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Report on the inquiry into home ownership

House of Representatives
Standing Committee on Economics

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Chair's foreword

This inquiry was established to assess issues related to home ownership in Australia, and potential policy responses by government.

A range of views on the challenges facing home buyers today were canvassed throughout this inquiry. The core issues related to the housing market inevitably centre on supply and demand – these factors drive property prices around the nation.

Demand for housing is strong in Sydney and Melbourne but it must be noted this is not the case throughout Australia. Many parts of Australia have a relatively weak housing market. It is important that government policy in this area is cognisant of the significant variations in the domestic housing market.

The committee's view is that government policy in this area should predominantly focus on boosting dwelling supply in underserved markets. Many of the witnesses before the inquiry stated that a lack of supply was contributing to rising house prices in Sydney and Melbourne. In the committee's view, state and territory governments need to do more to adequately address land supply and ensure that existing policies and processes are not unnecessarily causing an undersupply.

The Federal Government is also focused on this key supply issue through the Smart Cities Plan announced this year, which will partner with the states and territories, and local governments to deliver coordinated housing supply solutions tailored to local needs. The committee welcomes this initiative.

Tax arrangements for the buying and selling of property were key areas of discussion throughout the inquiry. This included negative gearing, capital gains tax on investment properties, stamp duty and land tax.

The committee supports the maintenance of existing negative gearing arrangements, which have been a feature of the Australian tax system for most of the last century. The committee does not support tax increases in this area.

The committee also does not support increases to capital gains tax rates on the sale of housing. In the committee's view, increasing these tax rates would have a negative impact on the housing market and broader economy.

In relation to possible overheating of the housing market by increased investor activity, the committee notes that APRA has the capacity to further limit the growth of borrowing by investors, should it deem this to be in the interest of financial stability. APRA acted in this manner in late 2014 and may elect to do so again.

The committee notes the strong majority view amongst the contributors to this inquiry that stamp duties are inefficient and out-dated. The committee would be supportive of any future cross-government review of stamp duties to determine whether reform is possible.

Changes to current land taxes, such as the introduction of a broad-based system, would be a major change to Australia's existing taxation arrangements. Any proposal by state governments to make such a change should only be considered in the context of an overall review of property taxation.

On behalf of the committee, I thank all of the organisations and people who contributed to this inquiry and helped to inform the committee through written submissions and appearances at public hearings.

David Coleman MP
Chair

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Terms of reference

On 24 April 2015 the then Treasurer, the Hon Joe Hockey MP, referred an inquiry into home ownership to the House of Representatives Standing Committee on Economics (the committee). The committee adopted the following terms of reference for this inquiry:

- current rates of home ownership;
- demand and supply drivers in the housing market;
- the proportion of investment housing relative to owner-occupied housing;
- the impact of current tax policy at all levels; and
- opportunities for reform.

The committee had not reported when the House of Representatives was dissolved on 9 May 2016. The Treasurer, the Hon Scott Morrison MP, re-referred the inquiry on the 22 November 2016 and asked that it be concluded.

List of abbreviations

ABA	Australian Bankers' Association
ABS	Australian Bureau of Statistics
ADI	Authorised Deposit-Taking Institution
AHURI	Australian Housing and Urban Research Institute
ANZ	Australian and New Zealand Banking Group Limited
APRA	Australian Prudential Regulation Authority
CFFR	Council on Federal Financial Relations
CGT	Capital Gains Tax
COAG	Council of Australian Governments
CPI	Consumer Price Index
HIA	Housing Industry Australia
OECD	Organisation for Economic Co-operation and Development
RBA	Reserve Bank of Australia
UDIA	Urban Development Institute of Australia

1

Introduction

Referral of the inquiry

1.1 On 24 April 2015 the then Treasurer, the Hon Joe Hockey MP, referred an inquiry into home ownership to the House of Representatives Standing Committee on Economics (the committee). The committee adopted the following terms of reference for this inquiry:

- current rates of home ownership;
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- the proportion of investment housing relative to owner-occupied housing;
- the impact of current tax policy at all levels; and
- opportunities for reform.

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Objective, scope and focus

Previous reviews

1.3 The committee was cognisant during this inquiry of a number of previous reviews that related to the housing market and home ownership. These include a Productivity Commission inquiry report in 2004[1], the report of the Senate Select Committee on Housing Affordability in Australia in

1 Productivity Commission, *Report no 28, First Home Ownership*, March 2004.

2008[2], and the report into housing affordability by the Senate Economics References Committee.[3] The committee did not seek to duplicate the work of these previous inquiries. The inquiry was focussed specifically on whether the present policy settings are optimal in terms of giving Australians a fair chance of becoming home owners.

1.4 The principal issues raised in the inquiry are discussed in Chapter 2 and can be broadly summarised as follows.

Home ownership – trends, patterns and challenges

1.5 Evidence to the inquiry indicates that the rate of home ownership in Australia is among the highest in the developed world and has remained quite stable for many decades. Current house prices are very high in the major capitals but the committee was advised that the current price cycle is not out of step with historical trends given the current economic conditions and low interest rates.

1.6 The challenges facing first home buyers were raised throughout the inquiry and were central to the committee's deliberations. In addition to price, these included demand side issues such as competition from investors and supply side constraints, such as the release of land, development of infrastructure, and the costs and taxes associated with new construction.

1.7 There are potential avenues for intervention by the Commonwealth on the demand side, for example through increases to taxation rates for investors. As summarised below, however, the committee's view is that there should be no change to existing negative gearing or capital gains tax discount arrangements and that any evaluation of stamp duties or land tax would have to form part of a broad review of the whole tax system.

1.8 On the supply side, principal considerations such as planning authorisation and land release to address undersupply are largely a matter for the States and Territories.

1.9 However, the committee notes in relation to supply issues that the Assistant Minister for Cities and Digital Transformation, the Hon Angus Taylor MP, released a Smart Cities Plan for public consultation on 29 April 2016. As part of this initiative, the Commonwealth Government will invite state and territory governments to partner on City Deals.[4] According to

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2 Senate Select Committee on Housing Affordability in Australia, *A good house is hard to find: Housing affordability in Australia*, June 2008.

3 Senate Economics References Committee, *Out of reach? The Australian housing affordability challenge*, May 2015.

4 Department of the Prime Minister and Cabinet, *Smart Cities Plan*, April 2016, p. 21.

the Assistant Minister, the 'new City Deals approach to urban planning will link infrastructure investment to the delivery of more affordable homes in our cities.'[5]

1.10 Social housing requirements were also raised during the inquiry and the committee notes the establishment of an Affordable Housing Working Group following a request from Treasurers at the Council on Federal Financial Relations (CFFR) meeting in October 2015. The Treasury states that the Working Group is:

> focussed primarily on investigating ways to boost the supply of affordable rental housing through innovative financing models. These models are aimed at the social housing sector and the private rental market for low-income and disadvantaged households.[6]

Taxation

1.11 The current taxation on housing was also a major theme in this inquiry. This included negative gearing, capital gains tax on investment properties, stamp duty and land tax.

1.12 Both the abolition and the retention of negative gearing and the capital gains tax discount were advocated by different contributors to the inquiry. In contrast, the removal of stamp duty as an inefficient and out-dated tax was almost universally supported.

1.13 As discussed in Chapter 2, the committee supports the maintenance of existing arrangements for negative gearing and the capital gains tax discount. The committee does not support tax increases in relation to either negative gearing or capital gains tax.

1.14 As the Federal Government has no jurisdiction over stamp duty and land tax, the committee cannot make any direct recommendations to reform these measures. However, the committee would support any future cross-government discussions on possible changes to these taxes.

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5 The Hon Angus Taylor MP, Assistant Minister for Cities and Digital Transformation, 'New City Deal approach will deliver more affordable homes', *Media Release*, 12 September 2016.

6 The Treasury, Council on Federal Financial Relations Affordable Housing Working Group - Innovative financing models, 6 April 2016, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/CFFR-Affordable-Housing-Working-Group>, viewed 1 December 2016.

Conduct of the inquiry

1.15 The details of the inquiry were published on the committee's website at the link given below. A media release announcing the inquiry and seeking submissions was issued on 13 May 2015.

1.16 Eighty six submissions and five exhibits were received and are listed at Appendix A. The committee held public hearings on 26 June 2015 in Canberra, 6 and 7 August 2015 in Sydney, 12 August 2015 in Canberra, 14 August 2015 in Melbourne, and 21 August and 25 September 2015 in Canberra. The witnesses who appeared are listed at Appendix B. The submissions and transcripts of the public hearings are available on the committee's website at: www.aph.gov.au/HomeOwnership.

2

Key issues raised in the inquiry

Background

2.1 The main issues canvassed throughout this inquiry included house price trends and affordability, taxation policies, supply and demand drivers and constraints, investor activity, and the desirability of a coordinated housing strategy.

2.2 Housing affordability has been reviewed by the Productivity Commission in 2004[1], by the Senate Select Committee on Housing Affordability in Australia in 2008[2], and in the May 2015 report of the Senate Economics References Committee on housing affordability.[3] The committee did not wish to in any way duplicate the work of these earlier inquiries but to focus instead on the issues that directly impact on home ownership.

Home ownership

Affordability

2.3 The issue of housing affordability and its impact on home ownership was discussed by a number of contributors to this inquiry. The Treasury informed the committee that both the ratios of the median dwelling price to household disposable income and average incomes to mortgage repayments on an average loan indicated a broadly stable level of

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1 Productivity Commission, *Report no 28, First Home Ownership*, March 2004.

2 Senate Select Committee on Housing Affordability in Australia, *A good house is hard to find: Housing affordability in Australia*, June 2008.

3 Senate Economics References Committee, *Out of reach? The Australian housing affordability challenge*, May 2015.

affordability over the past 20 years:

> … if you look at general measures of affordability, this is something that we monitor all the time. But, in general terms, affordability is remaining broadly around the level of the average of the last couple of decades.[4]

2.4 The Treasury also submitted that 'while the ratio of prices to income is currently high, low interest rates mean that mortgage affordability is a little better than the average level experienced since 2000.'[5]

2.5 Housing Industry Association (HIA) had a somewhat different perspective on this issue however and stated in its submission that a growing population combined with supply constraints has negatively impacted on affordability and restricted housing choices for many people.[6]

2.6 HIA also took the view that the level of infrastructure in the Sydney market in particular has reduced housing affordability by failing to keep pace with inherent demand.[7]

2.7 The Australian and New Zealand Banking Group Limited (ANZ) agreed that Sydney is now an expensive market although does not describe it as a bubble.[8]

2.8 Mr John Symond takes the view that affordability for first time buyers is severely impacted by delays in local government approvals for new developments and the range of indirect taxes that apply to new houses.[9]

2.9 The National Affordable Housing Consortium states in its submission that whereas home ownership rates in Australia are high among developed nations, they have been declining across all age groups other than the oldest cohort for over a decade.[10] The Consortium further submits:

> … many of the drivers of the declining rates of home ownership are hard to measure and may be impossible to fix, or even undesirable to fix… A wide range of economic, tax and social policy arrangements seek to underpin, or are based upon the assumption of continued high levels of home ownership. The

4 Ms Jenny Wilkinson, Acting Deputy Secretary, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 8.

5 The Treasury, *Submission 41*, p. 11.

6 Housing Industry Association (HIA), *Submission 27*, p. 6.

7 Dr Harley Dale, Chief Economist, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 13.

8 Mr Graham Hodges, Deputy Chief Executive Officer, Australian and New Zealand Banking Group Limited (ANZ), *Committee Hansard*, Melbourne, 14 August 2015, pp. 18-19.

9 Mr John Symond, *Committee Hansard*, Sydney, 7 August 2015, pp. 24-25.

10 National Affordable Housing Consortium, *Submission 13*, p. [2].

> falling rate of home ownership has implications across economic and social policy.[11]

2.10 Mr Saul Eslake contended that the current policy framework combined with lower interest rates benefits existing home owners to the detriment of younger people who may be seeking to enter the market:

> The combined effects of lower interest rates, more readily available mortgage finance and federal, state and local taxation and housing policies have been capitalised into housing prices for the particular benefit of those who already owned one or more properties before these trends became entrenched. Given what we know about property ownership among different age groups, this amounts to a significant redistribution of wealth from younger households to older ones.[12]

2.11 In response to questioning from the committee around the first home buyer loan share, The Treasury stated that this was at around the four per cent level from 2011 to 2015:

> They go up and down a bit from one quarter to the next… but, if you look back 20 years, loans to first home owners were sitting at maybe five per cent. So it is a little lower than it was maybe 20 years ago, but we are not seeing, in the data, any significant changes in recent periods which move it out of the area that it has moved between.[13]

2.12 The Australian Bankers' Association (ABA) submits that any policies that seek to increase the purchasing power of the house buyer will only drive up house prices and reduce affordability. The ABA's view is that supply and not demand must be increased to deal with affordability issues, and that this will necessarily require better coordination between State and Federal Governments.[14]

2.13 Supply and demand issues, and the potential policy responses, are discussed later in this chapter.

2.14 The ABA expressed the view that first home buyers are still active in the market.[15] The ABA further commented that based on household financial metrics such as the debt-to-asset ratio, the debt-to-income ratio or the

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11 National Affordable Housing Consortium, *Submission 13*, p. [2].

12 Mr Saul Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 61.

13 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 21.

14 Australian Bankers' Association (ABA), *Submission 14*, p. 2.

15 Mr Tony Pearson, Executive Director, ABA, *Committee Hansard*, Sydney, 6 August 2015, p. 36.

income-to-debt ratio, existing home owners are well placed to service their mortgages if interest rates increase.[16]

2.15 Recent data compiled by Credit Suisse places Australia among the highest in the world in terms of household wealth, with wealth per adult in 2016 calculated at USD 375,573 (as a comparison this figure is USD 288,808 in the United Kingdom and USD 344,692 in the United States) and making up 2.5 per cent of the world's wealth.[17]

2.16 As outlined by the ABA, dwelling ownership accounts for the majority of household assets (58%) in Australia.[18]

2.17 With regard to home ownership rates, the Australian Bureau of Statistics (ABS) informed the committee that their survey of income and housing has indicated a decline from 71 per cent to 67 per cent between the 1994 and 2011-12 survey.[19]

2.18 Evolve Housing commented that one avenue to addressing affordability, and the supply of social housing, could be through a mixed tenure model. In this model, existing government owned houses are redeveloped into higher density dwellings with a portion of these new properties retained as social housing and the rest being sold to the private sector.[20]

2.19 Improving housing affordability in Australian cities is a key focus of work being undertaken by the Assistant Minister for Cities and Digital Transformation, the Hon Angus Taylor MP. As part of this work, the Government is developing City Deals, which aim to ensure that 'investments in infrastructure be linked to increases in the supply of housing and greater access to more affordable housing.'[21] The Government has committed to early City Deals for Townsville, Launceston and Western Sydney.[22]

2.20 The committee notes that an Affordable Housing Working Group was announced on 7 January 2016, following a request from Treasurers at a

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16 Mr Pearson, ABA, *Committee Hansard*, Sydney, 6 August 2015, pp. 38-39.

17 Credit Suisse, *Global Wealth Databook 2016*, Table 2-1, available at <http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=AD6F2B43-B17B-345E-E20A1A254A3E24A5>, viewed 1 December 2016.

18 ABA, *Submission 14*, p. 5.

19 Mr David Zago, Assistant Statistician, Australian Bureau of Statistics (ABS), *Committee Hansard*, Canberra, 26 June 2015, p. 41.

20 Ms Andrea Galloway, Chief Executive Officer, Evolve Housing, *Committee Hansard*, Canberra, 21 August 2015, p. 3.

21 The Hon Angus Taylor MP, Assistant Minister for Cities and Digital Transformation, 'New City Deal approach will deliver more affordable homes', *Media Release*, 12 September 2016.

22 Department of the Prime Minister and Cabinet, *City Deals*, April 2016, <https://cities.dpmc.gov.au/city-deals>, viewed 7 December 2016.

Council on Federal Financial Relations (CFFR) meeting in October 2015 for further work on housing affordability. According to The Treasury, the working group is focussed ‘primarily on investigating ways to boost the supply of affordable rental housing through innovative financing models’.[23]

House price cycles and regional variation

2.21 The committee received evidence from a number of contributors that house price cycles have always existed in Australia and are largely regionally based. In addition, although evidence to the inquiry indicates a spike in investor activity in recent years in certain respects, it appears that this has been largely confined to major metropolitan areas where the prices are highest, most notably Sydney and Melbourne.

