An Chomhairle
Náisiúnta Iomaíochas
National Competitiveness
Council

Submission to Department of Finance Public Consultation

The Potential of Taxation Measures to Encourage Development of Zoned and Serviced Land

April 2015

1. Introduction

The National Competitiveness Council welcomes the consultation on the potential use of taxation measures to encourage the development of zoned and serviced land and the opportunity to make a submission.

The Council has addressed issues relating to efficient land use, development levies and property taxes over the last decade or so. This short submission builds on that work.

Given the complexity of the property market, it is worth highlighting that taxation measures are likely to be just one part of the solution – a broader range of initiatives addressing both supply and demand factors are likely to be required to deliver a sustainable property sector that enhances living standards, quality of life and competitiveness[1].

2. Background

A properly functioning property market is essential to Ireland's competitiveness for a number of reasons.

- An adequate, sustainable supply of appropriate commercial property is a key determinant of Ireland's ability to attract foreign direct investment and to support the growth of indigenous firms. Shortages of appropriate commercial property (e.g. offices, industrial, retail and warehouses) in the right location, both within cities and around the country, can act as a major barrier to growth.
- From a cost perspective, property costs are a significant determinant of Ireland's international competitiveness, both in terms of the direct cost of construction and renting and through a more indirect impact on wage demands. In the residential market, there is a direct link between house prices and labour costs; rapid increases in the former will, if left unchecked, result in further upward pressure on the latter. Such a negative spiral would threaten Ireland's overall competitiveness offering.
- In terms of the costs of living and quality of life, high and rising residential prices and rents make Ireland less attractive in terms of attracting overseas talent to Ireland and in encouraging Irish emigrants to return. It can also have a negative impact on labour mobility and entrepreneurship.
- After a prolonged period of unsustainable growth, the Irish construction sector has contracted to a low level of output. It is imperative that construction activity returns to a sustainable level so that it can make an optimal contribution to economic recovery.

3. Recent Price Trends

Property is once again emerging as a significant threat to sustained cost competitiveness – increases in commercial rents are occurring alongside rapid growth in residential rents and house prices.

The charts in Appendix 1 demonstrate the impact that the current imbalance between supply and demand is having on prices. In the commercial market, concerns persist about the shortage of available prime office space for rent in Dublin, Cork and Galway as the market tightens and vacancy rates decline. This could result in further rent increases

1 These issues are not new – the Kenny report, which was published in 1973, was prepared by the Committee on the Price of Building Land and was chaired by Mr. Justice Kenny. Its key objective was to identify measures to control the price of land required for housing and other development. Many of its recommendations were never implemented.

and any shortage of supply of new commercial space could adversely impact our competitiveness in attracting investment[2]. Please see Appendix 1 for greater detail.

In the medium term, demand for housing is likely to increase: according to Housing Agency forecasts, a minimum supply of 79,660 residential units in urban areas is required to support the population between 2014 and 2018[3]. This equates to an average equivalent of 15,932 units. The per annum requirement ranges from 9,526 units in 2014 to 20,853 units in 2018. Demand also varies geographically with 47 per cent of total supply over the 5-year period required across the Dublin Region. On the supply side, approximately 8,700 new homes were built in 2014. The ESRI have forecast a significant increase in completions for 2015, taking account of the recently announced investment in social housing. So long as the rate of completions is below the forecast rate of new household formation, the inevitable result is higher prices and less affordable housing, putting more upward pressure on wages and damaging competitiveness.

4. Opportunity for Reform

4.1 Merits of property taxes

Taxing land and property is one of the most efficient and least distorting ways for governments to raise funds and to encourage economic and social development. Sustainable and broad based property taxes, when properly structured, can enhance Ireland's fiscal stability while supporting competitiveness (e.g. by reducing the need to tax labour, etc.)

4.2 Development of a single, broad and national approach

In the consultation paper, it is noted that there is a perception that some owners of zoned and serviced land are waiting for higher prices before taking steps to develop their land or sell it to others who will. The Council notes the purpose of the consultative process is to "*assess the extent to which the taxation system (through corrective measures) can be utilised to encourage the development of such zoned and serviced land to assist in reducing the shortage of residential properties in certain areas*".

