop a mixed use building compromising of apartments and commercial spaces. While the valuation process offers the flexibility of assessing the uplift in values for complex proposed developments, some stakeholders have argued that this process has room for improvement. Project proponents have expressed concern that determinations can take a significant amount of time and depart from expected values, which presents challenges in factoring this cost into project feasibility assessments.

Using the codified approach the LVC amount is known before development begins. The valuation approach, while potentially offering more flexibility, is unlikely to be appropriate for smaller and simpler developments. This is due to several factors, including the time and cost of undertaking valuations relative to the cost of the development, additional time required to process the lease variations and the likelihood of disputes over the value uplift. These factors combined may work to introduce greater uncertainty in relatively simple developments (such as subdividing and adding an additional dwelling on an existing block with a detached house) if a valuation approach was used.

However, codified charges are relatively resource intensive to maintain to ensure that they continue to reflect movements in land lease values across all suburbs over time. Different schedules apply to varying lease types, which means that current schedules are lengthy and detailed, as well as being linked to the Territory Plan.

> **Stakeholder views are sought on whether the two methods of assessing LVC are appropriate for the purpose and the type of developments to which they are applied.**

> **Stakeholders are invited to provide feedback on how the current system could be improved to assist leaseholders, project proponents and builders to better understand their estimated LVC liabilities when considering development proposals.**

> **Stakeholders are invited to discuss whether extending codified charges to other types of development be beneficial, and if so, what types of development could be subject to codified charges.**

> **Stakeholders are encouraged to identify other alternative approaches that could be considered.**

The current residential codified LVC schedules are lengthy as they have been set to cover as many circumstances as possible. For example, the current schedules include values for each suburb based on the increased number of dwellings proposed for a variation[6]. Feedback from industry stakeholders suggests that these schedules are not easy to use and could be simplified by aggregating at a district level.

While the review will look at options to simplify the schedules, it should be noted that aggregated values are less precise, as they can vary considerably from suburb to suburb according to proximity to services and perceived attractiveness. The variance of an aggregated value from the actual uplift will result in leaseholders in some suburbs benefitting at the expense of other leaseholders, potentially distorting long term development outcomes.

> **Stakeholders are invited to indicate whether there would be support for a move towards more aggregation even though the values may not be as precise.**

> **Stakeholders are encouraged to identify other feasible alternative approaches.**

Submissions in favour of aggregation are requested to include the values recommended to be used in an aggregated schedule and/or under any alternative approaches proposed above. Alternatively, submissions could also include a proposed approach for calculating these values.

Housing affordability

Improving housing affordability and ensuring that a range of suitable housing options are available for Canberrans at every life stage is a priority of the ACT Government. The ACT Government is currently developing a new Housing Strategy for the ACT to support the delivery of equitable, diverse and sustainable housing supply across Canberra. The new Strategy will have a particular focus on increasing housing access and choice for households in the lowest 40 per cent of incomes.

Some stakeholders have argued that the LVC may adversely impact housing affordability where project proponents pass this cost through to home buyers, and in turn to renters in case of investment properties. It has also been suggested that LVC does not support the goal of seeing existing properties repurposed for affordable housing.

However, LVC is only paid where a lease variation is required in order to undertake a particular development. As it is levied on the value uplift of the change in lease, the LVC reflects the price that would be paid for the land if the lease already enabled the proposed development. The LVC puts a proposed development on an equal footing with a development on land which already includes the appropriate development rights.

It is not evident that prices of dwellings in developments where the payment of LVC was required exceed prices paid for other similar dwellings after land lease values and construction costs are taken into account. This indicates that the market price paid by a buyer would remain unchanged even if a lease variation was not required. This financial benefit would instead be captured by the lease holder, prior to the sale of the dwellings. Evidence suggests that the key determinant of dwelling prices and rents in the ACT is supply and demand in the market.

> **Stakeholders are invited to supply evidence on the impact of the LVC on dwelling prices or dwelling supply.**

Some stakeholders have suggested that the LVC disincentivises the development of medium sized townhouses which provide a housing option between larger detached houses and smaller apartments.

Economic principles suggest the decision to build a larger number of apartments over a smaller number of townhouses will primarily be driven by the expected sales and profitability of the development. Affordable

[6] http://www.legislation.act.gov.au/di/2017-208/default.asp

townhouses are more likely to be built where land lease values are relatively lower. Higher priced leases, for example close to employment centres and major transport routes, are more likely to attract higher density developments and provide a greater number of dwellings in these areas.

This can be observed in townhouses currently available for sale in the ACT. While there are a number of lower priced townhouses for sale in newer suburbs and greenfield developments (with lower land lease values), townhouses in established suburbs attract a significantly higher price. It is considered unlikely that the supply of affordable and lower priced townhouses in these areas would significantly increase even if a separate lower LVC was instituted to favour townhouses, given current land values.

> **Stakeholders are invited to provide input and evidence on the relationship between LVC and the development of affordable medium density housing.**

The ACT Government has a range of housing affordability policies in place that assist eligible households to purchase a property. These include Affordable Home Purchase, Home Buyer Concessions, Land Rent, and Deferred Duty schemes. Changes to LVC policy have been suggested as an additional way to address housing affordability by providing an incentive to deliver affordable housing within developments. An important consideration for the Government is whether this is likely to be better targeted and provide better outcomes than existing policies, and how any changes to LVC policy would interact and align with these existing policies.

