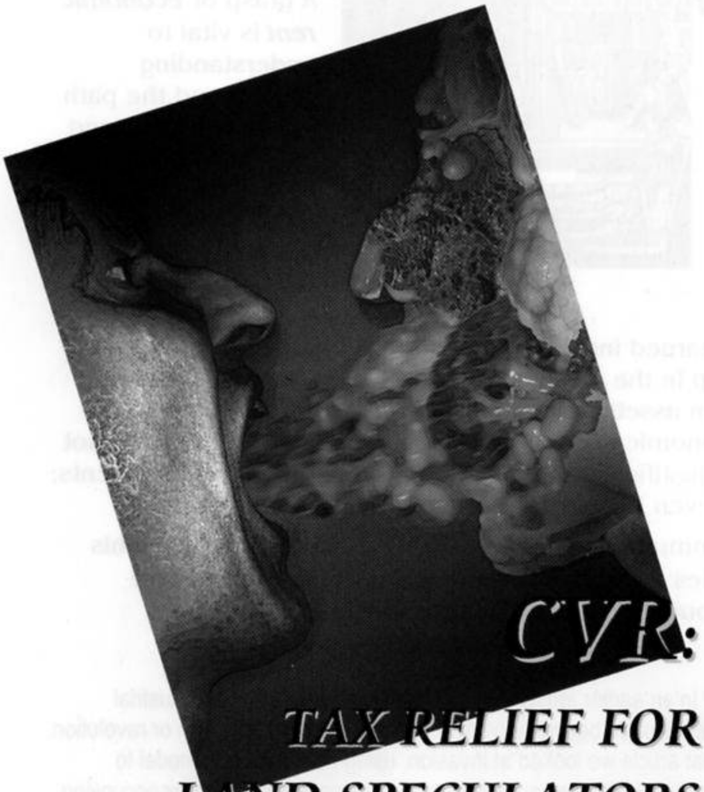

CVR: TAX RELIEF FOR LAND SPECULATORS AT YOUR EXPENSE

Dastardly deeds are being done across the ditch! *GAVIN PUTLAND* ***explains what's happening in New Zealand***

Land-Value Rating (**LVR**) means your Council Rates are levied on the value of your land alone. **Capital-Value Rating** (**CVR**) means they are levied on the combined value of your land *and your house*. So does **Annual Rental Value** Rating, except that the combined value is expressed as an annuity.

Travesty of democracy

By 1988, about 90% of local governments in New Zealand, including five of the seven Councils in the Auckland region, had adopted LVR. Moreover, **every Council that ever adopted LVR did so by a direct vote of the ratepayers.** But in 1989, following illegal or devious reversions to CVR in Christchurch, Wellington and Dunedin, the (Labour) Central Government **removed the right to demand a popular vote** on the rating system. The Minister for Local Government promoted CVR and unsuccessfully sponsored a bill that would have made CVR irreversible wherever it was adopted, notwithstanding that LVR had been Labour policy for over 40 years.

Since 1988, more than half of the Councils that used LVR have changed to CVR (or, in one case, Annual Rental Value). **In every municipality that abandoned LVR, a system chosen by the ratepayers was displaced by a system imposed from above.**

In 2007 a so-called Independent Inquiry into Local Government Rates, chaired by former IMF / World Bank employee David Shand, recommended that CVR "be promoted across the country for general rates" (Recommendation 9). The people's overwhelming preference for LVR was simply ignored.

Now a Royal Commission on Auckland Governance has been established with David Shand as one of the Commissioners, and with Terms of Reference requiring the Commission to "*take into account the implications of the findings of the Independent Inquiry into Local Government Rates for local government arrangements in the Auckland region*". In short, **the Commission has been set up in order to recommend CVR** for the entire region. This in turn would give the Central Government an excuse to impose CVR on the whole country in defiance of the people.

Disaster for working families, economy, environment

The consequences of introducing Capital-Value Rating include the following:

- Ratepayers with above-average ratios of building value to land value — such as ordinary home owners, and owners of rental properties — will pay more. Those with below-average ratios — such as developers holding "land banks", and speculators holding vacant or derelict sites in anticipation of capital gains — will pay less. In effect, **home owners and renters will be taxed for the benefit of developers and speculators**.

- Poorer home owners in outer suburbs, who have lower land values and higher ratios of building value to land value, will suffer greater fractional increases in rates than richer households in inner suburbs. (*N.B.*: More "expensive" localities are such because the *land* is more expensive. Locational value is attached to *land*, not buildings, because the value of a building is limited by the depreciated construction cost regardless of location, whereas land has a location, and therefore a locational value, even if no building yet stands on it.)