The Council also note, as set out in the consultation paper, that a number of other proposals are also being progressed to address related issues including:

- The Minister for the Environment, Community and Local Government is separately developing proposals to underpin the development of priority areas identified in local authority city and county development plans. The legislation being proposed relates to a process of identification of priority development areas by local authorities in the context of their statutory development plans coupled to liability for an annual levy at a rate of 3 per cent of the market value of any site where the owner fails to develop the site.
- The Government's Construction 2020 Strategy published in May 2014 outlined a range of actions aimed at incentivising increased housing construction activity and supply. These actions are being progressed as a matter of urgency, including the introduction of the vacant site levy.

It is not clear how these strategies and the current consultation fit together.

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2 According to SCSI, the strong increase in office take up in 2013 was largely driven by multi-national organisations engaged in the Telecoms, Media and Technology (TMT) and Financial Services sectors, reflecting Ireland's continued success in attracting foreign direct investment. See SCSI, Annual Commercial Property Review and Outlook 2014

3 http://housing.ie/Housing/media/Media/Publications/Future-Housing-Supply-Requirements-Report.pdf

The Council believes that the ambition of this consultation should be extended - there is an opportunity to deliver fundamental reform that would result in increased supply of both residential and commercial property, whilst simultaneously benefitting existing enterprises.

The Council believes that a single, broad and national approach should be considered to the taxation of commercial property and land which is zoned and serviced for development. It would be easier to link such a system to clear national long term goals. It would also be easier for potential taxpayers to comply with and easier for tax administration purposes.

4.3 Merits of a national site value tax

The Council believes that consideration should be given to introducing a site value tax - that is, a tax on the unimproved value of commercial property and land which is zoned and serviced for development. It is proposed that this would encompass the current system of commercial rates and other proposed initiatives referenced above.

An annually recurring site value tax (SVT), levied without regard to how land is used or what is built on it, is considered the most effective type of land tax in terms of ensuring the most productive use is made of the land[4]. Since the amount of land is fixed, taxing it cannot distort supply in the way that taxing employment impacts upon the supply of labour. Instead a land tax encourages efficient land use. Property taxes that include the value of buildings on land are less efficient, however, since they are in effect, a tax on the investment in that property. An SVT, by contrast, taxes the value that has not been created by the landowner (e.g. nearby public investment in transport, water and waste water networks, social facilities such as schools, etc.). The introduction of an SVT would achieve many similar outcomes as a levy on vacant development land (as currently proposed in the Planning Reform No.1 Bill)[5]. The merits of an SVT as a policy instrument, however, extend beyond vacant sites.

- An SVT would incentivise owners of commercial sites to maximise the earnings potential of their holdings and in this way would encourage rejuvenation of properties which are not being used to their full potential.
- Under an SVT, those sitting on derelict sites in Ireland's town centres and in areas which could support residential development will be strongly incentivised to use it to its maximum potential, sell it on, or pay for the privilege of wasting land – as opposed to the current situation whereby land owners can hoard land until land values increase and windfall gains can be realised without any investment required on the part of the owners. The

Commercial Rates

Commercial rates are a property-based source of income by Local Authorities on the occupiers of non-domestic property or properties that are considered rateable for the purposes of the Valuation Acts.

The taxation of commercial properties in the form of commercial rates has not changed significantly in many decades – despite long held concerns on its fairness and efficiency.

At present, the revenues generated through the Commercial Rates system enable Local Authorities to provide important services to both businesses and households[1]. The dependence of local authorities on commercial rates has increased sharply in recent years due to reduced central government funding.

As it stands, the Commercial Rates system does nothing to encourage the efficient use and development of vacant land. In many instances, owners of vacant and derelict properties are entitled to a refund of a proportion of their rates bill. This can result in the creation of perverse incentives, whereby certain properties are allowed to fall into disrepair, thus minimising the rates bill owed.

