30 April 2004

Mr Matt Brown MP
Chairman
Legislative Assembly Public Accounts Committee
Parliament House
Macquarie Street
Sydney NSW 2000

Mr Brown

Comment on interim report into funding fire services in NSW

The Property Council of Australia welcomes the opportunity to comment on the Public Account Committee’s (PAC) interim report entitled Quantitative Modelling of NSW Fire Services Levy Funding Methods as part of an ongoing review of fire services funding in NSW.

In summary, this submission finds that the interim report:

- provides a valuable framework to assess the impact of shifting fire services funding from insurance to property; and
- stipulates levy rates for commercial property which would increase costs to building owners by up to 2000%.

We recommend that:

- further work be undertaken to ascertain the level of FSL contributions commercial tenants currently provide (both in quantum and on an individual basis where possible);
- commercial property be subjected to a range of different levy rates according to risk;
- further work be undertaken to identify appropriate levy rates for commercial property so owners don’t face massive increased costs;
- a flat levy up of $15 be imposed on all motor vehicles registered in NSW to raise $70 million, and for this money to be directed towards reducing commercial property levy rates; and
- the NSW maintain its funding contribution at 13.7% and forgo the $31 million in stamp duty and GST inefficiencies, and for this money to be directed towards reducing commercial property levy rates.
The Property Council made a formal submission to the committee’s review, responding to the committee’s terms of reference, in October 2003 (a list of our recommendations from that submission are attached at appendix A) and also appeared before a public hearing on November 21 2003.

We have maintained support throughout this review for fire services in NSW to be funded through an equitable, efficient and simple mechanism. We maintain our support for fire services in NSW to be funded through a broad based tax, to ensure that the cost of these services is shared evenly across the community.

We reiterate our position that any change in the funding mechanism for fire services should not render anyone who currently contributes worse off. Indeed, given the inherent inefficiencies and inequities of the current model, existing taxpayers should achieve savings.

Our support for a shift from an insurance based funding system to a levy on property and motor vehicle ownership is made on the basis that this will reduce the burden on existing taxpayers. Our support for any change is contingent on this occurring.

The committee’s interim report provides a valuable framework to assess whether existing taxpayers would indeed be better or worse off under a set of four property based funding systems. Until now, this assessment has been purely theoretical.

The framework established in the interim report is helpful in determining characteristics of a new property based funding system. It does not, however, provide a final result, being too preliminary in nature. As such it offers an excellent springboard for further investigation.

We applaud the committee for endeavouring to make the modelling as comprehensive as possible. Unfortunately, while the model provides a high data match for residential property, its matching of commercial property data is disappointingly low, rendering its analysis weak in this area.

While it appears from the report that residential property owners would in the main benefit under a property based system, the same cannot be said for commercial property owners. Indeed, far from enjoying savings, commercial property owners actually appear to face substantial increases in fire levy costs. We are extremely concerned by this outcome.

The interim report outlines four scenarios:

**Beneficiary pays** – Under this scenario FSL contribution is linked to the level of benefit received from fire services.

**Service Standards** – Under this scenario FSL contribution is linked to the level of service received from fire services

**User pays** – Under this scenario FSL contribution is linked to the level of usage of fire services.

**Combined** – this scenario contains all of the above features and treats small commercial properties as residential.

Among the range of scenarios identified, the Property Council supports further examination of the combined scenario. This scenario incorporates a range of important characteristics which should be included in a new property based funding system. However, we strongly oppose the adoption of the combined scenario as it is reflected in the report. As is, our members report increases in FSL contributions in the vicinity of 2000% under the report’s combined scenario.
Following the release of the committee’s interim report in March, we have been working with its authors, Professional Financial Solutions, to identify modifications to the combined scenario to improve the outcome for the business sector. These include:

- considering fire risk as a criteria in determining levy contributions,
- varying the base and ad valorem levy rates;
- including motor vehicle contributions in the model; and
- maintaining the NSW Government’s contribution at 14%.

These changes go some way to improving the outcome for commercial property owners, increasing the number made better off. However, vital information concerning the degree to which commercial tenants currently contribute to funding fire services is missing, making it impossible to predict accurately the actual final impact on commercial property owners.

**Shortcomings with the interim report**

1. **Lack of data on commercial tenant FSL contributions**

Moving from insurance to property based funding mechanism should theoretically broaden the tax base. While this appears to occur for residential property owners, the tax base is being narrowed for commercial property owners.

