IPTI Xtracts

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Taxing vacant land is just too hard

The Government has said no to a Capital Gains Tax but is still considering a tax on vacant land as a way to discourage land bankers and help ease the housing crisis. Economist Kirdan Lees argues that a tax of this type would be too complex to implement and Grant Robertson should bin the idea.

The Finance Minister believes taxing vacant could improve housing affordability and is asking the Productivity Commission for advice. Their draft report out last week says little – it's just too soon. But targeting vacant land is far from straight-forward. Tax policy should be simple to understand and revenue collection easy, and there are better alternatives.

Distinguishing land banking from standard business activities is hard. Truly vacant land, already zoned for urban development, is rare. Instead, most land holds low value activities such as car parking, deer farms, and activities that have benefits while accumulating capital gains. In the absence of clear markers of land banking there is too much room for "we reckon" that could cloud tax collection.

And landowners often hold land only indirectly, through a myriad of companies. Moreover, if truly vacant land plots are taxed, expect a proliferation of marginal value activities that would mask if land is vacant and being under-utilised for housing development.

That's important because Inland revenue would need significant resources to run the ruler over who owns what and where. Tasking Inland Revenue with deciding and enforcing these new rules would chew up valuable resources. Instead, these resources could be spent elsewhere - for example, on better monitoring and surveillance of existing policies, such as the bright-line test on sales of residential property.

There are other options to tax land that deserve a closer look

Vacant land is a small fraction of the total stock of land available for housing. So, we should not expect a tax on vacant land to have large impacts on the price of land and housing affordability. The Productivity Commission notes a vacant land tax doesn't raise much revenue.

Thankfully there are other options to tax land that would encourage housing development. Applying local rates on land rather than capital would encourage development. This makes efficient use of existing land that is constrained by geographical limits around New Zealand cities. Such a policy would have broader benefits of incentivising – but not imposing – density on our cities.

Capital value can be useful when capital values relate tightly to user costs for water. But with networked cities, water costs typical relate to the maintenance of the network rather than use. So rating on capital values are not particularly useful.

When housing and commercial developments that sit on land are taxed, tax eats into the return from constructing more units, reducing the incentive to develop land intensively. But unlike capital, when land is taxed, land remains available to be used. Economists love these kinds of efficient taxes since the tax leaves the behaviour of firms and households unchanged.

So, in theory a land tax encourages development of extra housing units on a plot of land. And in practice there are cases of cities that change from taxing capital to taxing land that we can learn from. For example, changes towards taxing land encouraged development in Pittsburgh and Tennessee.

But locally, we are moving in the opposite direction. The Productivity Commission note that in 2007 half the councils applied rates based on capital value but that has risen to 71 percent by 2019. Hamilton looks set to apply rates on capital rather than land valuation. That seems a shame. With a title register in hand councils only need to use land valuations – a task made much easier by today's mass valuation methods that use big data to make assessments in seconds.

Are there unintended consequences of taxes?

There would be winners and losers from taxing land rather than capital. But today the value of property in prime suburbs of urban centres is derived from the land value. So, moving to a land tax would be mildly progressive in most cases.

And efforts to improve infrastructure financing will help free up councils to release land more effectively

Land banking is at least partly due to staged land release. Cash strapped councils release land in chunks, allowing landowners to effectively have a monopoly and artificially keep prices high.

Some of the Productivity Commission's draft report on Local Government Funding and Financing could help improve financial balance sheets and loosen constraints, improving the sequencing problem and reducing the opportunity for land bankers to thrive.

Mixed zoning continues to be the norm, while releasing land for housing in brownfields also relaxes constraints.

There is a role for central government here. Australia's 2010 Henry tax review recommended State governments move to land value taxes. The Australian Capital Territory moved on the advice, but local politics meant other states did nothing, adhering to stamp duties that dried up when the housing market moved south last year. Now the big states envy ACT's foresight.

Looking closer at the regulations that govern the supply side is well overdue but taxing vacant land would be too complex to implement and achieve little. It would be far better for central government to push local councils to implement rates based on land rather than capital value.

The latest monthly Quotable Value data shows property values declining in Auckland and Queenstown with tentative signs of falls in Wellington

Average residential property values are slowly but steadily declining in Auckland and Queenstown, according to the latest valuation data from Quotable Value (QV).

QV says the average value of homes in Auckland has declined every month for the last seven months, from $1,050,647 in November last year to $1,027,113 in June this year. That means it's now 2.7% lower than it was 12 months ago.

The drop in values has affected most parts of Auckland, with average values in June lower than they were 12 months ago in all city districts except Papakura and Franklin.

The biggest annual declines in values occurred in North Harbour -4.9%, followed by Central Auckland -4.7%, Coastal North Shore -4.2% and Gulf Islands -3.6%.

Compared to June last year, average values were up in Papakura +0.9%, and Franklin +1.6%, although those gains were modest.

Queenstown-Lakes has followed a similar trend to Auckland, with the average value there falling for each of the last four months, from $1,204,828 in February to $1,173,692 in June, which was down 0.1% compared to June last year.

There are also tentative signs of property values beginning to ease in Wellington City, where the average value has fallen for the last two months in a row, from $831,614 in April to $827,125 in June, although values are firmer in the Hutt Valley, Porirua and Kapiti.

Around the rest of the country average values are mostly continuing to rise, although the rate of increase appears to be slowing (the table below shows the average property value and the three month and 12 month percentage change for all districts throughout the country).

The average residential property value across the entire country was $687,021 in June, up just 2% compared to a year earlier.

"Overall the New Zealand property market remains quiet with value growth continuing to slow," QV said in its June report.

"The rate of annual growth nationally dropped from 3.5% in June last year to 2.0% at the same time this year.

"The rate of quarterly value growth has dropped to 0.1%."

QV General Manager David Nagel said there was a lack of impetus in the market, as expected at this time of year.

"Demand remains steady and listings relatively low, resulting in stable market conditions but subdued value growth," he said.

"We anticipate this will continue over the coming months, with supply remaining fairly constrained and demand either staying flat or dropping slightly in many areas."