Fire Services Funding Review

A submission prepared by the Property Council of Australia
February 2003
Table of Contents

Introduction ........................................................................................................... 3
The Property Council of Australia .................................................................. 3
Property: The People’s Asset ........................................................................... 3
Economic Role of the Industry and the Burden of Taxes on Property .......... 3
About this submission .................................................................................... 3
Outline of submission ...................................................................................... 4
Participation in Alliance .................................................................................. 4
Further information ......................................................................................... 4
Inadequacies of Current System .................................................................... 5
FSL is inequitable ............................................................................................. 5
FSL is tax inefficient ......................................................................................... 5
The current funding scheme is complex ....................................................... 6
The Commercial Property Sector’s Contribution to FSL .......................... 7
Comparisons with other states ....................................................................... 9
Principles for a new system ........................................................................... 10
Caps on payments ........................................................................................... 10
Next Steps ...................................................................................................... 10
Introduction

The Property Council of Australia

The Property Council of Australia represents the broad interests of the commercial property sector. The Property Council is the largest and most influential industry organisation within its sector and has in excess of 2000 member companies throughout Australia, with approximately 500 of those in the Victorian Division, representing property assets of over $140 billion nationally.

Property: The People’s Asset

There is a widespread misconception that the commercial property sector favors wealthy individuals. This view is at least 20 years out of date. There are more than nine million Australians who have a stake in the commercial property market through superannuation, property trusts or life insurance policies.¹ This represents one in every two Australians, or two thirds of the nation’s adults.

Commercial real estate has emerged as one of the fastest growing stock market investments in the country. Australian Stock Exchange research shows an 88 per cent increase in the number of people investing money in listed property trusts in the 12 months to November 1999.² In fact, less people own shares (7.6 million) or own their own homes (5.6 million) than have a share in commercial property.³

Economic Role of the Industry and the Burden of Taxes on Property

Property investment is a major investment class in its own right, competing with other investment sectors in Australia and around the globe. The property investment industry is an important contributor to the Victorian economy. The Property Council’s institutional members alone own or manage more than $20 billion worth of office, retail, industrial and hotel investment property in Victoria.

Although there has been a global slowdown, the Victorian economy has performed strongly over the past year, exceeding the national average in measures such as consumer spending and economic growth. Despite this performance, Victorians still pay above average tax per capita. The Property Council believes that the current system of taxation relating to property transactions is a disincentive to investment. Combined with some of the highest taxes in the world in regards to insurance, the commercial property sector certainly pays a multitude of taxes. Fire Services Levy (FSL) is a tax that should be shared more equally throughout the community.

About this submission

Adherence to Terms of Reference

The Terms of Reference for this review clearly state that issues relating to the costs of provisions of fire services, or the cost effectiveness or efficiency with which these services are currently being delivered are out of the scope of this review. The Terms of Reference also

² ASX Australian Share Ownership Survey 1999
state that other taxes associated with property or financial instruments are out of scope. Therefore the Property Council will not address such areas. Such policy issues are clearly stated in Victoria First, the Property Council’s policy platform for 2003, of which the Department of Treasury and Finance has a copy.

The Terms of Reference also indicate that any recommendations should have a neutral impact on the State’s total expenditure on fire services. This issue is not addressed in detail, as this submission focuses on the principles of a new system, rather than actual costings. The Property Council would be pleased to participate in further consultation relating to modelling, costs and other issues.

Outline of submission

This submission consists of three key parts:

- The inadequacies of the current system from the commercial property sector’s viewpoint;
- The current contribution made by the commercial property sector; and
- Proposed principles for a new system

Participation in Alliance

The Property Council is a member of the alliance of organisations calling for the abolition of the current FSL system. The Property Council has also contributed to reports and analysis provided by the Alliance, and has attended briefings by the Department of Treasury and Finance. As informed by the Department of Treasury and Finance, the review of the FSL system is being conducted in an open manner, seeking industry feedback at key milestones. The Property Council commends the Department for this approach and is pleased to participate in the review from an individual perspective, or through the Alliance.

The submission and supplementary documents provided by the Alliance largely reflects the position of the Property Council. However this submission focuses specifically on the issues that the commercial property sector sees as essential when the government makes considerations for a new system.

Further information

For further clarification or information relating to this submission, please contact

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Inadequacies of Current System

The Property Council believes there are three serious flaws with the current system:

- The system is inequitable
- The system is inefficient
- The system is complex

**FSL is inequitable**

FSL is the principle source of funding for fire services in Victoria. Currently, only those who take out property insurance pay FSL. Therefore the system is inequitable because those who do not insure, or under-insure their property are being cross-subsidised by those who fully insure. In other words, FSL is a tax on responsible property owners.