2.22 The Treasury comments in its submission that national data on house prices disguise the marked differences that exist between the states and that price growth has been concentrated in Sydney, and to a lesser extent in Melbourne.[24]

2.23 By comparison, the most recent RBA Statement on Monetary Policy reports that there has been a ‘noticeable decline in rents and prices in Perth’, as a consequence of a decline in population growth, an increase in unemployment and persistently high dwelling completions. The RBA further notes:

> In some residential markets, such as apartment markets in inner-city areas of Melbourne and Brisbane, there are concerns that the significant new supply of dwellings in the pipeline will outpace growth in demand for housing and place downward pressure on rents and prices.[25]

2.24 The Treasury noted that the current price cycle is not that unusual or more exacerbated than previously. The Treasury commented:

> If you look at Australia overall and if you look over a long period, it is not unusual to have cycles in house prices. Dwelling prices have always exhibited a reasonable degree of cyclicality… Growth over the year to, I think, the middle of 2014 peaked at around about 12 per cent. That is certainly a lower peak than a couple of

23 The Treasury, *Council on Federal Financial Relations Affordable Housing Working Group - Innovative financing models*, 2 December 2016, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/CFFR-Affordable-Housing-Working-Group>, viewed 5 December 2016.

24 The Treasury, *Submission 41*, p. 8.

25 RBA, *Statement on Monetary Policy*, November 2016, p. 32.

> the previous cycles. It has come down and is currently sitting at about nine per cent.[26]

2.25 Master Builders Australia also remarked that house prices in the Sydney market had increased but were not showing abnormal trends for the most part:

> I think there are certainly different pockets within the Sydney rental market where perhaps you could argue there is speculation and potentially a housing bubble. I would contend, when you look at statistics, that they would tend to be more at the higher end as opposed to the mainstream housing. Yes, house prices in Sydney have increased, but it is not unusual when compared to other cycles if you look at the mainstream.[27]

2.26 The Reserve Bank of Australia (RBA) also commented that there has not been strong growth outside of Sydney and Melbourne:

> … outside of Sydney and Melbourne there really has not been a huge amount of strong growth. Individual locations are related; people can make choices to move to cheaper areas, should they want to do so, so there is some connection between all the different geographic markets. But each of those markets is subject to its own pressures and different supply-and-demand fundamentals. So you will get different outcomes in different areas.[28]

2.27 ANZ Bank also remarked that house prices in Sydney had indeed increased rapidly over 2014-2015 but had in fact been quite static from 2000-2011.[29]

2.28 The ABA submits that marked price cycles are a feature of the Australian housing market and that although there have been two episodes of post-GFC national price declines, these were followed by strong rebounds. The ABA further states that the latest strong price growth is consistent with historical cycles.[30]

2.29 LF Economics takes a somewhat different view of the current housing market, arguing that Australia is currently experiencing a speculative housing bubble and that 'the growth of housing prices has completely

26 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 2.

27 Mr Wilhelm Harnish, CEO, Master Builders Australia, *Committee Hansard*, Canberra, 21 August 2015, p. 26.

28 Dr Luci Ellis, Head, Financial Stability Department, Reserve Bank of Australia (RBA), *Committee Hansard*, Sydney, 6 August 2015, p. 17.

29 Mr Hodges, ANZ, *Committee Hansard*, Melbourne, 14 August 2015, pp. 18-19.

30 ABA, *Submission 14*, Appendix 3: *Key truths on housing in Australia – Economic Report*, p. [3].

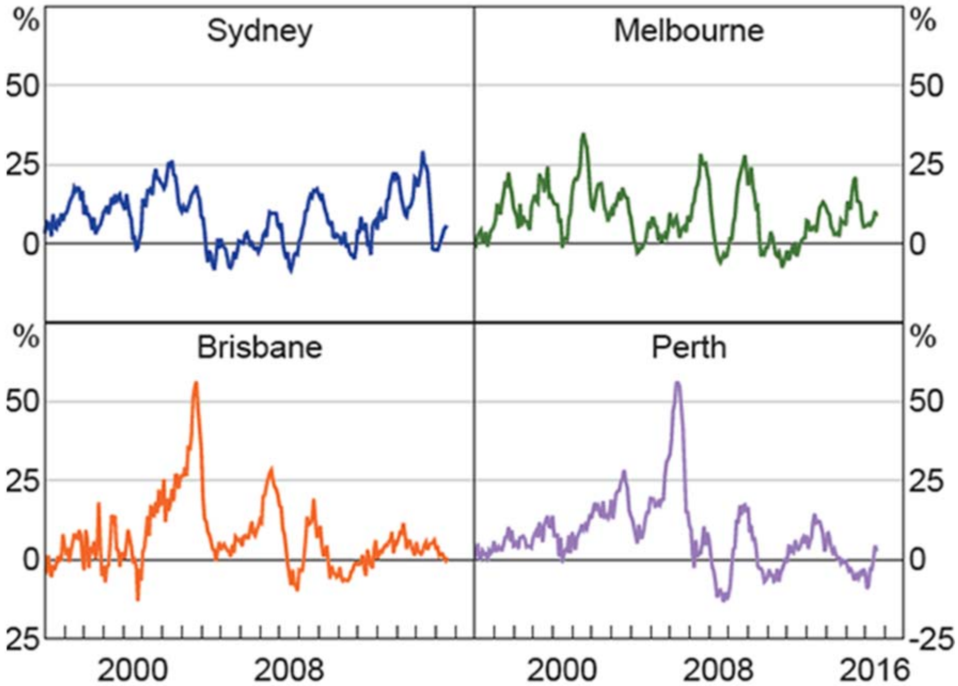
outstripped all economic fundamentals except for the expansion of household debt'.[31]

2.30 Notably also, the RBA commented in its November 2016 Statement on Monetary Policy that:

> Notwithstanding the recent strengthening in housing market conditions in Sydney and Melbourne, overall conditions in the established housing market have eased relative to mid last year. Housing price inflation remains below the peaks in 2015.[32]

2.31 The graph released by the RBA in October 2016, shown in Figure 1, reflects these recent house price trends.

Figure 1 Recent housing price growth: six-month-ended annualised, seasonally adjusted



Source *RBA, Financial Stability Review, October 2016, p. 18.*

2.32 Further to this, HIA's Affordability Report for the September 2016 quarter states that in 'Australia's capital cities, affordability improved by 0.5 per cent during the September 2016 quarter and was 2.7 per cent more favourable than a year earlier.'[33] HIA reported that, in Sydney, 'affordability improved by 1.5 per cent during the September 2016 quarter and was 2.6 per cent more favourable than a year earlier'.[34] HIA further states in this report:

31 Mr David Lindsay, LF Economics, *Committee Hansard*, Sydney, 7 August 2015, p. 31.

32 RBA, *Statement on Monetary Policy*, November 2016, p. 31.

33 HIA, *Affordability Report*, September 2016 Quarter, p. 2.

34 HIA, *Affordability Report*, September 2016 Quarter, p. 4.

> During the September 2016 quarter, affordability improved in six of the eight capital cities. The biggest improvement was in Darwin (+7.8 per cent), followed by Hobart (+7.6 per cent) and Perth (+7.5 per cent). Two of the capital cities experienced less favourable conditions in affordability during the quarter: Melbourne (-2.6 per cent) and Canberra (-1.3 per cent) …The overall improvement in affordability across Australia during the September 2016 quarter is the result of the reduction in the RBA's official cash rate from 1.75 per cent to 1.50 per cent at the beginning of August, part of which was passed on to mortgage borrowers through a lower discounted variable mortgage rate which had the effect of lowering mortgage repayments.[35]

Investor activity

2.33 The impact of investor activity on house prices and on the ability of first time buyers and owner occupiers to compete in the market was also a key area of interest for the committee in this inquiry.

2.34 The RBA commented that the current conditions are very favourable for investors who will typically have more equity and borrowing capacity than first time buyers and other owner occupiers.[36]

2.35 Genworth Mortgage Insurance, quoted data from CoreLogic that 60 per cent of the loans in the Sydney market are for investors, compared with 50 per cent for Australia overall.[37]

2.36 Mr John Symond expressed concern at the same hearing in Sydney that investors were borrowing too heavily in the current low interest rate environment.[38]

2.37 Mr Eslake expressed the view that increased investor activity adds to the risks of instability in house prices and that this has potentially serious consequences for the Australian economy and the financial system if price movements become high enough.[39] He stated that this was 'not an immediate risk but one that I think will increase over the longer term if house prices continue to rise and the proportion of the housing stock owned by investors continues to increase'.[40]

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35 HIA, *Affordability Report*, September 2016 Quarter, p. 2.

36 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 2.

37 Ms Ellen Comerford, CEO, Genworth Mortgage Insurance, *Committee Hansard*, Sydney, 7 August 2015, p. 5.

38 Mr Symond, *Committee Hansard*, Sydney, 7 August 2015, p. 24.

39 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 62.

40 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 62.

2.38 The Urban Development Institute of Australia (UDIA) is less concerned however about investor activity and its impact on the market. UDIA stated that the idea of lower interest rates allowing investors to out-compete owner occupiers is overblown. UDIA further commented that there is still a minority of investors in the market and that they are still for the most part negatively geared and thus constrained by the losses made on their properties.[41]

2.39 The RBA also commented that although lower interest rates will result in a fewer number of investors who negatively gear properties, the tax data indicate that people continue to do so.[42]

2.40 The Property Council of Australia commented that most property investors are spread throughout the community and are not high income earners but people in middle-income brackets who have a greater affinity for property as an investment than shares or other types of assets.[43]

2.41 The Treasury expressed the view that whereas investor activity relative to that of owner occupiers was both higher and more cyclical in Sydney and Melbourne, it was broadly constant in the rest of the country.[44] The Treasury further commented that the share of investor housing in new dwellings has varied over time and in different regions but is still around a broadly similar mean.[45]

2.42 The Property Council of Australia submits that whereas ABS data indicate that property investors mostly invest in existing housing, they also finance a significant proportion of new dwelling construction:

> Property Council commissioned research has shown that around 27 per cent of all loans for the construction of new housing in 2014 were to investors. This proportion has remained relatively constant over the last 30 years. Investment loans for new housing grew at a significant rate after the reintroduction of negative gearing concessions in late 1987. In this regard, the popular depiction of the declining amount of investor loans committed to new housing construction relative to the total value of housing finance for established properties is highly misleading.[46]

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41 Mr Liam Foley, Policy Advisor, Urban Development Institute of Australia (UDIA), *Committee Hansard*, Canberra, 21 August 2015, pp. 20-21.

42 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 11.

43 Mr Kenneth Morrison, Chief Executive, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 10.

44 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 5.

45 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 12.

46 Property Council of Australia, *Submission 40*, p. 11.

2.43 The RBA commented that the proportion of investor loans for dwelling finance, currently about one third of existing housing loans, will necessarily rise in the future with increased investor activity. The RBA further remarked that first home buyers are also now increasingly entering the market as investors.[47]

2.44 The RBA also commented that the contribution of investors to new construction had not diminished and that investors were 'disproportionately represented in the new construction sector—in particular, units.'[48]

2.45 The committee queried The Treasury whether investors were prepared to accept lower rental yields due to rising house prices because of the capital gains tax (CGT) discount on investment properties (explained in detail later in the chapter). The Treasury responded that this was not certain and also that it was not clear that the reduced return from investment properties was any worse than other types of investment:

> It is not clear to me that there has been a deterioration in the return on investments in rental properties compared with other investments that investors could take… I think the general point that is important to have in mind is that yes, you want to look at rental yields in an absolute sense and their trends over time, but you also want to be thinking about how they are performing relative to other investments that an investor could make.[49]

2.46 The Australian Prudential Regulation Authority (APRA) has previously informed the committee that subdued income growth combined with increased house prices and household debt, historically low interest rates, and strong competition were contributing to a heightened risk in the property market. This led to APRA's decision in December 2014 to introduce a 10 per cent benchmark for growth in investor lending by Authorised Deposit-Taking Institutions (ADIs).[50]

2.47 Following the introduction of APRA's benchmark, a number of banks made the commercial decision to introduce an 80 per cent Loan to Value Ratio (LVR) cap for investor loans.[51]

47 Mr Christopher Aylmer, Head, Domestic Markets Department, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 15.

48 Mr Aylmer, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 15.

49 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 13.

50 House of Representatives Standing Committee on Economics, *Review of the Australian Prudential Regulation Authority Annual Report 2014 (Third Report)*, December 2015, pp. 8-9.

51 See: G. McKenna, An Australian bank has finally made the first move to clamp down on housing investors, *Business Insider*, 21 May 2015, <http://www.businessinsider.com.au/australian-banks-have-finally-made-their-first-move-to-clamp-down-on-housing-investors-

2.48 APRA stated in its evidence to this inquiry that most lending institutions were now meeting this requirement.[52] However, the committee notes the statement by the RBA in November 2015 that there had been very large upward revisions to the value of investor loans outstanding over the previous six months, resulting in the increase of this value by around $50 billion, or 10 per cent.[53]

2.49 ANZ Bank was asked by the committee to comment on whether this restriction on lending growth for investors would have any impact on house affordability. ANZ responded that it was too early to tell because there had never been a quantitative restriction on lending previously:

> This is going to be an interesting period when there may be investors who would like to get an investment loan from the banks but the banks are not overly happy to lend it, because they have to meet these quantitative restrictions. So, I think we are in an unknown area here, but I presume it will mean that some investors will not be able to borrow as much as they might like. I presume it will force some investors outside the regulated market into the non-regulated market.[54]

2.50 LF Economics criticised APRA for not taking action sooner to stem the growth of housing credit and queried the basis on which the 10 per cent metric for a lending growth restriction had been chosen. LF Economics remarked that this limit was too high as it will lead to rising debt to income and debt to GDP ratios, given that incomes are rising at only two to three per cent annually and nominal GDP growth is similar.[55]

2.51 LF Economics further commented that rising interest rates could precipitate a 'fire sale' by investors who are heavily leveraged, the effect of which would be exacerbated if unemployment was also rising.[56]

2.52 At the public hearing on 18 March 2016 as part of the committee's review of the 2015 APRA annual report, the Chairman remarked in his opening statement that APRA's supervisory work on lending standards for

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2015-5>, viewed 2 December 2016; C. Yeates, Westpac caps LVRs on investor mortgages at 80 percent, *The Sydney Morning Herald*, 8 July 2015, <http://www.smh.com.au/business/banking-and-finance/westpac-caps-lvrs-on-investor-mortgages-at-80pc-20150707-gi6zj7.html>, viewed 2 December 2016.

52 Mr Wayne Byres, Chairman, Australian Prudential Regulation Authority (APRA), *Committee Hansard*, Sydney, 6 August 2015, p. 22; Mr Brandon Khoo, Executive General Manager, APRA, *Committee Hansard*, Sydney, 6 August 2015, p. 30.

53 Dr Philip Lowe, Deputy Governor of the RBA, *Speech: Remarks at FINSIA Regulators Panel,* see: <http://www.rba.gov.au/speeches/2015/sp-dg-2015-11-05.html>.

54 Mr Hodges, ANZ, *Committee Hansard*, Melbourne, 14 August 2015, p. 20.

55 Mr Soos, LF Economics, *Committee Hansard*, Sydney, 7 August 2015, p. 32.

56 Mr David, LF Economics, *Committee Hansard*, Sydney, 7 August 2015, p. 33.

housing would continue in 2016. He further commented that housing lending is still growing at a solid rate of seven per cent but that new lending has shifted away from investors, from approximately 40 to 35 per cent, and towards owner occupiers.[57]

2.53 The APRA Chairman further remarked however that constraints on investment lending have not reduced the overall supply of credit. He stated:

> … the total speed of growth of credit to the housing sector has actually run pretty much unchanged for the last six months. There is this substitution of owner-occupiers for the investors that may not be as prevalent any more. But total housing finance is not actually greatly changed from where it was six months ago or 12 months ago.[58]

2.54 Recently, APRA has stated that constraints on investment lending have been broadly effective:

> Investor lending has now slowed significantly. We said 10 per cent was our benchmark. Currently, it is only running at about five per cent. [59]

2.54 The committee notes that APRA's actions in December 2014 appear to have been successful in addressing investor demand, and that APRA has the capacity to act further in this area should it deem conditions appropriate.[60]

Views of the housing market

2.55 There are opposing views on the current status of the Australian housing market and whether there is in fact a 'bubble'. There are clearly some pockets of the market, particularly in Sydney and Melbourne, where prices may be inflated. However, this is not a reflection of the Australian housing market as a whole and does not therefore affect the majority of Australians.

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57 Mr Wayne Byres, Chairman, APRA, *Committee Hansard*, Canberra, 18 March 2016, pp. 2, 14.

58 Mr Wayne Byres, Chairman, APRA, *Committee Hansard*, Canberra, 18 March 2016, p. 9.

59 House of Representatives Standing Committee on Economics, *Review of the Australian Prudential Regulation Authority Annual Report 2015 (Second Report*), November 2016, p. 15.

