POLYGON CAPITAL

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Australian Financial Services Licence No 225889

PROPOSED NSW STAMP DUTY AND PROPERTY TAX LAWS

MAJOR ISSUES NEED TO BE ADDRESSED

During the NSW Budget 2020-2021, the NSW Government released a Consultation Paper "Buying In NSW, Building A Future" (the "Consultation Paper"). The Consultation Paper proposes major changes to NSW Stamp Duty and Property Laws.

This paper summarises some major issues which need to be addressed by the NSW Government before such a new regime is implemented. The rationale for ultimate resolutions will need to be fully explainable to the NSW business community, current property owners and aspiring home owners.

Polygon Capital is a private investment company with active business interests in NSW, including the ownership and management of commercial and residential properties. Our owners, investors and clients are predominantly based in NSW.

ISSUES:

1. Does the proposed property tax supplant the existing land tax for properties electing into the new regime (with existing land tax laws ceasing to apply to properties electing into the new regime)? We assume it does

2. Short-term property owners (such as developers and speculators) are incentivised to elect into the new regime and not pay stamp duty on purchases (as they don't intend to pay much property tax due to their short-term holding period). Long-term investors are more likely to not desire the new regime and will place lower value on properties which have elected into the new regime (by former owners). The new regime may therefore have a material negative impact on some sectors of the property market, especially the market for commercial and industrial property (as discussed below). We note that the proposed regime may have more negative impact on properties that have a higher unimproved land value as a percentage of total value.

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3. Why is there such a big difference in property tax rates for different types of investment property? (Investment residential $1,500 +1% Versus Commercial Property $0 + 2.6%.) This is not a tax neutral policy and will impact capital allocation and property valuations in potentially harsh and unintended ways.

   Capital allocation will be skewed away from commercial properties (particularly those properties which have a higher unimproved land value component) and towards residential (as these will benefit from relatively lower property taxes), and will add to the already heavy bias in our tax systems towards residential property.

   As a result:

   i. Most commercial properties would likely become perpetually less valuable (less liquid and marketable) once elected into the new regime. These will carry higher property taxes and so will be less desirable for future long-term investors (who will therefore not want to pay as much for such properties).

   ii. Other commercial properties (such as office towers which have a relatively low ratio of unimproved land value to total value) may actually benefit from the new rules (and even appreciate slightly in value) as incoming owners decide that increased future property taxes will not outweigh stamp duty savings and thus opt into the new regime.

   iii. Such negative effects on commercial property values (as outlined in paragraph (i)), plus reduced stamp duty and property tax revenues (as outlined in (ii)) will probably have a negative impact on the State's future property tax revenues. The amount of this negative impact will probably not be counteracted by increased residential property taxes and reduced residential stamp duty under the new regime. As a result, the State risks running revenue shortfalls under the new regime, which may compel it to raise the rates of property taxes. This would be politically very unpopular, especially if Residential and/or Primary Production property tax rates are raised. It would also be terrible for the property markets.

   iv. Commercial property rents may be forced significantly higher (to enable some recoupment of the higher proposed property tax). This may threaten the viability of various businesses and industries in NSW, and over the long run may even result in the loss of businesses and industries to other jurisdictions (in Australia and offshore) with lower commercial property taxes and/or rents.

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v. All the above would be counterproductive for an economy desiring to build sophisticated industries (which require sophisticated forms of commercial property, eg data centres, new-age AI based warehouses, logistics centres, renewable energy power plants etc) and would accelerate our journey towards an unsophisticated land of home-owners.

vi. There need to be more (not less) incentives for the development and ownership of commercial and industrial property in NSW. At the very least, the property tax rate should be the same for all classes of investment property. Ideally, commercial & industrial property should benefit from lower property taxes (not higher rates as proposed) and other incentives for investment

vii. In any case, a 2.6% perpetual annual property tax on commercial property is too high. At current capitalisation rates, each dollar of reduced net return (due to higher property tax) will generally result in $20 (or more) of lost permanent value for a property. Perhaps an incentive can be introduced for long term investors who wish to not pay stamp duty on acquisition. For example, the property tax reverts to a lower rate (eg 1.6%) again after say 10 years of continuous ownership. Such a rule would probably mitigate large losses of property value.

4. How will "residential property" be defined? Clear definitions will be needed to address situations such as:

   a. Mixed use properties containing both residential and commercial elements. Will differential property tax rates be apportioned between residential and commercial components? On what basis? Or will the presence of some commercial elements taint the entire property and result in a higher property tax for 100% of the property (this would be grossly unfair)?

   b. What happens when a property transitions (in whole or part) to/from residential from/to commercial? This may occur simply by a change of tenancy, or by redevelopment.

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Clear rules and definitions will be needed as there may be much confusion and many harsh and unintended consequences. A simple solution would be a single property tax rate for all classes of property (as we have with the current land tax).

5. What happens with property in co-ownership? For example, 50/50 tenants in common, when one co-owner wants to elect into the new regime (and not pay stamp duty on acquisition, and pay the new property tax annually), with the other co-owner willing to pay stamp duty and the current annual land tax. Can both owners elect separately in relation to their own ownership interest? What if one co-owner sells their interest in the property? Can the new (incoming) co-owner force the hand of the other (pre-existing) owner by electing into the new regime for their interest? Will such an election by one co-owner commit the whole property to the new regime in perpetuity (again this would be very unfair)?

6. It is not hard to envisage a confusing multi-tiered property market arising as a result of the proposed rules. Distinctions will be made in the market between:

   a. Pre Versus Post regime properties; and
   b. Commercial Versus Residential properties; and
   c. Owner occupied residential Versus Investment residential properties; and
   d. Properties (both residential and commercial) with a lower ratio of unimproved land value to total value Versus properties with higher relative unimproved land value.

   Valuations will no doubt be impacted (some possibly very negatively). This will make the job of property valuation quite difficult and may also impact the terms of finance offered by banks and other property financiers. (They will need to factor in contingencies such as that outlined in paragraph 5, where an old regime property is partly sold to a new owner who wishes to elect into the new regime.)

As seasoned property market participants, we see many potentially harsh and unintended consequences arising from the proposed new stamp duty/ property tax regime. Hopefully our comments highlight this. In particular, the different tax rates for different property classes are not a good idea and are not sustainable. Commercial properties (whose land value is a high percentage of overall value) are going to be unfairly impacted. We also see the potential for large revenue shortfalls under the rules for NSW, which may compel very unpopular rises in property tax rates (as seen in many property tax-imposing cities in the USA). This would also be terrible for property markets.

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We urge the NSW Government to not rush into this new regime without first releasing proposed legislation to all stakeholders for comment and consultation.

We would be pleased to discuss our views with NSW policymakers and legislators.

Yours Truly

[redacted]

Managing Director

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