It has been argued that the fundamental inequity in the FSL scheme is overcome because the fire services can recover costs directly from property owners who are not insured. This argument is only partly correct. Fire services costs are not always recovered, particularly when an incident has occurred at a household or small business with little or no means to cover costs. Irrespective of the MFESB and the CFA’s capacity to recover costs directly with property owners, the fundamental inequity of a system based on insurance policies remains.

Those who choose not to insure and never have reason to call on the fire services (which is most non-insureds) will never contribute. Those who under-insure and never call on the fire services (which is most under-insureds), will contribute only partially. These same people, however, will always have full access to the fire services if they ever need them. This is a gross inequity, making FSL effectively a tax on the conscientious.

**FSL is tax inefficient**

The current fire services funding scheme is tax inefficient: it has a tax base limited to those persons and organisations that take out property insurance. The base is further reduced in practice by under-insurance and limited even more by self-insurance and other legitimate risk management practices in common use. These limitations are unnecessary – they result from poor scheme design, not from specific demands of equity, economic efficiency or transparency.

FSL rates for firms are determined according to predictions of the insurance company’s premium income approximately one year in advance. Given the imprecise nature of this method, it is impossible in practice for insurers to align recoveries with their contributions to the fire services. The consequence, in practice, is that insurers either under-recover or over-recover. If they under-recover, they pay the difference from their own funds. If they over-recover, the excess funds are absorbed into their revenues. This design inefficiency leads to distortions for insurers and insureds. The imprecise nature of this method also flows onto the policy holders, who must make estimates for the future FSL component of their insurance policies and make adjustments accordingly. This is another uncertainty that Victorian business face in the current difficult climate of insurance in this State. When combined with other tax inefficiencies, such complications can be a deterrent for investment.

Under the current FSL scheme, where a property is insured under two property policies, such as Industrial Special Risk (ISR) and Terrorism, FSL is payable on both premiums. This anomaly has created major additional insurance costs for large commercial property owners in Victoria. This is a serious flaw in the current system that must be addressed.
Non-insurance and under-insurance and their community consequences

An Insurance Council of Australia (ICA) study of non-insurance and under-insurance published in October 2002 showed that approximately one in four households and one in six businesses in Victoria have no insurance. Of domestic tenants, almost 70% have no contents cover.

The effects of non-insurance and significant under-insurance in commercial operations are underlined by the finding in the same report that some 70% of businesses which are faced with a sudden major threat to their operations, such as a major fire or serious storm damage, never recover. If they have no insurance, the chances of recovery often are negligible. These businesses close their doors forever. This is of particular concern in regional areas where closure of a single business can have a profoundly negative effect on the local economy.

To date no rigorous public study has been undertaken of the effects of pricing on the demand for property insurance. However, it is self-evident that higher prices affect affordability and affordability is a determining factor in demand for almost any product, including property insurance. Recent trends in rising premiums suggest that companies are transferring risk from insurance policies back to within their own businesses through self-insurance or deductibles. This further erodes the current base for FSL collections.

So while it cannot be determined at present with any precision what effects FSL has on the demand for property insurance, it is clear that the application of the tax will adversely affect demand and increase the levels of non-insurance and under-insurance in the community.

The current funding scheme is complex

There is no requirement for the FSL to be identified on an insurance policy. Many businesses and consumers who pay FSL are unaware that this levy funds fire services in Victoria. A survey commissioned by ICA and undertaken by Quantum Market Research in late 2002 showed that a large proportion of consumers and businesses do not have a clear idea of the extent of taxes and charges they pay as part of their premiums. The majority of those who do have an idea suggest rates of up to 20%, with 10-20% most mentioned.

Many property insurance policy holders are unaware that they fund the fire services through a levy on their premium. The calculation rates are complex and the rational for applying the rates appear arbitrary.5

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4 The ICA study explored households and small business. While a comprehensive study of non-insurance in the large commercial property sector has not been undertaken, the Property Council would assert that non-insurance levels in this sector would be considerably less than domestic or small business sectors.

5 Refer to ICA resource information for full details of FSL calculations.
The Commercial Property Sector’s Contribution to FSL

The commercial property sector currently contributes a significant amount to the fire services funds through a number of channels including FSL, upfront callout charges and through other transactions. The sector also assumes greater responsibility for risk management than the domestic sector, and is subject to tighter controls on the management of buildings, hazardous goods and other materials.