60 In its December 2014 letter to ADIs, APRA outlines a range of further measures that could be applied as market conditions and lending standards change. See: House of Representatives Standing Committee on Economics, *Review of the Australian Prudential Regulation Authority Annual Report 2014 (Second Report)*, Appendix B – Letter from APRA to all ADIs (9 December 2014), May 2015, pp. 32-5.

2.56 It must be noted also that the data on house price trends are lacking from the perspective that they do not take account of the cost of owning a home such as home improvements and renovations.

2.57 A further issue that has an impact on housing prices and affordability is stamp duty 'bracket creep' which is discussed in a later section of this chapter.

2.58 The committee notes that the rates of home ownership and investment in housing have remained broadly steady for many decades and that the current price cycle in the housing market across the nation overall is not inconsistent with historical trends.

2.49 In addition, the RBA has indicated in its November 2016 statement on monetary policy that 'overall conditions in the established housing market have eased relative to mid last year. Housing price inflation remains below the peaks in 2015.'[61]

2.50 HIA has also published figures showing improved affordability in most of the major capitals including Sydney for the September quarter of 2016.[62]

2.51 Investors are an important component of the property market and its expansion and Australians have had a long and successful history of investing in housing. The committee notes that APRA is monitoring and regulating investor lending with the aim of alleviating risks to the financial sector and the wider economy.

Negative gearing

Background

2.52 Negative gearing is part of the Australian tax system that allows losses made on investments, including property, to be deducted against other income and thereby reduce the tax liability of the investor. As indicated in the Tax Discussion Paper however, this particular feature of the tax system is not specific to investment properties:

> Contrary to popular perception, negative gearing is not a specific tax concession for taxpayers with investment properties — it is simply the operation of Australia's tax system allowing deductions for expenses incurred in producing assessable income. Expenses incurred in producing income from other types of

61 RBA, *Statement on Monetary Policy*, November 2016, p. 31.

62 HIA, *Affordability Report*, September 2016 Quarter, p. 2, 4.

> investments are also generally deductible. This includes interest costs incurred when borrowing to purchase assets like shares.[63]

2.53 A property is said to be negatively geared when the costs exceed the net income from the property. As outlined in the Tax Discussion Paper:

> A property is said to be negatively geared when the mortgage interest repayments exceed the net income from the property (rental income minus other deductible expenses such as property agent fees, insurance, gardening, land tax and depreciation). In these circumstances the taxpayer can apply this 'loss' against their other income, such as salary and wages. This strategy is only financially effective where the taxpayer expects a future capital gain more than offsetting this 'loss'.[64]

2.54 The deduction of losses arising from negatively geared investments has been a feature of the Australian taxation system since the Commonwealth introduced uniform personal income taxation in the mid-1930s.[65]

2.55 For a brief period starting in July 1985, the Government quarantined negative gearing thus prohibiting rental property losses from being used to reduce tax on other sources of assessable income.[66] This was in response to recommendations of the Draft White Paper on 'Reform of the Australian Tax System', published in June 1985.[67]

2.56 This decision was reversed in July 1987 due to concerns that rental prices were being pushed up, and that the tax benefit to high income earners from negative gearing was effectively offset by other tax reform measures.[68] Since 1987, negative gearing has continued to be allowed on all types of investments.[69]

Discussion

2.57 This feature of the tax system was a topic of discussion during this inquiry.

2.58 In response to questions on notice from the committee on the impact on rental prices of quarantining negative gearing from 1985 to 1987,

63 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 64.

64 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 64.

65 *Income Tax Assessment Act 1936* (Cth). The (current) *Income Tax Assessment Act 1997* (Cth) is a plain English rewrite of the previous Act.

66 *Income Tax Assessment Act 1936* (Cth), pt. 3, div. 3, subdiv. G.

67 The Treasury, *Reform of the Australian Taxation System: Draft White Paper*, June 1985, pp. 42, 46.

68 The Hon. Mr Michael Duffy, Minister for Trade Negotiations, *House of Representatives Hansard*, 29 October 1987, p.1720.

69 R. Hanegbi, 'Negative Gearing: Future Directions', *Deakin Law Review*, 2002, vol. 7, no. 2, pp. 349, 355.

The Treasury commented that rents did increase slightly faster than general prices during that period but continued to do so for two years after this tax mechanism was reinstated.[70]

2.59 Mr Eslake argued that there was no historical evidence that the abolition of negative gearing had led to a landlord strike or, other than in Sydney and Perth, higher rents. He stated:

> Even if you accept that there would now be a landlord strike in the event that negative gearing or the capital gains tax discount were changed—that landlords would all of a sudden sell their properties—who would they sell them to? … They could only sell those properties to would-be home buyers who had been hoping to become home owners but had not been able to compete successfully with investors enjoying tax privileges.[71]

2.60 The RBA emphasised that although the tax system does not discriminate against asset classes in terms of the ability of an investor to negatively gear them, there is a far higher capacity to leverage property than any other type of asset:

> I think the distinction is not that different assets are treated differently; it is just that not all assets offer the prospect of capital gains. And to the extent that you can gear an asset it is treated the same, but it is not feasible to gear all assets to the same extent as can be done for property. It is not that property is treated differently; it is just that the effect is quite particular.[72]

2.61 The ABA remarked that further evidence would be needed to determine whether negative gearing and the CGT discount (discussed in the next section) were encouraging speculative behaviour in the property market.[73]

2.62 Mr Eslake is convinced however that negative gearing has increased the number of investors and levels of investment in housing, and thereby made house prices higher than they otherwise would have been.[74]

2.63 The Australia Institute also commented that negative gearing and the CGT discount have driven record numbers of investors into the property market:

> The interaction of these two tax treatments is driving people to invest in residential property in record numbers. Loans for rental properties have been rapidly increasing. They have grown from 16

70 The Treasury, *Submission 41.1*, p. [14].

71 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 64.

72 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 11.

73 Mr Pearson, ABA, *Committee Hansard*, Sydney, 6 August 2015, p. 37.

74 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 66.

> per cent of loans to 40 per cent of loans in the last 23 years, and the influx of investors into the market has increased the demand for and put upward pressure on house prices.[75]

2.64 The committee asked The Treasury to comment on which sections of the population were benefitting most from negative gearing. The Treasury, referred to information in the Tax Discussion Paper[76] that the distribution of people with negatively geared properties follows that of the tax system, that is, the majority are in the middle income bracket.[77]

2.65 Mr Eslake commented that although negative gearing is more commonly used by modest income earners than other mechanisms to reduce tax such as superannuation tax concessions or family trusts, the claims for benefits of negative gearing are five times as prevalent among people in the top tax bracket.[78]

2.66 Changes to negative gearing were advocated by a number of contributors such as a quarantining of the deductions so that they can be made against income from the asset only and not against other income.[79]

2.67 The RBA made the point that 'the combination of negative gearing and concessional taxation of capital gains creates an incentive for people to invest in assets that produce capital gains versus assets that do not.'[80] The RBA further commented:

> Even if negative gearing is not currently required given the current combination of interest rates, the fact that it is available should something goes wrong, should your rental yield not be what you expected and so forth, makes people more comfortable about taking that leverage. So in terms of our financial stability mandate, we think that it is within our mandate to make observations about where in the institutional framework, including the tax system, there might be incentives to engage in more leverage, because it is the leverage piece that is so important for financial stability, both of the financial sector and of the household sector.[81]

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75 Mr Matthew Grudnoff, Senior Economist, The Australia Institute, *Committee Hansard*, Canberra, 21 August 2015, pp. 31-32.

76 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 65.

77 Mr Greg Cox, Principal Adviser, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 15.

78 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, pp. 64-65.

79 Dr Yates, *Committee Hansard*, Sydney, 7 August 2015, p. 43; Professor Gavin Wood, *Committee Hansard*, Melbourne, 14 August 2015, pp. 29-30.

80 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 5.

81 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 5.

2.68 The RBA does not advocate any particular policy position but has expressed the view that tax mechanisms such as negative gearing should not be reviewed in isolation but as part of a holistic review of the whole tax system.[82]

2.69 The ABA commented in this regard that it does not take a position on the merits of these mechanisms, or how they interact, because the evidence is currently insufficient to make any policy prescriptions. The ABA stated:

> Our view was that what we really need is a first-class thorough look at those issues… you would want to have pretty clear evidence of the effects and any problems that might be arising from the interaction of those two taxes [negative gearing and the capital gains tax discount] before you made policy prescriptions for any changes. Our view was that there just did not seem to be hard and fast evidence.[83]

2.70 Peak industry bodies such as HIA and the Property Council of Australia support the retention of negative gearing.[84] The Property Council stated:

> Negative gearing is 100 years old. It has been a fundamental part of the taxation system for as long as we have had the Tax Act… When we look at the different options that have been floated by different parties to modify negative gearing, we can see only disadvantages… One of the advantages that our current system has provided us with is rents which have been modest.[85]

2.71 HIA submits that 'it is important to acknowledge that irrespective of the tax and financing arrangements of individual investors, the greater presence of investors during the current housing market cycle has added to the supply of housing and taken pressure off housing rents.'[86]

2.72 HIA also agrees that if any assessment of negative gearing and the CGT discount was to take place, it must be part of a review of the whole tax system[87] as revising such arrangements in isolation would create additional distortions and inefficiencies in taxation.[88]

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82 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 20.

83 Mr Pearson, ABA, *Committee Hansard*, Sydney, 6 August 2015, p. 35.

84 Mr Morrison, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 9; Mr Shane Goodwin, Managing Director, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 16.

85 Mr Morrison, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 9.

86 HIA, *Submission 27*, p. 29.

87 Mr Goodwin, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 16.

88 Mr Graham Woolfe, Chief Executive, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 17.

2.73 Master Builders Australia was also supportive of negative gearing in its present form and cited some observations made in the final report of the 2009 Henry Tax Review[89] in support of this position:

> '… changing the taxation of investment properties could have an adverse impact in the short to medium term on the housing market… A range of other policies are likely to have a more significant impact on housing supply than tax settings… The tax system is unlikely to be an effective instrument to move housing prices toward a particular desired level and the tax system is not the appropriate tool for addressing the impact of other policies on housing affordability.'[90]

Possible mechanisms to assist owner occupiers

2.74 During the inquiry, the committee queried whether it might be viable to partially restrict negative gearing during times of volatility in the housing market. With this mechanism, the allowable level of deductibility via negative gearing would be reduced by a certain amount if interest rates were lowered, and vice versa, as a means of moderating investor activity and helping to stabilise house prices. The committee further queried whether such an instrument could be operated by the RBA.

2.75 The RBA responded that it would be a surprising idea that parts of the tax system might come under its control and that it was not certain how such an instrument would work. Dr Ellis commented:

> I think the tax system is something that is very hard to change quickly. As we all learn in undergraduate economics about monetary versus fiscal policy, monetary policy has long and variable lags in its effect on the economy but has an advantage that you can change it very quickly, whereas in the tax system, where you have to legislate, where you have a political process, where people only pay tax once a year in many cases anyway, so it is over the course of a year, it is much harder to fine-tune. I guess the hypothetical instrument that you are referring to does rest on the idea that you can fine-tune this and that you know how to fine-tune it. It is not entirely clear to me. We have had 25 years of experience in seeing what happens when we change the interest rate. We have had zero years of experience in seeing what happens when we change an instrument like this.[91]

89 The Treasury, *Australia's Future Tax System Review final report*, Canberra 2010.

90 Mr Harnish, Master Builders Australia, *Committee Hansard*, Canberra, 21 August 2015, p. 28.

91 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 21.

2.76 Other contributors to the inquiry also expressed some reservations regarding such a mechanism. Professor Gavin Wood expressed a preference for automatic stabilizers in the market. HIA were not supportive, expressing the view that it may cause distortions in an already complex tax system and possibly steer investors away from housing which would negatively impact future supply. Master Builders Australia commented that such a mechanism would not tackle impediments to supply which it regards as the fundamental issue affecting home ownership and affordability.[92]

2.77 The RBA was further queried at one of its biannual public hearings with the committee whether instruments designed to counter potential volatility in the housing market were feasible. The Governor responded:

> … I, as a matter of principle, am open to the use of various new instruments. We might need to keep in mind that you have to think about who is going to wield them, how and to what end, and we, of course, do not have any experience in how these things would work. All those would be important considerations in getting too optimistic that we can tweak the property market as we would like with various new instruments. I would counsel caution—not undue negativity. But I would be cautious in that space, as I think I have said before.[93]

2.78 The committee also queried whether access to superannuation funds could be allowed to assist first home buyers.

2.79 The Treasury expressed the view that this would be a policy issue for government but commented that this is not the primary purpose of superannuation:

> One part of the thinking is that super is about retirement income not about investing in housing, not about paying off debts and not about funding education. They are completely legitimate investments and very legitimate areas of policy consideration, but the current settings of super are that it is about retirement income. That is why we have the preservation requirements.[94]

2.80 The committee queried whether this concern could be alleviated by quarantining the portion of the superannuation used to purchase the home so that it remained within the fund.

92 Professor Wood, *Committee Hansard*, Melbourne, 14 August 2015, p. 32; Mr Goodwin, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 19; Mr Harnish, Master Builders Australia, *Committee Hansard*, Canberra, 21 August 2015, p. 30.

93 Mr Glenn Stevens, Governor of the RBA, *Committee Hansard,* Sydney, 12 February 2016, p. 13.

94 Mr Paul Tilley, Acting Deputy Secretary, Revenue Group, The Treasury, *Committee Hansard,* Canberra, 25 September 2015, p. 2.

2.81 The Treasury remarked that this would not be allowed under the current law as the transaction would be a related party transaction and not an arm's length commercial investment:

> If a superannuation fund can invest in housing, as Mr Kelly was just asking, that is not a problem. The issue is if it is a related party transaction and is not returning income, to the super fund, to provide for the retirement income by the individual. You are talking about owner-occupied housing; you are investing in your own home, within the super fund. The super fund would hold the asset. On the face of it, that is okay as long as it is a genuine commercial investment and is not a related party. Investing in your own house is going to be, under the current legislation, not allowed.[95]

2.82 The Treasury further commented that allowing access to superannuation would likely put upward pressure on house prices, which was also an aspect of the debate around the impacts of first home owner's grant.[96]

Conclusions

2.83 The committee supports the maintenance of existing negative gearing arrangements, which have been a feature of the Australian tax system for most of the last century.

2.84 The viability of an instrument that could incrementally regulate or 'fine-tune' negative gearing to counter house price volatility if interest rates change is not certain. The introduction of such a mechanism would have to be very carefully considered to ensure that it did not cause distortions in the tax system or create uncertainty in the housing market.

2.85 The committee notes that APRA has the capacity to act to seek to limit the growth of borrowing by investors, should it deem this to be in the interest of financial stability. APRA acted in this way in December 2014, and may elect to do so again.

2.86 The use of superannuation funds to assist with the purchase of a home is another area of policy that would have to be considered very carefully to ensure that retirement incomes would not be adversely affected.

95 Mr Tilley, The Treasury, *Committee Hansard*, Canberra, 25 September 2015, p. 2.

96 Mr Tilley, The Treasury, *Committee Hansard*, Canberra, 25 September 2015, p. 4.

Capital gains tax

Background

2.87 Capital gains tax (CGT) is a type of income tax that is charged on an individual's net capital gains at their relevant marginal tax rate. CGT is charged on a realisation basis, which means that an asset needs to be sold in order to realise a capital gain or loss.[97]

2.88 Australia did not have a capital gains tax until 1985, when it was introduced by the Hawke government.

2.89 If an individual makes a profit from the sale of an asset, any net gain forms part of the individual's taxable income for that year, which is then subject to income tax. Similarly, if a net loss is incurred, the individual can either use that loss to reduce other capital gains in the current income year, or they can carry the loss forward and apply it against future capital gains.[98]

2.90 CGT is subject to particular rules. As outlined in the Tax Discussion Paper, the realised gain from the sale of an asset by an individual that had been held for more than 12 months is discounted by 50 per cent for tax purposes:

> … individuals can generally discount a realised capital gain by 50 per cent if they have held the asset for more than a year. The 50 per cent discount was introduced in 1999. This replaced the arrangement that had been in operation since 1985 whereby the capital gain to be included in taxable income could be adjusted for price inflation (CPI) since purchase to ensure only real gains were subject to tax.[99]

2.91 This rate applies to a realised gain from an investment property in the same way as any other type of asset that is held for more than 12 months and then sold.[100]

2.92 The introduction of the CGT discount in 1999 was part of a suite of changes implemented as a result of the recommendations of the Review of Business Taxation (the 'Ralph Review'). These changes were intended to 'increase the international competitiveness of Australian business and to

97 ATO, *Capital Gains Tax*, July 2015, <https://www.ato.gov.au/General/Capital-gains-tax/>, viewed 2 October 2015.

98 ATO, *Capital Gains Tax*, July 2015, <https://www.ato.gov.au/General/Capital-gains-tax/>, viewed 2 October 2015.

99 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 63.