- Property owners who add to the supply of accommodation by building, rebuilding or extending will be hit with higher rate bills. This will **worsen the slump in construction** and therefore worsen the shortage of rental accommodation, **forcing up rents**. (LVR avoids this problem. Indeed, LVR tends to reduce rents because it is payable regardless of whether the property is offered to tenants, and because the owner, in order to cover the Rates bill, must offer the property to let [or for sale], thereby increasing the supply of accommodation.)

- Owners who allow buildings to deteriorate will be rewarded with lower rate bills. Derelict buildings will become more common, spoiling neighbourhoods. Buildings that might have been renovated and let to tenants will instead be demolished or boarded up to keep out squatters, **further reducing the**

supply of rental housing. (LVR avoids this problem.)

- As redevelopment of inner-city sites will incur a tax penalty, there will be less infill development and more pressure for greenfield developments on the urban fringe. That means **more urban sprawl**, hence **longer commuting distances**, hence **less family time** and **more pollution**. (LVR avoid this problem.)
- Because building values, unlike land values, are not smoothly-varying functions of location, the valuation process for CVR is more complex, **more intrusive** (involving more inspections of buildings), and **more prone to error**.

Empirical studies overwhelmingly confirm that property taxes on combined values of buildings and land are less conducive to economic activity than those that tax buildings at lower rates or (preferably) exempt buildings altogether; see e.g. Section 3 of The superiority of Site-Value rating — and how to implement it with no losers (Prosper Australia, 2007).

Public-Private Partnerships (PPPs) fail because, instead of tapping uplifts in land values ("beneficiary pays"), they try to cover capital costs out of user charges ("user pays")

Twisted reasoning

Paragraph 9.111 (p.136) of the Shand Report impugns the accuracy of separate land valuations by pointing to the shortage of data on land sales relative to sales of land plus buildings:

For instance, in two Auckland cities over the past few years, there were around 50 sales of dwellings for every one sale of land.

Never mind that some of those "50 sales of dwellings" would have been promptly followed by demolition, in which case the land price can be obtained by adding the demolition cost to the sale price. Never mind that in the absence of significant boundaries, land value per unit area varies smoothly with location, allowing interpolation and consistency checks. Never mind that where necessary, the land value can be obtained by subtracting the depreciated replacement cost of the building(s). Never mind that a separate valuation of the building(s) is always needed for insurance purposes.

CVR by another name

Targeted rates are annual charges payable for *access* or *connection* to particular services, but not apportioned to actual *use* of those services.

Targeted rates tend to be payable *per dwelling*, and are levied on services such as water, sewerage and rubbish collection, which tend not to be needed unless the property is *inhabited*. So a targeted rate, however it is calculated, behaves as a tax on buildings and deters construction — just like CVR, and with the same ill effects.

It is therefore alarming, but not surprising, that the Shand Report is sympathetic to targeted rates, advising that *uniform* targeted rates be allowed to supply up to 50% of Council revenue (Executive Summary, paragraph 52). And of course a *uniform* rate, not being apportioned to property values, is regressive — like a per-household poll tax.

On "user pays" vs. "beneficiary pays"

The benefit of a networked service, net of user charges (e.g. fares, tolls, volumetric charges), is location-specific and is therefore is reflected in an uplift in land values in the serviced locations. The cost to the provider is also net of user charges. Hence the economic cost/benefit ratio of the project providing the service is simply the cost/uplift ratio, which is the fraction of the uplift that must be recovered through the tax system in order to pay for the project.

It follows that any public project that passes an economic cost/benefit test can be financed by a tax collecting something less than 100% of the uplift in land values caused by the project. The rest of the uplift is a net windfall for the land owners — who therefore should enthusiastically support this method of funding.

The utilization of a networked service will be socially optimal if the user charge is set at the marginal cost — that is, the cost of providing one additional unit. But in that case the user charge won't cover the capital cost, which therefore should be defrayed by reclaiming a sufficient fraction of the uplift in land values. If the initial cost is met by borrowing, the loan should be repaid out of the uplift in land values.

Public-Private Partnerships (PPPs) fail because, instead of tapping uplifts in land values ("beneficiary pays"), they try to cover capital costs out of user charges ("user pays"). Consequently user charges are above marginal costs, causing sub-optimal utilization, which in turn prevents the collection of enough user charges to cover the capital costs.

Yet the Shand report opts for "user pays", including toll roads (Recommendation 21), cost-recovery by water metering (Recommendations 30, 31) and other fees and charges (Recommendation 33), and extending the time limit on PPPs for water (Recommendation 22). And it favours greater use of borrowing (Recommendations 19,20) with *less* taxation of land values, leaving considerable doubt that the suggested loans can be repaid.

What can you do?

Does all this mean there is no point in making a submission or presentation to the Royal Commission? On the contrary, if the Commission is rigged it must be *seen* to be rigged. Let no one be able to claim that the Commission recommended CVR, targeted rates and user charges for want of submissions to the contrary. And let no politician think he/she can get elected without promising that there will be no extension of CVR and targeted rates, and no user charges above marginal costs.