The table below illustrates the cost of the FSL on domestic and commercial premiums for the MFESB. In all cases a risk premium of $100 is assumed. It can be seen that the commercial sector currently pays a higher levy than the domestic sector – this table indicates that the commercial levy rate can be more than double the domestic rate. When GST and stamp duty are added to this amount, the cost to business is considerable.

<table>
<thead>
<tr>
<th>Tax item</th>
<th>MFESB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Domestic</td>
</tr>
<tr>
<td>Risk premium</td>
<td>$100.00</td>
</tr>
<tr>
<td>FSL rate (Various)</td>
<td>13.00</td>
</tr>
<tr>
<td>Subtotal</td>
<td>113.00</td>
</tr>
<tr>
<td>GST (10%)</td>
<td>11.30</td>
</tr>
<tr>
<td>Subtotal</td>
<td>124.30</td>
</tr>
<tr>
<td>Stamp duty (10%)</td>
<td>12.43</td>
</tr>
<tr>
<td>Gross premium paid</td>
<td>$136.73</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tax effects</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total tax as % of risk premium</td>
<td>36.73%</td>
</tr>
<tr>
<td>Additional tax % as result of tax cascade</td>
<td>3.73%</td>
</tr>
<tr>
<td>Potential % reduction in gross premium as consequence of eliminating FSL</td>
<td>11.50%</td>
</tr>
</tbody>
</table>

However the link between the proportion of insurance claims on property that are related to fire versus the rate applied to fund fires services on the insurance policies is tenuous. Indeed data provide by the Insurance Council of Australia suggests that the percentage of fire and explosion claims related to building and contents fire and ISR policies is around 5%. This is significant when compared with theft, burglary, housebreaking and accidental loss or damage, which makes up around 50% of claims.6

Commercial properties are not the main source of fires in the Melbourne CBD. For example in the City of Melbourne, less than half of the fire incidents are structural, other types of incidents are vehicle, storage, grass or rubbish or explosions. Of the structural fires, only 24% of property involved are industrial or commercial, compared with 46% of property involved is domestic. In addition, figures from the MFB suggest that the number of callouts to false alarms, as well as the number of industrial and commercial property involved in fires is lower than the 1995-2000 average, suggesting the commercial sector is continually improving its risk management procedures.7 Therefore it is evident that the commercial property sector contributes a significant amount to fire services through the FSL, through expenditure on risk management and through upfront payments to the fire brigades for callouts relating to false alarms.

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6 Source: ICA resource document. The Property Council understands that this information has been provided to Treasury and Finance.
7 MFB Local Government Information Book 2000/2001
It is commonly asserted that companies that insure offshore avoid paying FSL. However, information provided by the Insurance Council of Australia and the MFESB suggests that when companies based in Victoria insure off shore through an Australian broker, FSL is paid through the broker. Where companies insure directly offshore, the MFESB charges the company directly for an FSL contribution. It is possible that there is some non-payment in this area, however the exact figures are unknown and difficult to determine with any accuracy. **Claims that the bulk of the owners/managers of commercial properties are tax avoiders because of off-shore insurance are based on assumptions, not facts.** In addition, payment of the fire services levy alone is not sufficient cause to insure off shore. Feedback received from the Property Council members indicates that off-shore insurance is becoming more prevalent because the local industry has been found wanting, or that obtaining various forms of insurance is extremely difficult.
Comparisons with other states

The joint submission from the Alliance panel provides a detailed analysis of the Queensland, South Australian and the (new) Western Australian systems. The Property Council endorses this analysis; however it is important to reiterate a number of key points from the Alliance submission.

The table below, provided by a Property Council member who owns commercial property in Victoria, New South Wales and Queensland demonstrates the added burden of FSL compared with other states. This member currently pays a fire service levy of 34%.