4 Site value is measured on the basis of the rental value of the land. An SVT is ordinarily charged as a percentage of the value of a site with regular valuations undertaken by an independent statutory body. See Quinn, O., Memorandum to the Department of Finance: Proposed Vacant Land Levy for the Inner City of Dublin, July 2013
5 The definition of vacant sites for the proposed Dublin City Council levy is vacant land which is zoned, but has not been developed and has no rateable buildings on it.

costs of such under development and vacancies are currently borne by others in general, by other rate payers in particular[6].

- By providing a disincentive against land hoarding, an SVT can also contribute to the prevention (or minimisation) of property bubbles.

An SVT administered on a self-assessment basis with oversight by the Revenue Commissioners would be much more efficient and economically aligned than the existing commercial rates system. An effective site-value tax levied on commercial property would produce a sustainable stream of income, encourage efficient land use benefiting town centres, result in more sustainable development and could ultimately replace commercial rates and the development contribution scheme[7] as a source of local authority funding.

5. Some Practical Considerations[8]

The Council believes that a site value tax offers the potential to reform existing systems and to meet new policy goals (i.e., encouraging the use of underused sites). Its adoption would ensure that the tax is sustainable, fairly targeted and sufficiently flexible to respond to both changing patterns of property usage and conditions in the wider economy.

The Commission on Taxation recognised the strong economic rationale for introducing a land value tax, while also acknowledging the practical difficulties which would have to be overcome[9]. The pros and cons of an SVT as applied to a residential property tax are discussed in the Report of the Inter-Departmental Group on the Design of a Local Property Tax[10].

The difficulties primarily relate to the valuation exercise which conceptually separates the value of the buildings on a site from the value of the site itself. Undoubtedly, the introduction of an SVT creates a range challenges, both from an administrative and communications perspective[11]. The same discussions, however, highlights the underlying attractions of an SVT, which are particularly forceful when applied to commercial properties and development land. It could also be expected that the owners of zoned and serviced land have greater awareness of the differences between the value of buildings on land and the site itself.

There are instances of site value taxes being applied in other jurisdictions – further investigation of the operation of such measures (i.e.to understand the administrative requirements and effectiveness of levying such a tax) where they have been applied should be undertaken. For example, the Danes applied a land tax ("grundskyld"), while in Pennsylvania a form of SVT is levied which taxes land at a higher rate and built property at a lower rate. In New Zealand, local authorities have the choice of three alternative systems on which to base property taxes - the total value of land, buildings and other improvements (i.e. capital improved value); land value only (previously known as unimproved value); and the annual rental value.

It is also clear that reform of the current system of commercial rates would present considerable challenges. The legislation underpinning the current system has been in place for a considerable period of time. It could be expected

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6 In 2013, a Dublin City Council "Vacant Land Audit" identified 312 sites or 63 hectares of land zoned for development but left unused, sometimes for decades, in prime city centre locations. See Dublin City Council, Dublin City Development Pan 2016 – 2022, Background Papers, November 2014

7 In contrast, a property tax (i.e. a tax levied on buildings, for example) is not levied on undeveloped land, and so is not able to replace Development Levies. For further details see Smart Taxes Network, Implementation of Site Value Tax in Ireland, July 2010

8 Collins and Larragy, while focusing on residential properties, set out a range of options to overcome the challenges on introducing a site value tax in Ireland. See Collins, M.L., and Larragy, A., Designing a Site Value Tax for Ireland, November 2011, Economic Research Unit WP 2011/1.

9 Commission on Taxation, Commission on Taxation Report, 2009

10 The report is available for download at www.environ.ie/en/PublicationsDocuments/FileDownLoad,31669,en.Pdf

11 In terms of overcoming some of the practical, data related challenges associated with an SVT, many of these have been considered previously in some depth. For example, See Lyons, R., Residential Site Value Tax in Ireland: An Analysis of Valuation, Implementation and Fiscal Outcomes, December 2011

that there will be winners and losers from a move to a new system. However, as noted by the UK Institute of Fiscal Studies, "*…significant adjustment costs would be merited if the inefficient and iniquitous system of business rates [in the UK] could be swept away entirely and replaced by an LVT (land value tax)*"[12].