100 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 63.

encourage greater investment by Australians.'[101] The changes also aimed to reduce the tax bias towards asset retention, thereby promoting more efficient asset management and improving capital mobility.[102]

2.93 The Re:think Tax Discussion Paper notes that the availability of the CGT discount encourages purchasers to make bigger investments in property by borrowing, in addition to using their own savings because 'larger investments can result in greater capital gains and therefore benefit more from the CGT discount'.[103]

2.94 The CGT arrangements in Australia for investment property are not unique and a number of other countries provide comparable tax concessions and even full exemptions.

2.95 A 2013 OECD report[104] compared the CGT rules for investment properties across a large number of countries including Australia (Table 1). Austria, and Canada apply a 50 per cent CGT discount to the sale of investment property under certain conditions. Notably, a number of countries including Belgium, Czech Republic, France, Germany, New Zealand and the United States, do not apply CGT to the sale of an investment house if specific rules are met.

101 The Treasury, Review of Business Taxation, John Ralph AO (Chair), *A Tax System Redesigned: More Certain, Equitable and Durable*, Final Report, July 1999, p. 14.

102 S. Reinhardt and L, Steel, Department of the Treasury, A brief history of Australia's tax system, *Economic Roundup*, Winter 2006, p. 12.

103 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 64.

104 Harding, M. (2013), *Taxation of Dividend, Interest, and Capital Gain Income*, OECD Taxation Working Papers, No. 19, OECD Publishing, Paris.

Table 1 Calculation of tax payable on capital gains on real property at the individual level as at 1 July 2012

Country	Nominal capital gain on realisation	Longest holding period (yrs)	Proportion included as taxable	Taxable Individual income	Personal tax rate	Personal tax payable	Post-tax Individual income	Combined tax rate
Australia	100.00	1.00	50%	50.00	47%	23.25	76.75	23%
Austria	100.00	35.00	50%	50.00	25%	12.50	87.50	13%
Belgium	100.00	5.00	-	-	-	-	100.00	-
Canada	100.00	-	50%	50.00	48%	23.99	76.02	24%
Czech Rep	100.00	5.00	-	-	-	-	100.00	-
Denmark	100.00	-	100%	100.00	46%	45.50	54.50	46%
Estonia	100.00	-	100%	100.00	21%	21.00	79.00	21%
Finland	100.00	10.00	100%	100.00	32%	32.00	68.00	32%
France	100.00	30.00	-	-	-	-	100.00	-
Germany	100.00	10.00	-	-	-	-	100.00	-
Japan	100.00	5.00	100%	100.00	20%	20.00	80.00	20%
Korea	100.00	10.00	70%	70.00	42%	29.26	70.74	29%
New Zealand	100.00	-	-	-	-	-	100.00	-
UK	100.00	-	100%	100.00	28%	28.00	72.00	28%
USA	100.00	-	-	-	-	-	100.00	-

Source *Harding, M. (2013), Taxation of Dividend, Interest, and Capital Gain Income, OECD Taxation Working Papers, Table 15, p. 43.*

Discussion

2.96 The CGT rate was also the subject of considerable discussion during this inquiry in relation to its impact on the property market and a number of different views were canvassed.

2.97 The Australia Institute favours full abolition of this tax concession, arguing that it is causing speculation in the housing market and distorting behaviour:

> I would still advocate the capital gains tax discount being a prime focus for government attention. It is what is causing the speculation in the market, and its removal would not only remove a tax that is distorting behaviour but also raise revenue for the government. As I said, that revenue could be then used to fund services or lower taxes in other areas.[105]

2.98 Mr Eslake argued that the CGT rate has encouraged further speculative behaviour in the property market when combined with negative gearing and together increased the cost of housing:

105 Mr Grudnoff, The Australia Institute, *Committee Hansard*, Canberra, 21 August 2015, p. 36.

> The halving of the capital gains tax rate in 1999 made negative gearing much more attractive to property investors than it had previously been, by turning it into a vehicle for permanently reducing income tax as opposed merely to deferring it, as it had previously been, and thus had the effect of encouraging more investors into the property market. Since the proportion of taxpayers who have negatively geared properties increased significantly after 1999 to the point where, in the last two years, borrowing for property purchases by investors has exceeded that by owner occupiers, and since over 90 per cent of geared investors purchase established properties, this has also added to the upward pressure on established property prices.[106]

2.99 Mr Andrew Skinner remarked that this mechanism is no longer equitable and should be phased out:

> My suggestion is that it is no longer equitable, and it is no longer consistent with the philosophy of taxing capital gains, to allow a 50 per cent discount after 12 months and a day. So after 12 months and a day you can sell a property, and that is effectively giving you 25 per cent more if you are on the top marginal rate. My suggestion is a sliding scale—a very simple five per cent per year reduction in the amount of capital gains assessable. It starts at 100 per cent and goes down to zero after 20 years of completed ownership. The reason for this is to try, once again, to start levelling the playing field. At the moment the playing field is very disproportional: capital gains are very concessionally taxed, while income is very highly taxed.[107]

2.100 In response to questions about whether current tax arrangements are beneficial to investors but disadvantaging first home buyers, AHURI remarked that the current scheme does favour investors looking for CGT concessions.[108]

2.101 The ABA argues however that there is little evidence that the CGT arrangements are encouraging speculative investment in property:

> Some commentators argue that current CGT arrangements combined with negative gearing encourage speculative investment as deductions are made at the taxpayers' marginal tax rate, but

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106 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 61.

107 Mr Andrew Skinner, *Committee Hansard*, Sydney, 7 August 2015, p. 47.

108 Dr Michael Fotheringham, Deputy Executive Director, AHURI, *Committee Hansard*, Melbourne, 14 August 2015, p. 14.

> gains are taxed at half of that rate. There is little evidentiary support for this view.[109]

2.102 At the public hearing on 6 August 2015, Mr Pearson of the ABA also remarked that there is not enough evidence to support an upward effect of CGT concessions on house prices:

> There are many factors that affect house prices. If I can refer to our submission, one of the key drivers over a very long period of time is interest rates, and I know you have talked a lot about that at the inquiry. If you want to look at factors that drive house prices it is difficult to tease out the effects of tax changes, but one effect that is very clear is the fairly strong cyclical impact of interest rate movements and house prices and also housing activity. Given the strength of that relationship, I think sometimes it would be difficult to identify another factor on top of it that did or did not drive prices at a particular point in time.[110]

2.103 A supplementary submission by the Property Council of Australia to the inquiry (*Australian Housing Investment- Analysis of Negative Gearing and CGT Discount for Residential Property,* Acil Allen Consulting Final Report to Property Council of Australia and Real Estate Institute of Australia) states that:

> Removing negative gearing or the CGT discount altogether for property will dampen investment, diminish rental supply and make it more likely that in the short to medium term, rents and property prices will increase, as investors seek to recover their after-tax rental returns by increasing their before-tax returns… Key to the assessment of any proposed tax changes to property investment is the principle that the same tax rules should apply to all investments. Special tax rules for property investment would drive investment to other assets and would distort investment choices for no sound reason.[111]

2.104 Compass Housing Services submits that there seems to be logic in the argument that 'the important home building sector is kept viable by the current tax treatments and that their removal would have a consequential negative effect on rental property prices due to a decrease in supply'.[112] Compass further argues however that:

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109 ABA, *Submission 14*, p. 19.

110 Mr Pearson, ABA, *Committee Hansard*, Sydney, 6 August 2015, p. 35.

111 Property Council of Australia, *Supplementary Submission 40.3,* p. 8.

112 Compass Housing Services, *Submission 38*, p. 6.

> … a due and proper independent assessment of the current tax system that enables access to benefits to more younger Australians, while boosting supply of new dwellings should be conducted and the government respond accordingly.[113]

2.105 The Treasury noted at the public hearing on 25 September 2015 that the Tax Discussion paper discusses taxation arrangements for investment property (noting that owner occupied housing is fully exempt from CGT):

> The actual tax issue, where there is a divergence from the way other forms of deductions or income are taxed, is on the income side—how we tax the capital gain; the fact that we tax capital gain at 50 per cent. What we try to get to in our discussion paper is that, to the extent that we want to think about the issue of taxation on investment property, the place to start that thinking is around the capital gains tax treatment, not the interest deduction.[114]

2.106 The RBA comments in its submission in relation to CGT and other forms of taxation that 'Australia's treatment of property investors is at the more generous end of the range of practice in other industrialised countries, but not overwhelmingly so.'[115] The RBA also states in its submission that:

> The tax system also advantages owner---occupiers, particularly those with little or no debt: although they cannot deduct mortgage interest repayments from tax as in some other countries such as the United States, neither are they subject to taxation on imputed rent.[116]

2.107 The committee queried the RBA at the public hearing around the possible impacts of removing the CGT discount on the housing market and on the rental market. The RBA noted that while it could not make a quantitative assessment of this impact, a reduced number of investors would likely put downward pressure on house prices and take some people out of rental and into owner occupation. The RBA further commented:

> What the net effect [would be] on rents is hard to say. As we were discussing—not in terms of capital gains but in terms of negative gearing with the earlier questions—it is just very hard to extrapolate from a temporary shift where investors had not had a chance to shift their portfolios to then make an assessment of what the effect of a permanent shift would be.[117]

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113 Compass Housing Services, *Submission 38*, p. 6.

114 Mr Tilley, The Treasury, *Committee Hansard,* Canberra, 25 September 2015, p. 6.

115 RBA, *Submission 21*, p. 23.

116 RBA, *Submission 21*, p. 23.

117 Dr Ellis, RBA, *Committee Hansard*, Sydney, 6 August 2015, p. 18.

Conclusions

2.108 The committee does not support an increase to the rate of capital gains tax on housing. In the committee's view, a tax increase of this kind would be likely to have a negative impact on the housing market and broader economy.

Stamp Duty

Background

2.109 Stamp duty is a tax imposed by state and territory governments on certain types of written documents (known as 'instruments') and some transactions. Stamp duty is normally levied on motor vehicle registration and transfers, insurance policies, leases and mortgages, hire purchase agreements, and transfers of residential and commercial property.[118]

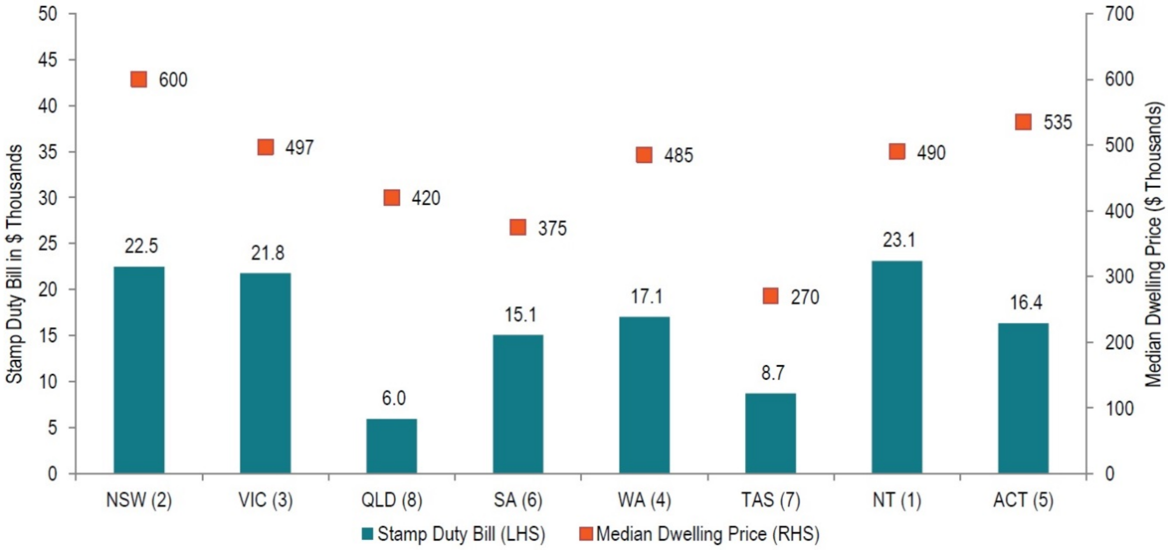
2.110 Stamp duty on conveyances (in other words, the transfer of property) is charged at progressive rate scales in all states and territories, although the specific rates, thresholds and exemptions vary by jurisdiction.[119] This means that, in general terms, the stamp duty charged will increase as the purchase price of a house increases.

2.111 As illustrated in Figure 2, the highest stamp duty on a median price dwelling in June 2015 is charged in the Northern Territory ($23 100), followed by New South Wales ($22 500) and Victoria ($21 800). By contrast, Queensland charges the lowest stamp duty on a median price dwelling ($6 000).

118 Australian Government, Business, *Stamp Duty*, < http://www.business.gov.au/ business-topics/tax-finance-insurance/taxation/Pages/stamp-duty.aspx>, viewed 14 October 2015.

119 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 145.

Figure 2 Stamp Duty bill and median prices for non-First Home Buyer Owner Occupiers, June 2015



Source *Housing Industry Association, Supplementary Submission 27.1, p. 8.*

2.112 Concessional stamp duty rates are available in most states and territories. Stamp duty concessions may be targeted towards first home buyers, owner-occupiers, seniors, new dwellings or vacant land.[120] The various concessions available, by state and territory, are summarised in Table 2.

120 Housing Industry Association, *Supplementary Submission 27.1*, p. 10.

Table 2 Stamp duty concessions by state and territory, July 2015

State	Principal Place of Resident Concession	First Home Buyer (FHB) Concession	Seniors Concession	Concession for New Homes	Notes
New South Wales	No	Yes*	No	Yes*	Applies to FHBs purchasing new homes or vacant land
Victoria	Yes	Yes	Yes	Yes	
Queensland	Yes	Yes	No	No	Additional concessions for FHB purchasers of vacant land
South Australia	No	No	No	Yes*	Partial concession for off-the-plan apartment sales in central Adelaide
Western Australia	No	Yes	No	No	
Tasmania	No	No	No	No	
Northern Territory	Yes*	No	Yes	Yes*	Place of residence concession applies to new homes only. Seniors, pensioners and carers concession also applies.
Australian Capital Territory	No	Yes*	Yes	Yes*	Place of residence concession applies only to new or substantially renovated homes subject to gross income

Source *Housing Industry Association, Supplementary Submission 27.1, p. 10.*

2.113 The Tax Discussion Paper illustrates that Australia is more reliant on stamp duties (particularly stamp duties on conveyances), than other OECD countries, with Australia's taxes on financial and capital transactions as a percentage of total taxation being three times the OECD average. [121] Stamp duties on conveyances are the second biggest source of state tax revenue, generating 24 per cent of state tax revenue.[122]

2.114 The Tax Discussion Paper also notes that given revenue growth from stamp duty is dependent upon property prices and the quantity of transactions, stamp duty on conveyances are highly volatile taxes, having fluctuated by over 50 per cent in recent years.[123]

121 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 145.

122 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 145.

123 The Treasury, *Re:think - Tax Discussion Paper*, March 2015, p. 145.

Discussion

2.115 The continuation of stamp duty was almost universally opposed by the contributors to this inquiry.

2.116 HIA advised the committee that the average stamp duty bill nationwide was around the $30 000 to $40 000 mark. HIA further commented:

> The reason for our focus and many people's focus on stamp duty comes from the fact that it is demonstrated as being the most inefficient tax in the entire Australian tax system. It is a question of national interest to reform that tax, because it would improve living standards, it would generate economic growth and it would boost productivity growth. So the benefits go way beyond just the dollar amount that might come off a new house, for example.[124]

2.117 HIA also remarked that the support in some quarters for GST increases to offset a removal of stamp duty is because of the efficiency of GST collection and the inefficiency of stamp duty collection. HIA advised however that as the GST applies only to new homes, the bulk of this offset would be met by new property transactions.[125]

2.118 Australian Housing and Urban Research Institute Limited (AHURI; Curtin Research Centre) submits that reforming stamp duty would reduce the deposit gap for households that have fallen out of home ownership and help them re-enter the housing market.[126]

2.119 AHURI further states that in addition to impeding access to home ownership, stamp duty limits incentives to transfer housing, restricts labour mobility, and is also a financial disincentive for older Australians to downsize.[127]

2.120 UDIA also states in its submission that stamp duties cause a number of distortions by penalising owners who wish to move, incentivising renovation rather than relocation and thus diverting investment into existing rather than new housing, and preventing retirees from relocating and thereby reducing the release of larger sized housing stock into the market.[128]

2.121 The Property Council of Australia also argues that stamp duty is a highly distortionary tax with very negative impacts on housing supply and on the economy as a whole:

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124 Dr Dale, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 14.