Direct tenant contributions are abolished under a property based system, thereby shifting the burden from both the building owner and its insured tenants to just the building owner. In effect, the tax base is being dramatically narrowed for the business sector.

An underlying assumption of the interim report is that building owners will be able to pass on any increase in levy contributions to tenants - who will have received savings because their own direct levy contributions are abolished. However, there is no evidence available to indicate whether the increase facing commercial building owners is less than, equal to, or in excess of what is currently paid by the owner and tenants. If the amount is in excess of current contributions then it is probable that the building owners and/or tenants will be worse off under a property based system.

To determine whether this is the case, it is important to know the degree to which commercial tenants contribute to funding fire services in NSW. Anecdotal information obtained by Professional Financial Solutions suggests that in a large CBD office tower the combined contribution of tenants is equal to the contribution of the building owner.

It is impossible to accurately judge whether commercial property stakeholders are better or worse off without a better understanding of the role that commercial tenants currently play. The Property Council has sought information from its members about the level of tenants’ contributions where a building is owner occupied. We are still in the process of collecting this data, which while useful, will only provide a very small sample of evidence.

Total commercial tenant contributions should be sought from insurance companies.

2. **Lack of consideration of commercial property risk profile**

In our submission to the Public Accounts Committee in October 2003, the Property Council suggested that risk factors should be included to calculate levy contributions under a property based system.
We proposed that different types of property and associated risk factors could be used. Unfortunately, this recommendation has not been factored into any of the scenarios outlined in the interim report.

We do not support the total removal of risk consideration and its replacement with an entirely property value contribution, as occurs under existing scenarios. Removing risk altogether from the equation makes land values the primary determinant of levy costs and so increases costs to owners of land with high values regardless of whether that land is fire prone or not.

We maintain that some consideration of risk must be included in determining fire levy contributions so as to:

− provide an incentive for property owners to actively minimise the likelihood of fire, and
− more accurately reflect the true incidence of fire among the vast range of property owned in NSW.

So far consideration has only been given to the difference between residential and commercial property and property located in metropolitan versus non-metropolitan regions. We maintain that within ‘commercial’ a raft of different uses exist, each with very different risk profiles.

Consideration should be given to differentiating between office, light industrial, heavy industrial, farming and retail properties in determining fire levy contributions.

Including risk might add to the complexity of a new funding system, however, its absence would severely undermine a new system.

We propose that different ad valorem rates should apply to commercial property with land values in excess of $500,000 according to a risk rating.

The insurance industry should be well placed to advise appropriate property risk categories and levels. The NSW Fire Services could police the ratings awarded to individual premise through spot checks.

**Modifications to combined scenario**

The Property Council has been working with Professional Financial Solutions to identify modifications to the combined scenario to improve the outcome for commercial property owners.

1. *Varying the base and ad valorem rates*

Each scenario comprises a flat base levy supplemented by one ad valorem levy for residential and two ad valorem levies for commercial. As the authors of the interim report make clear, the flat levies and ad valorem rates used in the scenarios have been used merely for illustrative purposes. In essence, they provide a marker in terms of approach. More work is required to identify appropriate levy rates.

The rates applied in the interim report produce massive increases in costs for commercial property owners. The Property Council has received feedback from owners of a large number of large commercial property across NSW which indicates that increases of up to 2000% in levy costs would occur if the combined scenario were adopted in its current state.

Increases of this magnitude are outrageous. The Property Council has been working with Professional Financial Solutions to try and alleviate these increases by reducing the levy rate applied to properties with land worth in excess of $500,000.

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1 Quantitative Modelling of NSW Fire Services Levy Funding Methods, Professional Financial Solutions, March 2003, p5.
2. **Including motor vehicle contributions to reduce commercial property costs**

As noted in our earlier submission, motor vehicles generate significant demand for fire services in NSW. We propose that all vehicle registered in NSW contribute towards funding fire services through a flat levy imposed on registration.

The interim report identifies that motor vehicles account for between 10-15% of fire service callouts in NSW. It also notes that there are approximately 4.6 million registered vehicles in NSW.\(^2\)

A flat levy applied to all registered vehicles in NSW could be used to raise between $46-70 million towards funding fire services. The levy should be set at between $10–$15 on the basis that this represents 9%-14% of the total $509 million budget for fire service in 2002/03.