In addition, there are a number of issues the Council would like to raise briefly as matters for further consideration/noting:

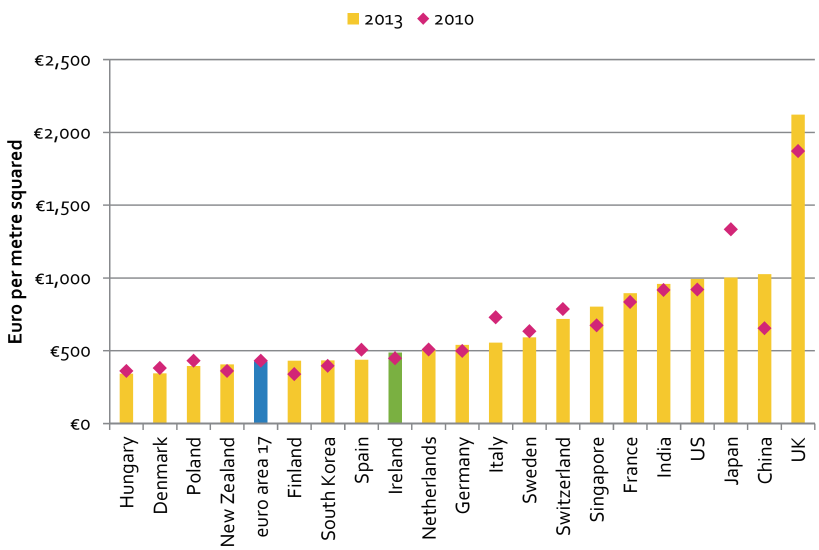
- The Council is not commenting on the rate of taxation which should be applied; rather this submission focuses on the principle of levying an SVT.
- It is important that development sites owned by Local Authorities, NAMA, and other public bodies (who are significant land owners) are subject to the same incentives/penalties as privately owned sites.
- Collection and enforcement should ideally be in the hands of the Revenue who have a variety of collection and enforcement measures available to them. This would also circumvent any potential conflicts which may arise where land banks are held by Local Authorities. Mirroring the residential property tax, revenues can remain in the area they are collected.
- Liability could arise from a specified valuation date with a once-off 12 or 18 month "holiday" or period of exemption to allow for genuine land bank assembly as opposed to hoarding.
- It is important that taxation measures work in concert with other policies which impact upon development (for example, ensuring that an SVT and zoning policy work in concert to deliver sustainable development, and protect the public good; ensuring that an SVT complements (or potentially replaces) the proposed levy on derelict sites etc.).
- Consideration is also required to overcome difficulties relating to land title – the complexity and related uncertainty attached to land title issues in Ireland often results development being delayed; for an SVT to operate effectively and fairly, such issues would need to be resolved.

12 Adam, S., and Miller, H., The IFS Green Budget: February 2014

Appendix 1: Recent Commercial and Residential Property Price Developments

The following charts, taken from the Council's most recent study into business costs in Ireland provides a brief overview of the impact of constrained supply and rising demand on cost competitiveness[13].

Figure 1: Cost of renting a prime office unit, € per square metre per year[14], 2013