125 Mr Woolfe, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 15.

126 Australian Housing and Urban Research Institute Limited (AHURI) (Curtin Research Centre), *Submission 17*, p. 26.

127 AHURI, *Submission 25*, p. 18.

128 UDIA, *Submission 35*, pp. [11-12].

> The Government's current tax discussion paper, and many other reviews including the Henry Tax Review, note that taxes such as stamp duties on conveyancing are destroyers of jobs and economic opportunities, restricting mobility and acting as a punitive barrier to people seeking jobs or better housing for their growing families, or elderly people seeking to downsize.[129]

2.122 The Property Council of Australia commented that property-specific taxes in Australia represent nine per cent of the total tax intake, versus an OECD average of five per cent.[130] The Property Council also remarked, as an example, that the stamp duty on a house in Melbourne at the median price is 795 per cent higher today than in the mid-1990s.[131]

2.123 Also raised during the inquiry was the issue of 'bracket creep' in relation to stamp duty. The Law Society of New South Wales commented that the stamp duty brackets had been unchanged in New South Wales since 1986 despite increases in property values:

> This issue of bracket creep is unaddressed. New South Wales introduced the rates that currently exist back in December 1986… At that time, back in December 1986, it was said that the maximum rate of 3.5 per cent would apply to homes up to $300,000 worth in value and that, therefore, average homebuyers would not be affected. At that time, by the way, the median home price, I understand, was far below $300,000. It was more around $150,000.[132]

Conclusions

2.124 The committee notes the strong majority view amongst the contributors to this inquiry that stamp duties are inefficient and out-dated. The committee would be supportive of any future cross-government review of stamp duties.

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129 Property Council of Australia, *Submission 40,* p. 13.

130 Mr Morrison, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 1.

131 Mr Morrison, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 1.

132 Ms Joanne Seve, Member, Law Society of New South Wales, *Committee Hansard*, Sydney, 6 August 2015, p. 48.

Land tax

Discussion

2.125 A number of submitters to this inquiry have proposed replacing stamp duty with a broad-based land tax, noting transitional arrangements would need to be taken into consideration.[133]

2.126 The 'Henry Tax Review' (*Australia's Future Tax System* report) in 2010 suggested a number of reforms to potentially improve the operation of land tax, including:

> (a) ensuring that land tax applies per land holding, not on an entity's total holding, in order to promote investment in land development;
>
> (b) eliminating stamp duties on commercial and industrial properties in return for a broad land tax on those properties; and
>
> (c) investigating various transitional arrangements necessary to achieve a broader land tax.[134]

2.127 Many contributors to this inquiry support these recommendations.[135] The Senate Economics References Committee also made a recommendation in its May 2015 report into Affordable Housing 'that state and territory governments phase out conveyancing stamp duties, and that as per the recommendations of the Henry Review, this be achieved through a transition to more efficient taxes, potentially including land taxation levied on a broader base than is currently the case.'[136]

2.128 A 2015 working paper by the Grattan Institute also proposes that a broad-based property levy calculated from the council rates base would provide more stable revenues to the states and could fund the reduction and eventual replacement of stamp duty.[137]

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133 Mr Matthew Ellis, *Submission 8,* p. 14; AHURI, Curtin Research Centre and Bankwest Curtin Economics Centre, *Submission 17,* p. 24; Housing Industry Association, *Submission 27,* p. 28; Australia and New Zealand Banking Group Limited, *Submission 36,* p. 17; Prosper Australia, *Submission 37,* pp. [11, 15]; Mr Benjamin Ward, *Submission 45,* p. [13]; Customer Owned Banking Association, *Submission 48,* pp. 18-19; Shelter WA, *Submission 49,* pp. 2, 7; Mortgage & Finance Association of Australia, *Submission 51,* p. 7; Emeritus Professor Gavin Wood and Associate Professor Rachel Ong, *Submission 52,* p. 1.

134 The Treasury, *Australia's Future Tax System Review final report 2010,* p. 90.

135 Housing Industry Association, *Submission 27,* p. 25; Dr Yates, *Submission 3,* p. 13; Prosper Australia, *Submission 37,* pp. [11-12]; Mr Benjamin Ward, *Submission 45,* p. [13]; Customer Owned Banking Association, *Submission 48,* pp. 18-19.

136 Senate Economics References Committee, *Out of reach? The Australian housing affordability challenge*, May 2015, p. 85.

137 Grattan Institute, *Property Taxes,* July 2015, p. 4.

2.129 Prosper Australia commented that high land prices were causing serious damage and booms and busts would continue unless the tax system was changed. Prosper Australia submits:

> The ideal tool to moderate land bubbles and properly fund infrastructure already exists in the hands of state and territory governments: State Land Tax. Unfortunately, this tax has been so riddled with exemptions and concessional treatments it must be considered dormant. The states show no interest in, for example, removing conveyancing Stamp Duty or Payroll Tax – both very damaging tax bases – and funding this by also removing exemptions from SLT. They say they fear the political consequences.[138]

2.130 In light of this, Prosper Australia recommends that the Commonwealth Government impose a one per cent federal land tax, fully rebateable against state land tax paid, to prevent the economic injury caused by the present system.[139]

2.131 Prosper Australia further stated in the support of this view:

> What we have at the moment is a kind of preventative speculation where developers need to buy a great supply of land in advance. The bigger developers are advantaged in that respect, because there is limited competition within the industry. The more land you can hold, the more you limit the competition of other developers coming in and buying up that land.[140]

2.132 In contrast, the Property Council of Australia does not support recent proposals to replace stamp duty with a broad-based land tax as a revenue source for the states as it suggests the experience of the ACT in attempting to make this transition has been 'politically and economically problematic.'[141]

Conclusions

2.133 The introduction of a broad-based land tax would be a major change to Australia's existing taxation system. Any proposal by state government to make such a change should only be considered in the context of an overall review of property taxation arrangements.

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138 Prosper Australia, *Submission 37,* pp. [14-15]

139 Mr David Collyer, Policy Director, Prosper Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 35.

140 Ms Catherine Cashmore, Vice President, Prosper Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 37.

141 Property Council of Australia, *Submission 40*, p. 8.

Supply and demand drivers

2.134 The supply and demand drivers in the Australian housing market were central to many of the discussions held with the committee during the inquiry and also formed an important component of the submitted evidence.

2.135 The Treasury summarised the fundamental, as opposed to the cyclical, drivers of demand and supply as population growth, migration between regions and the rate of household formation.[142]

2.136 Master Builders Australia expressed the view that the issues of home ownership and housing affordability will not be tackled by the tax system or the interest rate mechanism but by housing supply and its impediments.[143]

2.137 In addition to considering the written evidence to the inquiry on this issue, the committee canvassed the views of a range of witnesses on whether the future supply of housing in Australia can meet the expected demand.

Land release

2.138 A fundamental requirement for future housing supply will be the availability of land for development. The Treasury commented that it is challenging to obtain information on the drivers of supply:

> … what is interesting is that data on new residential land releases does suggest that these have been declining over time. It is notable that land releases have been declining for both capital cities and regional areas. Land release redevelopment zoning is a matter for state and local governments, but it is certainly interesting to us that in a period in which we have had ongoing population growth—and, if anything, slightly higher population growth new residential land sales seem to have been falling in a trend sense.[144]

2.139 The Treasury further commented that development activity has picked up more recently, particularly for medium-density dwellings.[145]

2.140 The ABA emphasises that land release in Australia is insufficient due to structural issues, commenting that Australia ranks poorly in international

142 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 3.

143 Mr Harnish, Master Builders Australia, *Committee Hansard*, Canberra, 21 August 2015, pp. 28, 30.

144 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 4.

145 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 4.

surveys of land availability and that this is reflective of excessively restrictive regulations and developer levies by local governments.[146]

2.141 AHURI comments that the evidence for downward pressure on house prices by an increased release of land is varied and that the connection between land supply and price, and the flow on to eventual house prices, is complex.[147] AHURI further submits however:

> … a well-run and timely land release policy can help with the supply of new houses. When planning controls deliver certainty about what is going to be developed where, and that information is made widely available, then each developer can plan the nature and scale of their developments with confidence.[148]

2.142 The Property Council of Australia also takes the view that land release policies are in need of urgent reform and that the states and territories should be incentivised to do this by the Federal Government.[149]

2.143 In this regard, The Treasury comments that reforms to state and territory land supply policies are not a new area of work as they were addressed by the 2004 Productivity Commission report into first home ownership,[150] and more recently in 2012 through a commitment by the Council of Australian Governments (COAG) to the recommendations of the Housing Supply and Affordability Report (HSAR)[151] on improving planning, development and rezoning processes, and the release of land.[152]

2.144 HIA emphasised that land supply for new houses and for medium-to high-density apartments were different issues. HIA commented that whereas it can take 9 to 15 months to bring greenfield land to market in some cases, infilled or brownfield land supply for apartments of medium and high density can take far longer to secure.[153]

2.145 HIA further noted that there is still an insufficient supply of housing coming to the market because of the considerable constraints in supplying shovel-ready land, such as the high levels of taxation on new housing.[154]

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146 ABA, *Submission 14*, p. 18.

147 AHURI, *Submission 25*, p. 14.

148 AHURI, *Submission 25*, p. 14.

149 Property Council of Australia, *Submission 40*, p. 16.

150 Productivity Commission, *Report no 28, First Home Ownership*, March 2004, Chapter 6.

151 Council of Australian Governments, Housing Supply and Affordability Reform (HSAR) Working Party, *Report: Housing Supply and Affordability Reform*, July 2012, pp. 10-13, 20-21.

152 The Treasury, *Submission 41*, pp. 17-18.

153 Mr Woolfe, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 14.

154 Dr Dale, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 11.

2.146 UDIA regard the Victorian system of land supply as best practice and gave the example of more subdued price growth in Melbourne compared with Sydney as evidence of this.[155]

2.147 The Property Council of Australia concurs with this view:

> Melbourne has done land release and zoning pretty well out of the major cities. Sydney has been appalling; Perth has been okay. Perth and Brisbane are at a stage in their size where, for them, a lot of the challenge is now around urban renewal and urban infill so that is a market transition and also a policy transition that need to be made in those cities.[156]

Dwelling supply

2.148 The Treasury further commented however that although there has been an increase in dwelling completions over time, there has been some flattening and also very different behaviours in different regions:

> The pattern of dwelling approvals and the pattern of dwelling investment vary quite significantly across regions and across time. The red line on this graph [Chart 5, the Treasury, *Submission 41,* p. 6] shows that dwelling completions in Victoria have typically trended up over time in a reasonably consistent way, whereas we have had much less investment, particularly in New South Wales, in the period since about 2004.[157]

2.149 HIA noted that there has been an accumulation of housing undersupply for many years and that despite an increase of dwelling completions to over 200 000 per year at present, the underlying demand has still to be met.[158] The HIA remarked that the longer term average of new dwellings each year needs to be 180 000 to 185 000.[159]

2.150 The National Affordable Housing Consortium cites a projection by The National Housing Supply Council of a shortfall of 663 000 dwellings by 2031.[160]

2.151 ABA submits that only supply side interventions, and not policies on the demand side, will resolve housing affordability issues.[161]

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155 Mr Cameron Shephard, National President, UDIA, *Committee Hansard*, Canberra, 21 August 2015, p. 20.

156 Mr Morrison, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 8.

157 Ms Wilkinson, The Treasury, *Committee Hansard*, Canberra, 26 June 2015, p. 2.

158 Dr Dale, HIA, *Committee Hansard*, Canberra, 21 August 2015, pp. 11-12.

159 Mr Goodwin, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 12.

160 National Affordable Housing Consortium, *Submission 13*, p. [4].

2.152 AHURI concurs that there is an undersupply, but remarked to the committee that there were regional differences in this respect, with the major cities experiencing more of a problem.[162]

2.153 The Property Council of Australia also commented that a mix of dwelling types in the right areas is needed and that house prices will be much higher than they need to be, and much more vulnerable to demand-induced price spikes, without strong housing supply pipelines.[163]

2.154 In contrast, LF Economics do not accept that there is a shortfall in dwelling supply and expressed the view that as rental prices cannot be leveraged, they are more likely to be efficient and be determined by supply and demand interactions.[164] LF Economics commented:

> … the main thing to take away from this is that we should be looking at the trend in rents to determine if there is a shortage. For most of the period of the housing price boom, from 1996 to 2015, rents have been pretty much flat in inflation-adjusted terms, apart from during the GFC and in some mining towns… if there really was a shortage, as the mainstream were saying, we should see a very, very strong increase in rents. In fact, rents would be matching the trend in prices, but that did not occur.[165]

2.155 The Australia Institute's view, which also differed from the majority opinion, was that the problems with supply, vis-à-vis increased investor activity, is primarily a demand side issue that can be tackled accordingly. The Australia Institute stated that there is very little that the Federal Government can do on the supply side but that it can intervene on the demand side through changes to tax arrangements.[166]

Supply constraints

2.156 The committee heard evidence from a number of contributors that state and local government bureaucracies were the main bottleneck in terms of meeting housing supply requirements. UDIA commented in this regard:

> Over recent years, to different degrees in different jurisdictions, some local governments can be extremely hostile to new development and new housing and some others are far more

161 ABA, *Submission 14*, p. 15.

162 Dr Fotheringham, AHURI, *Committee Hansard*, Melbourne, 14 August 2015, p. 14.

163 Mr Morrison, Property Council of Australia, *Committee Hansard*, Melbourne, 14 August 2015, p. 2.

164 Mr Phillip Soos, LF Economics, *Committee Hansard*, Sydney, 7 August 2015, pp. 36-37.

165 Mr Soos, LF Economics, *Committee Hansard*, Sydney, 7 August 2015, pp. 36-37.

166 Mr Grudnoff, The Australia Institute, *Committee Hansard*, Canberra, 21 August 2015, p. 33.

> accommodating. I think, in answer to your question, that local government is probably where the majority of the barriers are to the orderly development of new housing, whether it be infill, greenfields or brownfields locations. Local government is probably where the most angst is found, from the development industry's perspective.[167]

2.157 Mr Symond remarked that the length of time it takes to get approval for housing developments, and the numerous taxes that then apply, is a common concern for developers, and impacts strongly on affordability for first home buyers.[168]

2.158 Mr Symond was also very critical of the lack of any strategy for the orderly supply of housing or collaboration across governments to tackle this issue and meet the demand for housing in different regions in Australia.[169]

2.159 Master Builders Australia also commented that a cross-government approach that deals with the structural issues around development processes, and not a 'one size fits all' approach, was needed.[170]

2.160 Mr Eslake remarked that current state and local government planning laws, and policies around the financing of suburban infrastructure and urban transport, were restricting increases in housing supply.[171]

2.161 UDIA also remarked in its submission that delays in state and local government planning processes are a considerable barrier to housing supply:

> Delayed, complex, and restrictive planning regimes at the state and local government level are often a major barrier to the supply of new housing, and can contribute considerably to the affordability problem by increasing costs. The holding costs involved in the urban development process are often very high, which means that development projects are usually very sensitive to time delays, as they blow out holding costs. Unfortunately planning, zoning and approvals processes in many cities can be extremely slow, adding considerably to the cost of new housing.[172]

2.162 Urban Task Force Australia stated that a better structure and a better approach to infrastructure funding is needed that will spread the costs

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167 Mr Shephard, UDIA, *Committee Hansard*, Canberra, 21 August 2015, p. 21.

168 Mr Symond, *Committee Hansard*, Sydney, 7 August 2015, p. 25.

169 Mr Symond, *Committee Hansard*, Sydney, 7 August 2015, pp. 23, 29.

170 Mr Harnish, Master Builders Australia, *Committee Hansard*, Canberra, 21 August 2015, p. 28.

171 Mr Eslake, *Committee Hansard*, Sydney, 6 August 2015, p. 61.

172 UDIA, *Submission 35*, p. [9].

across a larger number of people and make projects more viable for developers.[173]

2.163 HIA regarded the underinvestment in infrastructure in Sydney as one of the main impediments to the supply of housing failing to meet the inherent demand in that city.[174]

2.164 ANZ Bank also stated that there is an infrastructure deficit in Australia but that State governments have to be fiscally prudent and balance this against future investments:

> … governments are actually sitting on a number of very prospective assets that are already well seasoned or performing, and, in a market where there is significant demand for infrastructure assets coming from investors, they can actually sell those assets at good prices and reinvest those funds to bring on new infrastructure which eventually could also be brought to market… I think it has been a logical response by the state governments to do that asset recycling.[175]

2.165 The committee notes however that the Commonwealth government is being proactive in addressing ongoing housing supply issues. The government is currently undertaking consultation on a 'Smart Cities Plan', which aims to partner with state and territory governments to deliver more affordable housing in the 'right locations to help young people into the housing market and relieve stress on homebuyers.'[176] The Smart Cities Plan states that the Turnbull government 'is boosting the supply of land and housing' through:

- Investments in transport projects that drive urban renewal and housing supply
- City Deals that will create incentives to streamline planning and development approvals, and meet long term housing supply targets, and
- Taking an innovative approach to investment in affordable and social housing—building on the outcomes of our Affordable Housing Working Group.[177]

2.166 The Smart Cities Plan also notes that the United Kingdom has utilised City Deals to prioritise government investment in cities since 2012, and cited

173 Mr Christopher Johnson, Chief Executive Officer, Urban Task Force Australia, *Committee Hansard*, Sydney, 6 August 2015, p. 55.