While the interim report identifies the possible funding contribution motor vehicles might make, it does not actually include these contributions as part of its scenario analysis. The Property Council urges that a motor vehicle levy set at $15 per vehicle is incorporated into the combined scenario, and the $70 million raised used to reduce the ad valorem rate applied to commercial properties valued in excess of $500,000.

3. **Maintaining the NSW Government’s contribution at 13.7%**

The Property Council strongly opposes any attempt by the NSW Government to recoup the costs of tax on tax inefficiencies from the current insurance based levy.

Under the existing funding model the NSW Government collects stamp duty from insurance policy holders calculated on the fire services levy and GST inclusive price. In other words, the NSW Government is collecting tax on a tax on a tax.

The NSW Government estimates this triple tax inefficiency is reaping it an additional $31 million in stamp duty revenue annually.

As a result of the inflationary impact of the GST and stamp duty, commercial property owners are currently paying over half the value of their basic premium price in taxes. The highly distortionary impact of the triple tax effect is illustrated in the chart below (assuming a basic $100 premium price for simplicity).

**Triple tax impact on insurance premiums**

\(^2\) Ibid, p36.
Part of the reasoning behind removing the fire services levy from insurance premiums is to eradicate inefficiencies such as the triple tax impact to deliver savings to NSW households and businesses.

We urge that the Government forgo the $31 million in stamp duty revenue it collects through triple tax inefficiencies, and for this money to be used to alleviate the sharp increase in levy contributions facing commercial property owners under the existing combined scenario. This $31 million would enable the ad valorem levy rate applied to commercial properties valued in excess of $500,000 to be reduced.

The issue of revenue neutrality should not be considered in isolation of the fact that the NSW Government is on the verge of collecting millions in additional stamp duty revenue from the new terrorism insurance levy, and has already reaped a windfall of $4.4 billion in stamp duty on property transfers over the last nine years. The combined stamp duty take from terrorism insurance and property transfers dwarfs the revenue we seeking to be forgone.

**A new look combined scenario**

Taking into account the modifications suggested above, the Property Council proposes that the following funding scenario be used as a starting point to determine a more equitable funding mechanism. We have worked with Professional Financial Solutions to devise this scenario which goes some way to addressing the massive increases in levy costs owners of large commercial buildings face, however, we are keen to continue to modify the scenario further because our members still face increases in levy costs in the vicinity of 300% under this scenario.

These increases would largely be passed through to the business tenants within the building. Clearly increases of business costs of this nature would not be intended by the Government.

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Base Levy (per property)</th>
<th>Ad valorem rate 1 (per $1,000 of LV)</th>
<th>Ad valorem rate 2 (per $1,000 of LV)</th>
<th>Levy Cap</th>
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</thead>
<tbody>
<tr>
<td>GMR properties</td>
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<tr>
<td>Residential</td>
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<tr>
<td>Commercial</td>
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<td>$1.95</td>
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<tr>
<td>Non-GMR</td>
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<tr>
<td>Residential</td>
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</tr>
</tbody>
</table>

Note: Ad valorem rate 2 applies on the value of property in excess of $500,000, in addition to the ad valorem rate 1.

We are keen to see if the base levy or first ad valorem rate could be increased to enable a further reduction in the second ad valorem rate, as it is owners of buildings with high land values that are experiencing the most dramatic increase in costs. We believe this model should also be modified to incorporate some differentiation between commercial property types according to risk.

Of course before any new scenario is adopted, information about tenant contribution must be obtained on a scale sufficient to satisfy commercial property owners that they would not face absolute increases in levy contributions (i.e. increases which could not reasonably be recouped through rents without harming tenants).

A final aspect of the review which the Public Account Committee must consider is providing a legislative mechanism to enable commercial landlords to recoup the cost of the levy from tenants. Clearly business tenants who currently contribute to funding fire services through their insurance should continue to contribute if it is shifted to a property base. While most modern leases are drafted to provide owners with the ability to recoup such costs, older leases tend not to provide this capacity.
Legislation should be drafted to enable owners to adjust leasing agreements where necessary to reflect additional costs that result from the introduction of a fire services levy on property.

Thank you for the opportunity to provide feedback on the committee’s interim report. Please do not hesitate to contact me about any aspect of this submission.

Yours sincerely

[Signature]

Ken Morrison
Executive Director