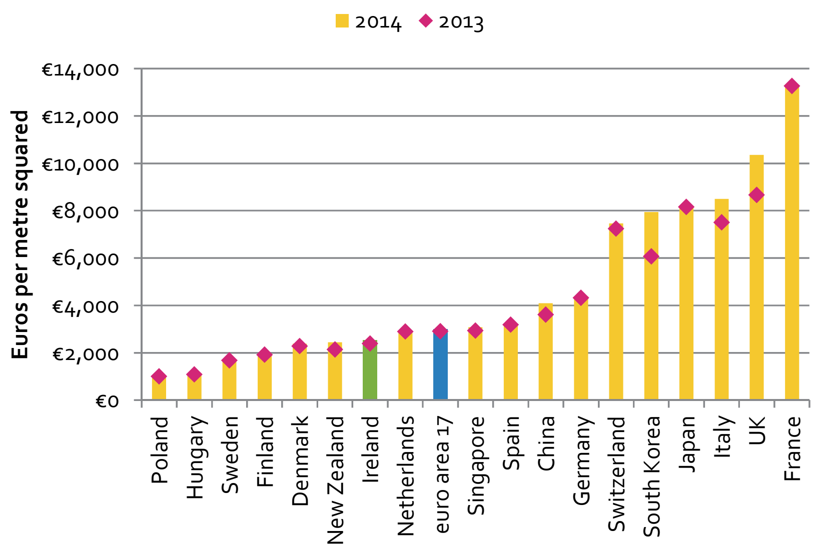


Office rents on new leases in Dublin fell by 47% between their peak in 2007 and 2012. The majority of this decline was realised early in the recession. Thereafter prices stabilised. Between 2012 and 2013, however, rents began to rise again and an 11% increase was recorded. In 2013, Ireland was the 6th most expensive location in the euro area.

Source: Cushman and Wakefield, Office Space Across the World, 2014

13 National Competitiveness Council, Costs of Doing Business in Ireland 2015, Unpublished
14 Euro area 17 excludes Cyprus and Malta

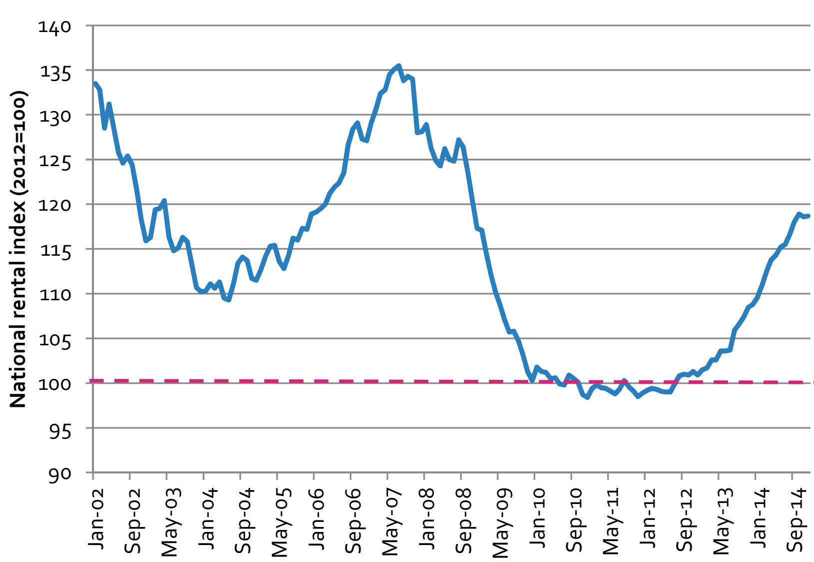
Figure 2: Cost of Renting a Prime Retail Unit, € per square metre per month[15], 2014



While trading conditions and occupier activity improved across Europe in 2014, rents, however, remained relatively stable. In Ireland, prime retails rents increased by 6% over the year, with strong increases recorded in Galway and to a lesser degree, Dublin. Ireland was the 7th most expensive location in the euro area and rents ranges from €500 per square metre in O'Connell Street Limerick to €4,500 in Grafton Street, Dublin.