174 Dr Dale, HIA, *Committee Hansard*, Canberra, 21 August 2015, p. 13.

175 Mr Hodges, ANZ, *Committee Hansard*, Melbourne, 14 August 2015, p. 21.

176 The Hon Angus Taylor MP, Assistant Minister for Cities and Digital Transformation, 'More affordable homes in "right locations"', *Media Release*, 26 October 2016.

177 Department of the Prime Minister and Cabinet, *Smart Cities Plan*, April 2016, p. 24.

the example of the Greater Manchester Deal where 'a housing investment fund has been established, using local and national investment funds to develop 5,000 to 7,000 new homes by 2017'.[178]

Demand pressures

2.167 Dr Judith Yates commented that demand pressures for housing in Australia have arisen due to population and income growth, neither of which will reverse in the future.[179]

2.168 The RBA stated that a fundamental determinant of housing demand is the rate of new household formation, which depends on the interaction between population growth and average household size:

> After relatively stable growth from the early 1990s through to the mid 2000s, Australia's population growth stepped up significantly owing to higher net immigration and, to a lesser extent, a slightly higher rate of natural increase. Average household size, the other component of household formation, has declined markedly since the 1960s and, all else equal, has generated an increase in demand for housing for a given level of population.[180]

2.169 ANZ bank commented in its submission that housing demand is a product of population growth, demographic changes and economic conditions, including interest rates and labour market conditions.[181]

2.170 The Treasury stated that a combination of factors, including access to finance and household confidence in a lower inflationary outlook, had contributed to increased housing demand:

> Once the household sector had confidence that the inflation outlook had changed permanently, the resulting increase in mortgage affordability associated with lower nominal interest rates, combined with innovations in home lending that made it easier for households to borrow, generated an increase in demand for housing and an increase in dwelling prices.[182]

2.171 Dr Nigel Stapledon argued that population growth and interest rates have had a far stronger effect on housing demand and increased house prices than taxation policies.[183]

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178 Department of the Prime Minister and Cabinet, *Smart Cities Plan*, April 2016, p. 23.

179 Dr Yates, *Committee Hansard*, Sydney, 7 August 2015, p. 39.

180 RBA, *Submission 21*, p. 13.

181 ANZ, *Submission 36*, p. 1.

182 The Treasury, *Submission 41*, p. 10.

183 Dr Nigel Stapledon, *Submission 53*, pp. 4-5.

2.172 AHURI noted that many of the levers that affect demand pressure, such as tax and immigration policies, are under the control of the Commonwealth, whereas the supply side drivers are primarily under state and territory jurisdiction.[184]

Conclusions

2.173 There is no doubt that supply and demand factors underpin almost all aspects of the Australian housing market. Demand for housing is strong in Sydney and Melbourne but notably this is not the case throughout Australia.

2.174 The committee does not support proposals to reduce demand for housing by increasing taxes.

2.175 It is notable that APRA has the capacity to seek to reduce investor borrowing for housing should it deem it appropriate. It took such an action in December 2014. This action appears to have been successful in slowing the rate of growth of investor activity.

2.176 On the supply side, there appears that much could be done and the evidence to this inquiry predominantly indicates a housing undersupply. The principle constraints on this, such as land release and development planning processes, are largely an issue for the State, Territory and Local governments. State and Territory governments need to do more to adequately address land supply and ensure that existing policies and processes are not unnecessarily causing an undersupply.

2.177 Importantly, the Government is working to improve housing affordability through the Smart Cities Plan, which will partner with the states and territories, and local governments to deliver coordinated housing supply solutions that drive national priorities tailored to local needs.[185] The committee welcomes this important initiative.

David Coleman MP
Chair
14 December 2016

184 AHURI, *Submission 25*, p. 12.

185 Department of the Prime Minister and Cabinet, *Smart Cities Plan*, April 2016, p. 5.

A

Appendix A – List of Submissions

Submissions

No.	
1	LF Economics
2	Mr Cameron Murray
3	Dr Judith Yates
3.1	Dr Judith Yates Supplementary Submission
4	Mr Christopher Moore
4.1	Mr Christopher Moore Supplementary Submission
4.2	Mr Christopher Moore Supplementary Submission
4.3	Mr Christopher Moore Supplementary Submission
5	Australian Bureau of Statistics
5.1	Australian Bureau of Statistics Supplementary Submission
5.2	Australian Bureau of Statistics Supplementary Submission
5.3	Australian Bureau of Statistics Supplementary Submission
6	HomeStart Finance

7 Department of the Prime Minister and Cabinet

7.1 Department of the Prime Minister and Cabinet
Supplementary Submission

8 Mr Matthew Ellis

9 Affordable Housing Party of Australia

10 Mr Siow Tung

11 Ms Anne Carroll OAM

11.1 Ms Anne Carroll OAM
Supplementary Submission

12 The Insurance Council of Australia

13 National Affordable Housing Consortium

14 The Australian Bankers' Association

15 Australian Chamber of Commerce and Industry

16 Australian Prudential Regulation Authority

16.1 Australian Prudential Regulation Authority
Supplementary Submission

17 Australian Housing and Urban Research Institute (AHURI) - Curtin Research Centre and Bankwest Curtin Economics Centre

18 Business Council of Co-operatives and Mutuals

19 Dr Jane O'Sullivan

20 Indigenous Business Australia

21 Reserve Bank of Australia

21.1 Reserve Bank of Australia
Supplementary Submission

22 National Seniors Australia

23 Name Withheld

24 Department of Infrastructure and Regional Development

25 Australian Housing and Urban Research Institute Limited

26 Genworth

26.1 Genworth
Supplementary Submission

27 Housing Industry Association
27.1 Housing Industry Association
Supplementary Submission
28 Department of Social Services
28.1 Department of Social Services
Supplementary Submission
29 Urban Taskforce Australia
30 Mr Andrew Skinner
30.1 Mr Andrew Skinner
Supplementary Submission
31 ABN Group
32 The Australia Institute
33 Curtis Associates
34 Name Withheld
35 Urban Development Institute of Australia
35.1 Urban Development Institute of Australia
Supplementary Submission
36 Australia and New Zealand Banking Group Limited
37 Prosper Australia
38 Compass Housing Services
39 Australian Securities and Investments Commission
40 Property Council of Australia
40.1 Property Council of Australia
Supplementary Submission
40.2 Property Council of Australia
Supplementary Submission
40.3 Property Council of Australia
Supplementary Submission
41 The Treasury
41.1 The Treasury
Supplementary Submission

42 Australian Institute of Health and Welfare
43 ACT Chief Minister
44 Banking and Finance Consumers' Support Association
45 Mr Benjamin Ward
46 The Law Society of NSW
46.1 The Law Society of NSW
Supplementary Submission
47 Master Builders Australia
48 Customer Owned Banking Association
49 Shelter WA
50 Ms Ketki Madane, Mr Liam Mulligan, Ms Carys Wong and
Mr Benjamin Adams
51 Mortgage & Finance Association of Australia
52 Emeritus Professor Gavin Wood and Associate Professor Rachel
Ong
53 Dr Nigel Stapledon
54 Mr Howard Marosi
55 Evolve Housing
56 Mr Joe Langley
57 Mr Kevin Conlon
58 Queensland Government
59 Confidential
60 Real Estate Institute of New South Wales
61 Dr Lyndall Bryant
62 Mr Dominic Wykanak
63 Name Withheld
64 Mr Mark Houlton
65 Dr Shann Turnbull

B

Appendix B – Hearings and Witnesses

Friday, 26 June 2015—Canberra

The Treasury

Ms Jenny Wilkinson, Acting Deputy Secretary, Macroeconomic Group

Mr Greg Cox, Principal Adviser, Personal and Retirement Income Division

Ms Susan Bultitude, Manager, Household Analysis Unit, Macroeconomic Conditions Division

Mr Paul Fischer, Senior Adviser, Household Analysis Unit, Macroeconomic Conditions Division

Mr Brenton Goldsworthy, Principal Adviser, Macroeconomic Conditions Division

Mr John Swieringa, Senior Adviser, Macroeconomic Modelling and Policy Division

Department of the Prime Minister and Cabinet

Ms Marie Taylor, First Assistant Secretary, Housing, Land and Community Capability Division

Mrs Josephine Laduzko, Assistant Secretary, Commonwealth State Relations Branch, Economic Division

Ms Liza Carroll, Associate Secretary

Mr Colin Clements, General Manager, Homes, Indigenous Business Australia

Mr Roger Hall, Senior Manager, Policy and Planning, Indigenous Business Australia

Department of Social Services

Mr Iain Scott, Group Manager

Mr Stewart Thomas, Branch Manager

Ms Jill Mills, Acting Branch Manager

Australian Bureau of Statistics

Mr David Zago, Assistant Statistician, Social Conditions Branch

Ms Jacqueline Hodges, Program Manager, Macroeconomic Indicators Branch

Thursday, 6 August 2015—Sydney

Reserve Bank of Australia

Dr Luci Ellis, Head, Financial Stability Department

Mr Christopher Aylmer, Head, Domestic Markets Department

Australian Prudential Regulation Authority

Mr Wayne Byres, Chairman

Mr Brandon Khoo, Executive General Manager, Diversified Institutions Division

Ms Heidi Richards, General Manager, Industry Analysis

Australian Bankers' Association

Mr Tony Pearson, Executive Director, Industry Policy

Curtis Associates

Mr Christopher Curtis, Managing Director

The Law Society of NSW

Ms Joanne van der Plaat, Chair, Rural Issues Committee

Ms Joanne Seve, Member

Urban Taskforce Australia

Mr Christopher Johnson, Chief Executive Officer

Mr Saul Eslake, Private Capacity

Friday, 7 August 2015—Sydney

Insurance Council of Australia

Mr John Anning, General Manager, Regulatory Policy

Mr Kelvin Bannan, Senior Advisor

Mr Peter Morgan, Head, Westpac Lenders Mortgage Insurance, BT Financial Group

Genworth Mortgage Insurance Australia

Mrs Ellen Comerford, Chief Executive Officer

Business Council of Co-operatives and Mutuals

Ms Melina Morrison, Chief Executive Officer

Mr Stephen Nash, Director

Mr Christopher Moore, Private Capacity

Mr John Symond, Private Capacity

LF Economics

Mr Lindsay David, Co-founder

Mr Philip Soos, Co-founder

Dr Judith Yates, Private Capacity

Mr Andrew Skinner, Private Capacity

Wednesday, 12 August 2015—Canberra

AECOM

Mr Joseph Langley, Technical Director, Infrastructure Advisory

Central Japan Railway Company

Mr Shohei Yoshida, General Manager

Embassy of Japan

Mr Yasuhito Takahashi, First Secretary

Friday, 14 August 2015—Melbourne

Property Council of Australia

Mr Kenneth Morrison, Chief Executive

Mr Nicholas Proud, Executive Director Residential Development

Mr Nicholas Maher, National Government Relations Manager

Australian Housing and Urban Research Institute Limited

Dr Michael Fotheringham, Deputy Executive Director

Australia and New Zealand Banking Group Limited

Mr Graham Hodges, Deputy Chief Executive Officer

Emeritus Professor Gavin Wood, Private Capacity

Prosper Australia

Ms Catherine Cashmore, Vice-President

Mr David Collyer, Policy Director

Friday, 21 August 2015—Canberra

Evolve Housing

Ms Andrea Galloway, Chief Executive Officer

Housing Industry Association

Mr Graham Wolfe, Chief Executive, Industry Policy and Media

Ms Kristin Brookfield, Senior Executive Director, Building, Development and Environment

Mr Shane Goodwin, Managing Director

Dr Harley Dale, Chief Economist

Urban Development Institute of Australia

Mr Cameron Shephard, National President

Mr Richard Lindsay, Chief Executive Officer

Mr Liam Foley, Policy Officer

Master Builders Australia

Mr Wilhelm Harnisch, Chief Executive Officer

Mr Peter Jones, Chief Economist

The Australia Institute

Mr Matthew Grudnoff, Senior Economist

Friday, 25 September 2015—Canberra

The Treasury

Ms Susan Bultitude, Manager, Household Analysis Unit, Macroeconomic Conditions Division

Mr Greg Cox, Principal Adviser, Personal Retirement Income Division

Ms Michelle Dowdell, Manager, Transfers and Social Services Unit

Mr Brenton Goldsworthy, Acting Division Head, Macroeconomic Conditions Division

Mr Marty Robinson, Principal Adviser, Social Policy Division

Mr John Swieringa, Senior Adviser, Macroeconomic Modelling and Policy Division

Mr Paul Tilley, Acting Deputy Secretary, Revenue Group

Dissenting Report – ALP members of the committee

1. Introduction

The hearings for this inquiry were held between June and September 2015- more than a year ago. In this time the composition of the committee has changed extensively. None of the Labor Members of the committee were present for any of these hearings. With this in mind additional hearing dates to take fresh evidence were sought by the Labor members. This was refused by the chair and voted down.

The Government members report is a remarkable document in that it offers no recommendations to Government. It should be entitled The Claytons Report- the Report you have when you are not having a report.

What a complete waste of taxpayers' money! An inquiry and 55 page report that offers no recommendations to Government at all regarding home ownership and housing affordability. It reflects the Turnbull Government's economic policy- full of rhetoric and lacking substance.

2. Context of the inquiry

In October of 2013 the Grattan Institute released their Renovating Housing Policy. The report comments heavily on the ever increasing gap between real average weekly earnings and real house prices over the past three decades. The report also noted that:

> The combination of capital gains tax rule changes in 1999 and negative gearing has strongly increased the demand for investment properties. Investors compete directly with potential homebuyers, particularly for established houses. This makes it harder for first home buyers to secure a property.[1]

The difficulty for first home buyers to enter the market is a prime concern to the Labor members of the committee. As Labor has publicly stated time and time again, ownership rates have fallen from 60% to 48% for young people aged 25-34. Young people are being forced to take on levels of debt unimaginable just a few decades ago.

The former Chair of this committee, Mr John Alexander summed up the problem and the need for this inquiry perfectly when he was quoted saying:

1 Kelly, Jane, October 2013, Grattan Institute – Renovating Housing Policy

> Too often we see the young couple getting beaten out at the auction and then renting out the very place that they were trying to buy…First home buyers have really been unable to compete.[2]

This committee and the parliament must take action to level the playing field between investors and people trying to buy their first home.

3. Negative Gearing

While the House of Representatives Economics Committee held this inquiry into home ownership the Senate Standing Committee on Economics also held an enquiry into Affordable Housing. Mr Saul Eslake gave evidence to both inquiries relating to various aspects of the property market and provided an extensive written submission to the Senate inquiry.

The chair makes note of Mr Eslakes assessment that negative gearing has increased the number of investors and levels of investment in housing and as such this has meant housing is more expensive than it otherwise would be.

Mr Eslake goes far further than this in his submission to the Senate inquiry:

> Another long-standing policy which I have long argued has not only failed to deliver on its oft-stated rationale of boosting the supply of housing – in this case for rent – but has actually exacerbated the mismatch between the demand for and the supply of housing, as well as having distorted the allocation of capital, and undermined the equity and integrity of the income tax system, is so-called 'negative gearing'.[3]

The negative gearing rationale of boosting the supply of housing is also an issue worth investigating. In his submission Mr Eslake notes that 92% of all borrowing by residential property investors over the past decade has been for the purchase of established dwellings, as against about 72% of all borrowing by owner-occupiers.

The Australia Institute put the figure a little higher:

> It is claimed that encouraging investment in residential property brings new housing stock to the market… this argument is weak because there is little property investment in new housing, with just six per cent of investment finance going to new housing. The other 94 per cent is spent on existing stock. If the objective of negative gearing is to encourage new housing then this could be

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2 https://www.theguardian.com/australia-news/2016/may/02/labor-seizes-on-liberal-mp-john-alexanders-comments-on-negative-gearing

3 Eslake, Saul, Submission to the Senate Economics References Committee, 21st December 2013, p 9

> achieved by restricting negative gearing to apply only to new housing.[4]

4. Capital Gains Tax (CGT)

One of the most startling revelations of Mr Eslake's Senate submission is that:

> In 1998-99, when capital gains were last taxed at the same rate as other types of income (less an allowance for inflation), Australia had 1.3 million tax-paying landlords who in total made a taxable profit of almost $700m. By 2010-11, the latest year for which statistics are presently available, the number of tax-paying landlords had risen to over 1.8m (or 14% of the total number of individual taxpayers), but they collectively lost more than $7.8b Capital Gains Tax.[5]

The Chair's report correctly notes that the Australia Institute also commented that negative gearing and the CGT discount have driven record numbers of investors into the property market:

The interaction of these two tax treatments is driving people to invest in residential property in record numbers. Loans for rental properties have been rapidly increasing. They have grown from 16 per cent of loans to 40 per cent of loans in the last 23 years, and the influx of investors into the market has increased the demand for and put upward pressure on house prices.