In determining whether LVC should be used as a tool for housing affordability, it should be noted that it generally applies to developments in established suburbs involving change of leases, and does not apply to greenfield developments or sites where the proposed development is already allowed under the terms of the lease. Greenfield developments tend to have lower land lease values compared to established inner suburbs.

> **Stakeholders are encouraged to provide ideas and input on how an LVC policy could be designed to incentivise delivery of affordable housing within developments on relevant lease types.**

Alignment with planning policies

The Government has heard feedback that LVC charges should be aligned, or take into consideration, planning policies and requirements that may impact on the financial viability of a development. This may include zoning requirements, allowed plot ratios and gross floor area limitations.

The LVC is intended to capture a share of the increase in land value arising from a change in development rights, while planning requirements are set with a broader range of objectives in mind. This includes access to urban amenities, transportation corridors, environmental requirements and liveability.

In considering the alignment between LVC and planning policies, the Government must give close consideration to whether suggested changes to the LVC would support these broader requirements. This is because LVC applies to only a relatively small number of projects which require a lease variation, while the majority of developments undertaken across Canberra do not.

The Government must also consider questions of equity between projects for which LVC is payable and those where it is not, within the broader planning system.

> **Stakeholders are invited to provide input on how the LVC framework could be better aligned with planning requirements for relevant zones.**

Providing an incentive for better outcomes

The current LVC framework offers remissions that reduce the LVC payable if a development project delivers certain outcomes that are in the interest of the community. For example, remissions are currently provided for buildings with higher energy efficiency standards.

Remissions mean less revenue is derived through LVC for the provision of public services, and so are only offered to achieve specific and well-defined outcomes that benefit the Canberra community.

Remissions should not be considered a long term substitute where a direct policy, such as a specifically designed regulation, would be more appropriate and transparent in generating the desired development outcomes. However, the Government is open to updating or streamlining remissions to ensure these strike the right balance between community outcomes, transparency and simplicity in LVC assessment.

- **Stakeholders are invited to provide feedback on how effective LVC remissions have been in delivering intended policy outcomes in the residential sector.**
- **Stakeholders may wish to detail outcomes or conditions under which other specific purpose remissions may be appropriate, and/or propose other remissions the Government could consider for generating improved outcomes in the residential building sector.**

Submissions can be sent by email to LVCReview@act.gov.au.

Stakeholders are welcome to address the discussion topics in full, or simply focus comments and evidence on specific areas of interest.

APPENDIX

Lease variation charge—proposed review

(Extract from Hansard – 26 October 2017)

That this Assembly:

(1) notes that:

(a) the 2017-18 Budget increased the Lease Variation Charge on unit titling of residential dwellings on many residential crown leases from a tiered scale of $7 500 and $5 000 per dwelling to a flat charge of $30 000 per dwelling on the grounds that “this will improve consistency with the ‘per unit’ charges which apply to other types of residential lease variations”;

(b) this charge is primarily paid by new multi-unit residential developments such as duplexes, townhouses and apartments;

(c) industry groups representing individual developers who will pay the increased charges identified that this change could have unintended consequences for individual developers, housing affordability and the supply of new multi-unit housing and the Government responded to these concerns by announcing transitional arrangements on 19 July 2017; and

(d) industry groups supported these transitional arrangements but have raised concerns about the impacts of the change beyond the transitional period;

(2) further notes that:

(a) the Lease Variation Charge system is complex and presents opportunities for rationalisation and improvements in consistency;

(b) an implementation review of these revised charges is due within the next 18 months; and

(c) the Government is currently undertaking a substantial review of its housing affordability policies; and

(3) calls on the ACT Government to:

a) review the full suite of Lease Variation Charges and remissions that apply to residential and mixed-use development, with the review to:

(i) include consideration of options for simplification of charges, such as consistency across lease types;

(ii) consider charges in context with the factors that influence the financial viability of re-development including zoning, allowed plot ratios, gross floor area and the value of the completed dwellings;

(iii) be conducted in consultation with the community, industry groups and other stakeholders;

(iv) be closely co-ordinated with the review of housing affordability policies;

(v) seek to align charges with the Government’s housing affordability, housing supply and planning policies;

(vi) include modelling of the potential impacts of changes on the financial viability of development; and

(vii) be conducted on a revenue-neutral basis; and

(b) introduce any resulting changes to charges by the 2019-20 budget cycle, with appropriate communication and transitional arrangements as necessary.

LVC Remissions

There are currently two special purpose LVC remissions that apply to residential developments:

> Environmental Sustainability - A remission of up to 25 per cent where the associated development nominates a higher Green Star rating or NatHERS ratings in the residential sector7.

> Public Housing Assistance - A remission of 25 per cent (for a section 277 variation) or 50 per cent (for a section 276E variation) where the purpose of the variation is for the provision of housing assistance. The remission only applies to any variations of leases granted to the housing commissioner for a term beginning before 17 December 1987 and where the housing commissioner is the lessee.

[7] Green Star refers to the rating tool developed by the Green Building Council of Australia while NatHERS refers to a rating under the Nationwide House Energy Rating Scheme.

Chief Minister, Treasury and Economic Development Directorate

September 2018