Source: Cushman and Wakefield, Main Streets Across the World, 2014

Figure 3: National rental index (2012=100), January 2002-December 2014

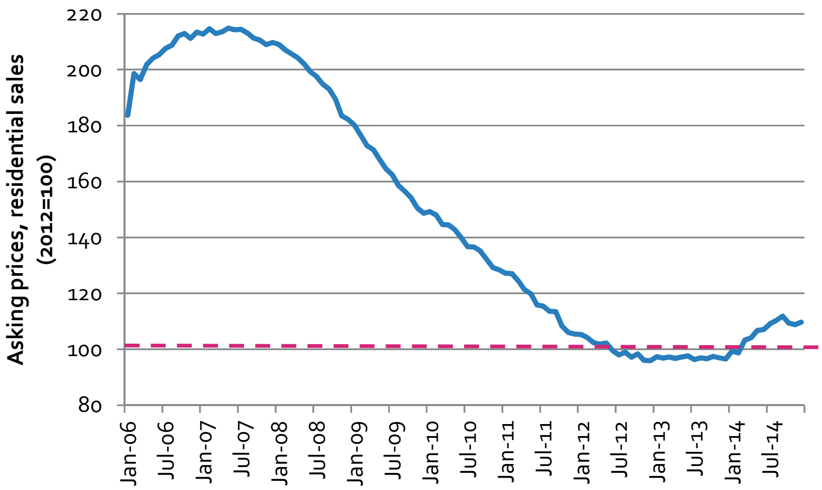


Residential rents continued their steady rise throughout 2014, are now almost 20% above their 2012 trough (rents nationally were 9.7% higher in Q4 2014 than a year previously). In Dublin, rents are now almost 30% above their lowest point in 2012 and just 6% below their 2007 peak. While still high (11% per annum), rent growth in Dublin slowed in both Q3 and Q4 2014.

Source: Daft.ie

15 The chart is based on the most expensive retail location in each country, and uses data collected in September 2014. Data for retail rents relates to the expected rent obtainable on a standard unit and/or shopping centre in a prime pitch in 330 locations across 65 countries around the world. Rents in most countries are supplied in local currency and converted to a common currency for purposes of international comparison. Data for Ireland is based on rents for Grafton St. in Dublin. The chart excludes data on the US (New York - €29,822 per metre squared) for presentational purposes.

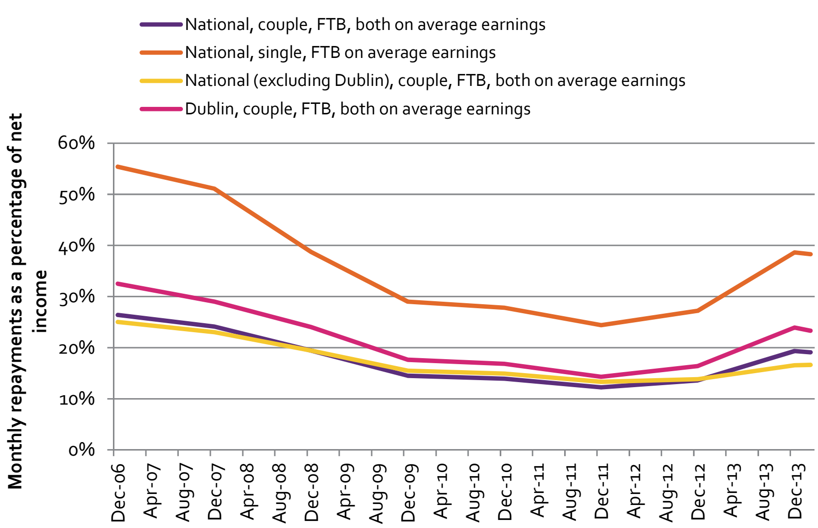
Figure 4: Residential sales asking prices (2012=100), January 2006-December 2014



The average asking price nationwide is now €193,000, 12.8% higher than a year ago. This compares to €378,000 at the peak in 2007. Particular concerns persist about the market in Dublin. Annual inflation in the capital has eased marginally from a high of 25% in September to 20% in December.

Source: Daft.ie

Figure 5: House price affordability: monthly repayments as a percentage of net income[16], December 2006-February 2014



Increases in prices are adversely impacting affordability – the degree of impact depends on both geography and family type. Overall, housing affordability nationally is currently estimated at 19.3% of net income for a (first time buyer) working couple. In Dublin the proportion of net income required to fund a mortgage for the average FTB working couple was 23.3%. However, affordability in Dublin is still some way off the peak reached in December 2006 (32.5%).

Source: ESB - DKM Affordability Index

16 Affordability refers to the potential buyer's ability to fund a mortgage.