5. Land Supply

Embarrassingly this report should have been delivered by the Committee's former Chair Mr John Alexander. Mr Alexander's public comments on the uneven playing field between investors and first home buyers have seen him moved on from the role as Chair. Mr Alexander who also chaired a committee into value capture for large infrastructure projects was quoted as saying:

> "We have been told time and time again that supply is the answer," he said. "But it's no good creating cities in the southern highlands and outside of Goulburn and outside of Shepparton if the same game is played … where the investor will have an enormous advantage over the homebuyer and then dominate that market"…
>
> "I feel owner-occupiers ought to be put in front of investors, but at the moment there is no restraint on how many [properties]

4 The Australia Institute, Submission to the Inquiry

5 Eslake, Saul, Submission to the Senate Economics References Committee, 21st December 2013, p 9

> investors can buy, which means they are dominating the market"…[6]

Clearly Mr Alexander is at odds with Treasurer, the Hon Scott Morrison MP who is suggesting that the answer to housing affordability largely rests with the states. The final report still contains more than enough proof that the Treasurer is out of touch.

In October 2016 Mr Morrison gave a key-note speech to the Urban Development Institute of Australia. In his speech he put the blame squarely on the states:

> The Government will therefore also be discussing with the states the potential to remove residential land use planning regulations that unnecessarily impede housing supply and are not in the broader public interest. This will be the strong focus of my discussions at the next Council on Federal Financial Relations that I will convene in early December.[7]

Clearly this is not just a State Government issue to be dealt with by increasing land release. There are strong and reasonable levers available to the Federal Government that are not being utilised.

6. Homelessness

Much the same as the Chair's report the Treasurer's speech to the Urban Development Institute made no mention of homelessness.

Homelessness still remains unacceptably high, according to the 2011 Census, 105,000 people, or 1 in 200 Australians, are experiencing homelessness on any given night.

ABS data reports that there are 657,000 low income households across Australia living in rental stress and 318,000 low income households in mortgage stress in 2013-2014.

It is a disgrace how little attention is given to an issue as important as this.

The Turnbull Government has only recently extended the funding for the National Partnership Agreement on Homelessness (NPAH) by one year to June 2018. NPAH provides up to 30 per cent of the budget of homelessness service providers across the nation.

Add to this there are around 185,000 households remain on waiting lists for public or community housing across the country.

Since 2013 the Government has:

- abolished the National Housing Supply Council

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6 http://www.macrobusiness.com.au/2016/10/john-alexander-shames-coalition-housing/

7 http://sjm.ministers.treasury.gov.au/speech/020-2016/

- abolished the National Rental Affordability Scheme and cancelled round five of that scheme
- cut funding to Homelessness Australia, National Shelter and Community Housing Federation of Australia
- cut $132 million from homelessness funding
- axed the Housing Help for Seniors program
- disbanded the COAG select Council on Housing and Homelessness.

The Turnbull Government's lack of policies to alleviate homelessness are further evidence of their incompetence.

7. Labor's Approach to Housing Policy Affordability and Home Ownership

Labor has developed and announced a positive plan to help housing affordability. This inquiry operated before the announcement of that policy. The Government have no policy in relation to this matter and the Government's members report offers no recommendations.

As Labor's policy document notes for young families in Australia, the dream of purchasing and owning their own home is almost completely out of reach.

Our plan will ensure first home buyers are not forced to compete with property speculators who may be buying their 7th or 8th investment property to negatively gear it.

The Labor members recommend reforming negative gearing and the capital gains tax discount to ensure that our tax system is fair, sustainable and targets jobs and growth.

The Government should limit negative gearing to new housing from 1 July 2017. All investments made before this date will not be affected by this change and will be fully grandfathered.

This will mean that taxpayers will continue to be able to deduct net rental losses against their wage income, providing the losses come from newly constructed housing.

From 1 July 2017 losses from new investments in shares and existing properties can still be used to offset investment income tax liabilities. These losses can also continue to be carried forward to offset the final capital gain on the investment.

The Government should also halve the capital gains discount for all assets purchased after 1 July 2017. This will reduce the capital gains tax discount for assets that are held longer than 12 months from the current 50 per cent to 25 per cent.

All investments made before this date will not be affected by this change and will be fully grandfathered.

This policy change will also not affect investments made by superannuation funds. The CGT discount will not change for small business assets. This will ensure that no small businesses are worse off under these changes.

This policy will see a boost in new housing and will provide young families with the chance to find a home, and will take pressure off inner city housing markets that are predominantly made up of existing dwellings.

This will also lead to new jobs for construction industry, with independent analysis from the McKell Institute estimating that these policy settings would result in an additional 25,000 jobs.

The independent Parliamentary Budget Office (PBO) has indicated Labor's policy will also raise an additional $565 million over the forward estimates, and $32.1 billion over the decade.

8. Labor Members Recommendations

To improve home ownership and housing affordability in Australia the Labor members of the committee recommend:

Recommendation 1.

The Government limit negative gearing to new housing from 1 July 2017. All investments made before this date will not be affected by this change and will be fully grandfathered.

Recommendation 2.

The Government halve the capital gains discount for all assets purchased after 1 July 2017. This will reduce the capital gains tax discount for assets that are held longer than 12 months from the current 50 per cent to 25 per cent. All investments made before this date will not be affected by this change and will be fully grandfathered.

Hon Matt Thistlethwaite MP **Ms Madeleine King MP** **Mr Matt Keogh MP**

Deputy Chair

Dissenting Report – Greens member of the committee

Young people are getting screwed

Australia has a problem with housing. A very big problem. The price of a house is, depending on where you live, likely to be high, very high or ridiculous. We have the dubious honour of spending the highest proportion of income on housing in the world. The proportion of people who own their own home, particularly amongst the young, is in decline and is now at the lowest level in 60 years. Inequality is being created on a generational scale, the economy is being distorted, and the financial system is being loaded up with risk.

In the post-war period, as income and quality of life increased, levels of home ownership rose and wealth became better distributed. There was no better depiction of the 'Aussie fair go' than the equalisation of the property market. But in the last twenty years, things have gone wrong. Housing has gone from being a roof over your head to being a financial product that millions are speculating on. Prices are well above the value that reflects the actual cost of building a house or the natural supply and demand. In some parts of some capitals cities, prices are in bubble territory.

Why is this so? Is it a supply issue? Is it interest rates? Is it lax banking regulation? Is it younger generations who want to have their house and eat their smashed avocadoes too? It is easy to play at the margins or find scapegoats, but it takes guts to address the core problems.

Australia's housing market is being driven by a tax system that favours investors above owner-occupiers. The nexus between negative gearing and a concessional capital gains tax has created an uneven playing field that gives property speculators an unfair advantage over prospective home owners. On any given Saturday, home owners are being priced up or priced out because they don't have the taxpayers shoulder's to stand on. Tax concessions for investors have supercharged the housing market by increasing the number of prospective buyers. This is what is behind the decline in home ownership rates. This is what is behind the record levels of household debt. This is the problem that needs to be fixed first and foremost.

But the Committee's report by Coalition government members will not concede the state of Australia's housing market. Reading the report is like being transported into a parallel universe. 'It's not happening.' Instead, the report seeks to perpetuate myths and half-truths. Tired tropes about 'current price cycles' and 'historical trends' are used to paper over the fact that Australians are paying more than they need to for a house and that house prices are being inflated by government policy.

Australia can't afford to ignore the issue of housing affordability if we are to avoid worsening inequality and an unsustainable build-up of mortgage debt. Unwinding the problem will be long and difficult and will require a multi-faceted response, including reform to the tax system, the banking system, and tenancy arrangements. But we need to do it. And we need start now.

The great Australian nightmare

Owning your own home—it's the great Australian dream. While the post-war suburban model of a quarter-acre block has evolved, this inquiry confirmed the fundamental role of home ownership to wealth equality and quality of life. Luci Ellis, Head of Financial Stability Department at the RBA, told the committee:

> Outright homeownership is widely regarded as key to avoiding poverty in old age. Before that life stage, homeownership is also regarded as a way to obtain the security of tenure that is so important to the wellbeing of many households, especially families with dependent children.

But home ownership is a dream that is slipping from the grasp of many Australians. And the younger you are the more likely it is that you are being locked out of the housing market.

Saul Eslake gave an account of level of home ownership in the post-war period.

> Australia's homeownership rate at the last census in 2011 of 67.0 per cent was lower than at any previous census since 1954, although it was still 4.1 percentage points above where it was then. The overall homeownership rate fluctuated between 72 and 68 per cent between the 1961 and 1991 censuses, but since then it has declined by five percentage points. That might seem like a small decline, but it masks a much more significant development.
>
> Among households headed by people aged between 25 and 55 years, homeownership rates have declined by an average of almost 10 percentage points. The effects of this on the overall homeownership rate have been partially obscured by an increase in the proportion of households headed by people in older age groups, among whom homeownership rates are typically much higher.

The most recent Household, Income and Labour Dynamics in Australia (HILDA) Survey report confirmed these findings, stating that:

> Home ownership among persons aged 25–34 declined from 38.7% in 2002 to 29.2% in 2014, with much of the decline occurring between 2010 and 2014. Among persons aged 35–44, home ownership declined from 63.2% to 52.4%, and among persons aged 45–54, it declined from 75.6% to 67.4%. There was also a slight

> decline in home ownership among persons aged 55–64, from 75.1% in 2002 to 72.9% in 2014. There was essentially no change in home ownership among those aged 65 and over.

Saul Eslake also explained the impact on wealth equality of this trend.

> Given what we know about property ownership among different age groups, this amounts to a significant redistribution of wealth from younger households to older ones, and, given what we know about property ownership among different income groups, it amounts to a significant redistribution of wealth from poorer to richer households.

It has always been the case that the young and the poor are the less likely to own their own home. But the widening gap in home ownership between the old and the young, and the rich and the poor is an enormously concerning trend. We are witnessing the creation of a structural divide in our society. Saul Eslake forecast the impact that this would have on our social fabric.

> … further significant increases in house prices from current levels are likely to cause social harm. You have already heard from the Reserve Bank today why homeownership has long been considered a good thing by Australians—because of its contribution to reducing poverty in old age, because of its contribution to providing a stable environment for raising children, because of the contribution it makes to fostering community engagement and because of the security it often provides for the financing of small businesses. Those things to which a large majority of Australians have traditionally aspired are likely to become less accessible to an increasing proportion of Australians if residential property prices continue to increase and homeownership rates continue to decline.

Paying through the nose

It's very easy to understand why home ownership is in decline. Housing in Australia is overpriced. Australians are paying world record amounts to buy a house. As a result, people either can't afford to buy a house or, if they decide they can, they are being saddled with world record levels of debt. And it's the youngest who are hit hardest. In 1990 house prices were approximately six times the income of a young Australian. By 2013 that had doubled to a multiple of twelve.

Saul Eslake set out for the committee the simple problem of housing affordability.

> The most important single factor detracting from housing affordability over the past 20 years has been the almost relentless increase in residential property prices over this period, an increase which, in most of Australia's largest cities, has outpaced the rise in

> incomes by a wider margin than in most other advanced economies.

Lindsay David from LF Economic explained the increase in house prices and household debt relative to other economic indicators:

> … between the June quarter of 1996, when real house prices first began to rise, and the December quarter of 2014, real housing prices rose by approximately 131 per cent. But, over the same period, inflation rose by 60 per cent, our population grew by 30 per cent, real GDP by 79 per cent, real rents by 21 per cent and real household income by 39 per cent. In short, the growth of housing prices has completely outstripped all economic fundamentals except for the expansion of household debt. Over the same period, total household liabilities boomed from 54 per cent relative to GDP to 118 per cent, and today Australian households owe creditors close to $2 trillion, and rising. Never has our household sector been as indebted as it is today.

Yet despite the evidence from regulators and economists, and despite what everyone in the country can see as clear as day, the committee's report does not acknowledge the reality of house prices in Australia. This is an insult to everyone who participated in this inquiry, including the former Chair and instigator of the inquiry, John Alexander MP.

The rise of the investor class

This inquiry heard consistently—putting aside those with a vested interest in the property market—that the primary reason for the rise of house prices in Australia is an increase in demand in the form of investors entering the market and that it is tax incentives that are attracting these investors into the market.

Deductions for rental losses (negative gearing) and the concessional rate of capital gains tax are separate policy instruments, but the whole is greater than the sum of the parts. Negative gearing acts as a form of taxpayer funded insurance on rental income. It provides property investors a buffer in their cash flow. It smooths out the bumps and lowers the barrier to entry. The concessional rate of capital gains tax then provides gold at the end of the rainbow. It is the prospect of ever increasing property prices, taxed at just 15%, that is the big prize.

In combination, negative gearing and concessional capital gains tax are corrupting the housing market. Investors are flooding the market and, in doing so, have created a disjoint between the market for buyers and the market for people who actually need a house to live in. The demand for housing is artificially high and is not the same as the demand for a home.

The mid to late 1990s is easily identified as the point at which house prices started to decouple from ordinary measures of inflation. This follows the liberalisation in the Australian banking sector, the stabilisation of interest rates at reasonable levels, and the beginning of gentrification of existing urban areas. But it also corresponds with the introduction of the capital gains tax discount. Saul Eslake explained:

> The halving of the capital gains tax rate in 1999 made negative gearing much more attractive to property investors than it had previously been, by turning it into a vehicle for permanently reducing income tax as opposed merely to deferring it, as it had previously been, and thus had the effect of encouraging more investors into the property market. Since the proportion of taxpayers who have negatively geared properties increased significantly after 1999 to the point where, in the last two years, borrowing for property purchases by investors has exceeded that by owner occupiers, and since over 90 per cent of geared investors purchase established properties, this has also added to the upward pressure on established property prices.

Luci Ellis, RBA, made a similar observation:

> We have made an observation that the combination of negative gearing and concessional taxation of capital gains creates an incentive for people to invest in assets that produce capital gains versus assets that do not. Even if negative gearing is not currently required given the current combination of interest rates, the fact that it is available should something goes [sic] wrong, should your rental yield not be what you expected and so forth, makes people more comfortable about taking that leverage.

The Financial Systems Inquiry (Murray Review) identified the tax treatment of investment property as a major tax distortion encouraging “leveraged and speculative investment in housing”.

Who benefits?

The government would have you believe that property deductions are all about helping middle Australia getting ahead—‘nurses, teachers and police’, according to the Treasurer. But this is a deliberate obfuscation and avoids the wider issue of inequality. The simple fact is the more you earn the more likely you are to be able to afford an investment property and the more likely you are to use and benefit from negative gearing. Saul Eslake explained:

> … the proportion of claims for benefits of negative gearing are five times as prevalent among people in the top tax bracket than they are in the general population. People earning taxable incomes of $180,000 or more account for over 11 per cent of property investor

> interest deductions, yet those people represent about 2½ per cent of total taxpayers.

Luci Ellis, RBA, agreed that tax concessions on investment properties favour high income earners:

> Dr Ellis: That is true. I think people on modest incomes would find it more difficult to fund the loss. Certainly negative gearing does make the use of leverage a little bit more comfortable, because then you know that if you do have the property vacant, or for some other reason you end up making a loss in a particular year, you are only wearing the post-tax loss rather than the pre-tax loss.
>
> CHAIR: And for high-income earners that is a greater deduction than for low-income earners.
>
> Dr Ellis: That is true. Of course, remembering also that you might be making a loss on your full marginal tax rate on the cash flow, but somewhere down the track you are gaining capital gains, which are concessionally taxed. So that is a difference.

However, it is true that more Australians of more modest means are becoming property investors. And this is what makes the case for the reform all the more pressing. As it stands, it is more financial advantageous for many Australians to be home owners who don't live in a home that they own. Left to its logical conclusion, everyone will be both a landlord and a renter, but no-one will be an owner-occupier. This is absurd. We have to break the cycle.

Undoing the bind of negative gearing and the capital gains tax discount will be difficult. Policy changes should aim to gradually unwind the artificial demand in the property market because the alternative—a dramatic correction in housing prices—is likely to shock the financial system and the economy in a way that further exacerbates inequality.

Recommendation: Progressively phase out the 50% capital gains tax (CGT) discount for trusts and individuals for capital gains realised on or after 1 July 2016, by a reduction of 10% each year for five years to be phased out entirely by 1 July 2020.

Recommendation: Remove negative gearing for all non-business assets purchased by individuals, funds, trusts, partnerships and companies on or after 1 July 2016, with assets purchased prior to this date grandfathered.