<table>
<thead>
<tr>
<th>State</th>
<th>VIC</th>
<th>NSW</th>
<th>QLD</th>
<th>WA</th>
<th>SA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium</td>
<td>$100</td>
<td>$100</td>
<td>$100</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td>FSL</td>
<td>$34</td>
<td>$36</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>GST</td>
<td>$13.40</td>
<td>$13.60</td>
<td>$10</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Stamp Duty</td>
<td>$14.74</td>
<td>$7.48</td>
<td>$9.35</td>
<td>$8.80</td>
<td>$12.10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$162.14</strong></td>
<td><strong>$157.08</strong></td>
<td><strong>$119.35</strong></td>
<td><strong>$118.80</strong></td>
<td><strong>$122.10</strong></td>
</tr>
</tbody>
</table>

Victoria has the highest total cost for insurance premiums compared with other states. In addition as highlighted by a member “the significant rise in insurance premiums over recent years has led to commensurate increases in the fire levy, GST and stamp duty. In the case of the fire levy, the increased revenue generated bears no relationship to the cost of providing the service.”

It is evident that South Australia has learned from the lessons of experience of the Queensland model, and in turn, the Western Australian model has attempted to avoid the deficiencies of the Queensland and South Australian experience. From the Property Council’s perspective, the key issues are simplicity and equality. Queensland sought to provide a more equitable system by applying risk-rating categories, however in doing so, it has conceded the principle of simplicity. From a property owner’s perspective, 168 risk rating categories cannot be considered to be simple to understand or administer.

In South Australia, the calculations for contributions are simpler, however as the system is applicable to both property and motor vehicles, some members of the community will be making a contribution on multiple properties and vehicles. It is also understood by the Property Council that the South Australian government’s decision that contributions would be collected centrally has been a costly exercise.

The Western Australian system is yet to be implemented, thus any analysis of the system is based on theory rather than practice. However the fundamental mechanism of the system (based on property values, collected by local government, providing caps on some sections of the community) appears to be favorable compared with the Queensland and South Australian systems.

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8 Reflects soon to be implemented changes in WA
Principles for a new system

The Property Council supports recommendation 5 of the Review of State Business Taxes, the “Harvey Report” which states

“The existing fire services levy raised on insurance premiums be replaced by a separately identifiable charge on all rateable property”

In addition, the Property Council supports the Alliance panel’s analysis of alternate models of funding, its rejection of the hypothetical models outlined and its final recommendation of a property-based scheme that includes consideration for expectation of service. The Property Council acknowledges the current inequalities experienced by the rural sector and agrees that a new system should address this issue. However the Property Council asserts the Government must also extend the principle of fairness to the commercial property sector.

The Property Council’s preferred method of collection is through the local government network; through an itemized amount on council rates notices. This method would clearly demonstrate to consumers the amount they are contributing and takes advantage of existing rates payment infrastructure. A more transparent system would in particular increase the community’s awareness of the need to adequately fund the fires services and provide savings to the bulk of insurance policy holders.

The Property Council acknowledges that there may be upfront costs associated with moving the collection mechanism to local government. However based on member feedback, a central collection authority such as the State Revenue Office (SRO) is less desirable. This is due to the current workload of the SRO. It is the Property Council’s belief that the expansion of the SRO’s function would cost more than the one-off establishment costs associated with altering the rates collection process. Furthermore, there may be cost savings to municipal councils in regards to insurance premiums that may off-set costs of collecting the new levy on behalf of the government. Certainly, such options would need to be explored in detail.

Caps on payments

A key component of the Western Australian model is caps for low income earners, vacant land, and commercial and industrial property. The Property Council in Western Australia endorsed this initiative by the Court government as one that supports the business sector, and ensures that the levy does not act as an impediment to investment.

The Victorian Division of the Property Council urges the Bracks government to extend the same principle to Victorian businesses, by including a cap on payments for commercial and industrial property at an amount to be determined in consultation with the industry. A cap could deliver real savings to Victorian businesses, and would have numerous flow-on benefits for the business community, but also ordinary investors in Victoria who own many of our iconic buildings, office blocks and shopping centres in Victoria through their superannuation and other investments.

Next Steps

In conclusion, the Property Council believes the current system is inequitable, inefficient and complex. The Property Council urges government to create a more equitable, simpler system, where the burden of funding fire services is shared by the community rather than a select few. The Property Council supports a new system that:

- Is based on rateable property
- Is collected by local government
- Provides caps on commercial and industrial property
Once design principles are confirmed, there will be a need for substantial modelling of the components of a replacement system to determine its configuration and parameters. The Property Council strongly recommends that the Government undertakes such modelling.

Elements to consider in the modelling exercise include: property elements which form the basis for contributions; contributions calculation mechanism; mechanism for delivering expectation of service differentiation; collection mechanism; sectoral interests (e.g., pensioner discounts) and system cost elements.

The Property Council looks forward to working with the Government to help ensure that the burden of funding fire services in Victoria will be shared in a fair manner.