Easy money

Laughing all the way with the banks

It follows that if Australia's level of household debt is world leading, then so is our banking system's exposure to housing. Australian banks lead the developed world in their exposure to the housing market. Mortgages account for over 60% of the loans book of Australian banks. Since 2002, the value of housing loans has increased fivefold. This growth in mortgages provides a good marker for the record profits that the big four banks have regularly posted since the housing boom took off.

The banks' love of housing poses a major risk to financial stability. The Murray Review identified the banks' exposure to housing as one of four sources of potential systemic risk, stating:

> Australia's banks are heavily exposed to developments in the housing market. Since 1997, banks have allocated a greater proportion of their loan books to mortgages, and households' mortgage indebtedness has risen. A sharp fall in dwelling prices would damage household balance sheets and weigh on consumption and broader economic growth. It would also reduce the quality of the banking sector's balance sheets and the capacity of banks to extend new credit, which would compromise the speed of a subsequent economic recovery.

APRA head, Wayne Byrnes, recently commented that "with such a concentration in a single business line, we are all banking on housing lending remaining 'as safe as houses'."

The RBA's Luci Ellis told this inquiry that it is leverage that is "so important for financial stability, both of the financial sector and of the household sector."

But, the banks don't see a problem with the amount of leverage in the housing market. Tony Pearson, Executive Director, Industry Policy, Australian Bankers' Association, told the committee:

> … there is no evidence of a problem with the current procedure whereby banks are assessing risk in terms of loan-to-valuation ratios. Again, I would say that all the metrics we have show that in fact the bank lending standards, which is what you are talking about, are if anything getting better, not worse. At the moment, the system seems to be working well.

It's easy to understand why the banks don't see a problem, particularly the big four who account for over 80% of the market in home loans. This committee's recent review of the Four Major Banks confirmed that ANZ, CBA, NBA and Westpac enjoy a privileged position in Australian society, benefiting from both implicit and explicit government guarantees that other businesses can only dream of. This public support insulates the big four from the full extent of risk in the financial system and the broader economy as a result of Australia's exposure to housing debt. They are too-big-too-fail. This is not to say that banks don't care if there is a correction in the housing market—they're doing very nicely just now—but, thanks to taxpayers, the big four are insured against the full cost.

This is moral hazard. The structure of the banking system is such that the supply of money into housing is higher than that which would otherwise be rational and prudent. In combination with tax concessions that have inflated demand, this is a potent mix.

Recommendation: That the terms of reference for a Royal Commission into banking include the existence of implicit and explicit government guarantees on the business practices of relevant entities, including: whether the cost of the risk covered is adequately borne by relevant entities, and whether the existence of guarantees impacts upon the conduct, business practices and culture of relevant entities; and the impact of the conduct, business practices and culture of relevant entities on the stability of the financial system and the broader economy.

Prudential regulation

But are the banks culpable, or are they just rational actors responding to market incentives, and should financial regulators have done more to rein in the housing market?

APRA Chairman, Wayne Byrnes, explained to the committee:

> … we cannot and do not seek to set house prices or determine where they go and what is too high, too low or just right. All we can do is make sure that lending standards maintain a good degree of prudence, given the economic environment and market conditions we are in. What we had observed, as markets got hotter and more competitive, is that lending standards were potentially being eroded. Our efforts are really designed to make sure that the banks are keeping a sensible head in the face of a range of quite extreme market conditions. Interest rates are extremely low; household debt is extremely high; prices, even in those cities where they are not rapidly accelerating, are still at historically high levels. There are a range of factors here, and we are just trying to bring a degree of moderation.

And, Mr Byrnes again:

> We cannot have a crystal ball. We cannot know where prices will go. We cannot know where interest rates will go. But what we need to do is make sure there is a degree of, if you like, buffer

> within the system that means people have the capacity to absorb what might come along.

In line with international action to improve stability of the banking sector, APRA has increased the capital requirements on authorised deposit taking institutions, particularly the big four.

However, Phillip Soos, LF Economics, set out a case as to how APRA has failed to reign in mortgage lending:

> APRA was founded in 1998 in the midst of an exponential boom in private sector debt, specifically mortgage debt. APRA has pretty much sat on its hands, pontificating about how best to regulate the market while not doing much of anything. In December 2014, it suggested that it was implementing regulations to limit the annualised growth of investor debt to 10 per cent a year, but it is unclear on what basis it has chosen this metric. Even so, that is still too high a figure, because if investor debt is rising at 10 per cent a year and overall household mortgage credit is rising at seven per cent a year, but incomes are only rising at about two or three per cent a year, that implies a rising debt to income ratio. Also, given that nominal GDP, generously, will rise perhaps three per cent this year, that implies a rising debt-to-GDP ratio, which indicates that mortgage debt is still rising exponentially.

Recommendation: That the terms of reference for a Royal Commission into banking include the funding, performance, governance and independence of regulators and dispute resolution bodies, including any real or perceived instances of regulatory capture.

Monetary policy and the redirection of capital

The already potent mix of tax incentives for investors and an accommodating banking sector has had a truck load more fuel thrown on it in recent years in the form of record low interest rates. Lax monetary policy has had a two-fold effect: it has lowered the cost of servicing a home loan, thereby further increasing the price people are prepared to pay; and it has created a 'search for yield' which has pushed even more individuals investors into the housing market.

This is contributing to a 'low growth trap', an international phenomenon that is seeing capital redirected into unproductive and speculative investment—such as housing—which is putting a handbrake on post-GFC economic recovery. This is of great concern to international regulators.

Saul Eslake explained to the committee the deleterious impact of rising house prices on the economy:

> … I think it is increasingly debatable whether continued increases in residential property prices are a good thing for the Australian

> economy, whatever you believe about the impact of previous increases. That is because, since the onset of the financial crisis, Australian households have become much less willing to borrow against increases in the value of the properties which they own in order to fund other types of spending. Indeed, it would seem that the only thing for which Australians seem keen to take on more debt is acquiring investment properties.

The OECD's most recent Economic Outlook confirmed Australia's status in so far as housing is a contributor:

> Despite the employment of macro-prudential measures to cool the housing market, the net gain from monetary easing has narrowed. Significant housing market concerns remain and there is growing discord between financial market developments and rest of the economy due to the low-interest-rate environment.

Again, the OECD's Economic Outlook made the following observation:

> In the event of disappointing growth, however, fiscal rather than monetary support should play the leading role given the housing-market concerns and fiscal leeway.

Yet this government is deaf to these concerns. The unwillingness of this government to pull the fiscal trigger has exacerbated the impact of monetary policy on house prices. Without an alternative investment avenue in the form of government borrowing for infrastructure, cuts to interest rates have translated straight into more speculation in the housing market.

Recommendation: That the federal government increase its level of borrowing to fund productivity enhancing infrastructure.

In this respect, there is a happy coincidence between the construction and provision of more public housing and greater housing affordability. With public housing waiting lists blowing out in several states and further exacerbating housing inequality, the Federal government needs to urgently work with the states to ensure the roll-out of new public housing stock. By treating public housing as crucial public infrastructure that governments have a lead role in building, not only will there be additional investment opportunities for private capital seeking the secure, long-term returns associated with government bonds, but the increase in the supply of low-rent properties will put downward pressure on the property market.

Recommendation: That the Federal government take a lead role in co-ordinating and financing, together with State governments, a significant expansion of Australia's public housing stock.

Financial regulation and superannuation

In what may be a quaint reminder of the historical view that housing is asset for use rather than speculation, investment property is not treated as a financial product under Commonwealth law. However, the effect of this exemption is no longer benign. 'Property investment advisers' are able to provide financial advice to prospective buyers outside of the regulatory framework that applies to other financial assets. These 'advisers' do not need to be qualified or licensed, and are able to receive commissions for the sale of properties from developers. This is further inflating the flow of money into housing, and often at the most risky end of the property market.

Recommendation: Include loans for investor properties within regulatory framework for financial advice to provide consumers the full range of protections.

ASIC noted in its submission to this inquiry that:

> As an alternative to investing directly in residential property, individual investors may choose to invest through an SMSF (self-managed superannuation fund). SMSFs are the fastest growing sector of the superannuation industry and investment in property through SMSFs is consequently also growing.
>
> As at March 2015, the value of residential real property investments through SMSFs was $21.78 billion, or 3.7% of total Australian and overseas assets, up from $19.49 billion, or 3.6% of total Australian and overseas assets, in March 2014. There has been an increase in investment in residential real property through SMSFs of 11.78% from March 2014 to March 2015, and an increase of 58.69% since March 2011.

The Murray Review made the following observation and recommendation:

> The GFC highlighted the benefits of Australia's largely unleveraged superannuation system. The absence of leverage in superannuation funds meant that rapid falls in asset prices and losses in funds were neither amplified nor forced to be realised. The absence of borrowing benefited superannuation fund members and enabled the superannuation system to have a stabilising influence on the broader financial system and the economy during the GFC. Although the level of borrowing is currently relatively small, if direct borrowing by funds continues to grow at high rates, it could, over time, pose a risk to the financial system.
>
> …

> Inquiry Recommendation 8 — Direct borrowing by superannuation funds: Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.

Yet, in wilful disregard for the further build-up of risk and the further flow of speculative investment into housing, the government disagreed with this recommendation. This is a decision that should be overturned.

Recommendation: That the Government implement FSI recommendation 8.

Supply side obsessions

The conventional response of the property industry to evidence of an overheated housing market is to blame it all on the supply side. Restrictions on land release, delays in planning approvals, and insufficient infrastructure investment. That's what the problem is, not investors. This inquiry heard the story and the Committee's report has unfortunately largely accepted this on face value.

Undoubtedly, supply constraints are impacting upon prices in some cases. Lucy Ellis, RBA, described where and how supply is most likely to be a factor.

> The population is highly urbanised and concentrated in a few large cities. Housing prices are typically higher in larger cities. Australia's cities are also unusually low density compared with those in other developed countries. The urban fringe locations, where first home buyers have typically located, are therefore becoming further out—and potentially inconvenient for access to jobs and some services. Some of our major cities also face geographic constraints on their expansion. All of these factors tend to increase the price of well-located housing.

Similarly, Michael Fotheringham, Deputy Executive Director, Australian Housing and Urban Research Institute, explained the inconsistent nature of supply side issues.

> Obviously land supply and planning have key roles to play, very complex roles to play, around housing. As you have heard previously, we have a traditional undersupply in this country, but I think it is important to note we are not just talking about gross supply of housing but about the right supply of housing—the right location, the right types of dwelling. We have some markers of oversupply in particular types of dwelling in particular locations, but it is about having the right supply in the right places.

Catherine Cashmore, Vice-President, Prosper Australia, also explained how, in some cases, it is the business model of the property industry, particularly large-scale outer suburban developers, that are contributing to supply side constraints.

> The way that developers will work is that they have to get a certain price for the land to cover the margins that they have bought for. So you will find that they will drip-feed that land onto the market in staged releases.
>
> …
>
> Mr Craig Kelly: So some of the developers are actually land-banking areas to hold it back—to hold up the market?
>
> Ms Cashmore : They have to.

But the evidence for supply underpinning the exceptional rise in house prices across the board is actually thin. Property Council of Australia CEO, Kenneth Morrison, and Executive Director Residential Development, Nicholas Proud, appeared before the committee and promised to provide the evidence on baseline levels of supply and demand:

> Mr Craig Kelly: Is there a natural level of housing vacancy in the market? So we talk about demand and supply and more people coming into the market. Is that something you have looked at?
>
> Mr Morrison: We have not looked at that closely. We can provide some figures for the inquiry. There will be a proportion of housing at any one time that is vacant, because it is in the midst of being transacted, or for other reasons—rentals. There is some vacancy in the market, but why don't we provide—
>
> Mr Craig Kelly: Is that tracked in any particular way?
>
> Mr Morrison: I have seen some figures on it in the past, so we can do that.
>
> Mr Proud: About three per cent is the general benchmark. If there is three per cent, that is fairly healthy. People can get into a vacant property, because they need to find a vacant property, but the ones that are in them are not getting in and getting out and flipping.
>
> Mr Craig Kelly: The squeezing of that three per cent would obviously be one of the big factors in your demand and supply imbalance, I would imagine.
>
> Mr Morrison: Yes. Why don't we provide some numbers for the inquiry, going back some years.

The Property Council did not follow through on this promise.

Phillip Soos, LF Economics, did provide detailed evidence comparing the change in population with the change in dwelling completions, and concluded that the supply of housing has been sufficient over most of the period of the last twenty year's housing boom. Mr Soos explained, instead, that rents are a better indicator of supply issues and that they do no indicate a problem with supply.

> What does make sense is looking at the trend in rents, not prices. The reason prices are as high as they are, as Lindsay has noted, is debt finance speculation, which is irrational. However, rental prices cannot be leveraged. They are more likely to be efficient and determined by the interactions of supply and demand. Between 1996 and 2006, rents in real terms were flat. After 2006, when we had the period of deficits during the global financial crisis, there was a strong increase in rents and also an increase in the rent-to-income ratio. Households were paying more and more in rent as a proportion of their total budgets.
>
> Since about 2013 the rent-to-income ratio has moderated. We are now seeing that rents are essentially plunging in some of the capital cities like Darwin, Canberra and Perth, while they are holding steady in Melbourne and Sydney. The major reason is the end of the mining boom in those states and also the APS cuts in Canberra. According to our supply index, that has resulted in continuing surpluses.
>
> We have only provided this at the national level. The submission would be far longer if we had to provide a breakdown for every state and territory. But the main thing to take away from this is that we should be looking at the trend in rents to determine if there is a shortage. For most of the period of the housing price boom, from 1996 to 2015, rents have been pretty much flat in inflation-adjusted terms, apart from during the GFC and in some mining towns.

More recent evidence would suggest oversupply is a more pressing problem in the housing market. RLB's most recent Crane Index registered a record number of 663 tower cranes in the skies of Australian cities. This is more than what RLB registered in the entire continent of North America.

A better deal for tenants

The terms of reference for this inquiry are, essentially, a proxy for housing security. Access to secure housing is one of the main reasons people seek to own a property. However, given the nature of private investment in housing, inevitably there will be those who will not own property for extended periods of time, if ever. And, given the issues of home ownership and affordability examined by this inquiry, the relationship between tenants and landlords is a more pertinent than it has been for sixty years. Housing security for renters deserved consideration by this committee. The absence of recommendation in respect of tenant's rights in the committee's report is an unfortunate omission.

Lucy Ellis, RBA, identified the peculiar nature of Australia's rental housing market during the inquiry:

> Another area where Australia seems quite unusual is that most rental housing is owned by private individuals who are not full-time professional landlords.

Saul Eslake made a similar observation about the nature of the rental market and the problems this can cause.

> In most countries of similar incomes and social structures to Australia, the rental housing stock is overwhelmingly owned by some combination of institutional investors, public authorities, social housing organisations and corporations specifically established to invest in rental housing. They tend to invest for very long terms, whereas in Australia the overwhelming majority of the housing stock is owned by individuals. And as you said, and as others have said, these are often individuals with only one or two properties in their portfolios. That is a much higher proportion than anywhere else. Many of those investors are in the housing market for much smaller periods of time than is the case with the people or institutions who own rental properties in overseas countries, and of course that is, in turn, one of the reasons for the relatively short periods for which rental leases are available, which, in turn, leads to increased insecurity of tenure amongst that proportion of the population that is either forced or chooses to rent.

Individual, non-professional property investors have different expectations and constraints to pooled, professional investors. Institutional investors tend to favour steady returns over the long-term, and tend to seek long-term tenants and treat them accordingly. Conversely, individuals are more likely to be seeking rental returns over a much shorter time frame. Realising these returns often impacts on tenants through rent rises, lack of property maintenance and no-fault evictions.

There is evidence for these impacts in the Australian Greens' 2016 Rental Health Survey. Of the 3,190 renters who responded:

- 68% are in housing stress, paying more than 30% of their income on rent;
- 62% had been forced to leave their rental through no fault of their own in the last five years, with almost 40% having to move between 2-5 times; and
- 58% have put up with maintenance problems because they were afraid of the lease not being renewed.

These dynamics point to a tension between the interests of the landlord and the interests of tenants. Regulation is needed to resolve these tensions and to ensure that those outside the property market are not being exploited and further marginalised. National minimum standards should be implemented to increase housing security for renters.

Recommendation: Establish a new national body responsible for implementing and overseeing a new National Standard for all rental tenancies, with the view to developing a National Residential Tenancy Act. The new standard and Act should enforce minimum standards relating to: security of tenure and long-term leases; stability and fairness of rent prices and bonds; a new 'green rental' efficiency standard to ensure the home is cheaper to run and comfortable to live in; safety and security of the home; and better protection for students and vulnerable groups.

Adam Bandt MP