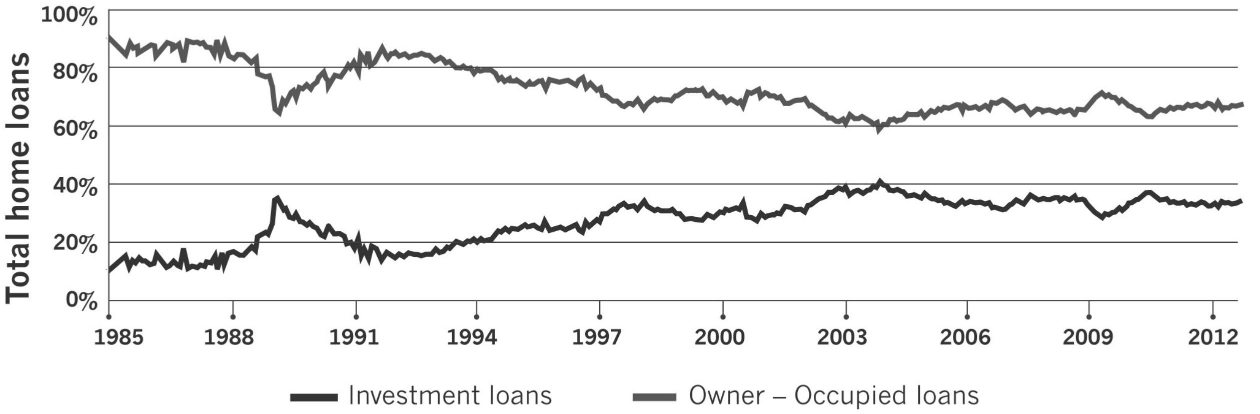
Senate Submission into Housing Affordability

14 Deterrents to Affordability

by Karl Fitzgerald, Project Director, Earthsharing Australia

1. Investors constitute nearly 40% of housing loans, up from 12% in the mid 80's. This does not include cash purchases by foreign investors.



Source: Philip Soos

2. Incentives for investors include interest only loans. Some 60% of investor related loans are interest only. This encourages short term capital gain strategies. The savings on a typical 10 year interest only loan are 54% compared to principal and interest.This encourages further distortions from economic fundamentals.

   Inherent in the argument that investors are key to affordability is the fact that land is fixed in supply. Incentives for investors can only act to crowd out genuine FHB's by pushing prices higher.

   Interest only loans should be limited to small scale developers in the production process.

3. SMSF capital gains exemptions: the 2010 move to allow capital gains exemptions for SMSF owners in their pension phase (over 55) helped place a floor under Australian property prices - at a time when a correction was underway. Whilst SMSF investment levels are still comparatively small, the signal to the marketplace is undeniable – property speculation is the easiest domain to earn wealth in an age of corporate concentration. With baby boomers already owning 47% of all residential property wealth, this will further enhance inter-generational inequalities.

   Such CGT exemptions should be removed.

4. A well funded campaign for additional land supply to solve the affordability crisis has failed, especially in Victoria. The Urban Growth Boundary acts to push prices up inside the boundary and down outside it. This suits the development industry in that it benefits from higher land valuations for land zoned residential. It also assists in negotiations with farmers outside the UGB for lower option contracts.

   Despite this, the Victorian government has provided the most extensive land supply rezonings in our history. The result? In Whittlesea, when land prices were falling at the second fastest rate since 1936 (June quarter of 2012), the AFR reported that developers pulled 58% of the land supply from the market in one quarter alone. Further evidence on supply manipulation can be seen here, here and here.

5. Part of the problem lies with the accuracy of vacancy figures. Current vacancy statistics analyse only those properties available for rent on the market. However, many properties are bought and sold only for capital gains. This wider subset must be included in vacancy measurements. When capital gains have delivered some $30 – 40,000 p.a and rental incomes only $17,000, there is little motivation to risk having a kitchen damaged.

   For five years Earthsharing Australia has measured vacant properties, using water consumption as a proxy for vacancy. Our findings are generally three times higher than mainstream analysis.

   In 2010 the Chinese State (Grid) Power company mimicked our methodology to find 65.4 million empty homes. Rising land prices encourage over building. Our current analysis gives little forewarning of such dangers. The cost in terms of the Global Financial Crisis was trillions in lost growth.

   I remind that the GFC was precipitated by the March 2006 quarter fall in US land prices that led to credit write-downs by mid 07. The risk of such trends to the global economy has now returned with the Chinese property sector suffering from ghost towns.

6. The ACCC recently garnered national headlines by targeting supermarkets for anti-competitive behaviour. However, we have been lobbying the ACCC for three years to investigate the challenges posed to affordability by 'staged releases' in the real estate sector. Pre-WW1, 200 properties would be sold off at 2.30pm on a saturday afternoon in a land sale. Today some developers boast to investors of 17 years of staged releases in a single development. Each week you can see these major developments drip feeding some 4 properties to the market. Surely this is a market manipulation?

   The ACCC responded to our requests by asking for more evidence. Unfortunately compiling such evidence is very costly. Prior to the 1970s land sales data could be accessed for free. In the US you can still access the data free online. We recently paid $6,000 for just residential sales turnover figures. This is not amenable to any form of checks and balances on the most powerful industry in the nation.

   However, there is much evidence available via print media. One of Melbourne's most prominent sprawl developments is Atherstone (Melton South). They have zoning for 55,000 properties. However, barely 50 properties have been sold. The development has been mothballed rather than reduce prices to clear stock – as would happen in any other market. There is debate that the mothballing is a tactic to strongarm the State government into building the neighbouring Toolern train station. This will deliver a windfall gain to the developers – an unearned income. This hints at the real motivation for the 'land supply' debate – to force government to deliver the golden pen tick via re-zoning.

   Staged releases should be outlawed as a form of market manipulation.

7. The affordability distortion in housing comes from the drive for unearned income. Unearned income is money delivered through no productive activity. Economics once saw this as detrimental to the comparative advantage of a nation. Higher land prices feed through to consumer prices, deterring export income. High land prices also curtail the velocity of money at the community level, with more and more channelled towards banks and investors. When combined with the 23.4% commercial vacancy rate here in Melbourne, the lean and mean aspect to industry is cut off at the knees. More spent on rent ensures less is available for wage rises.

   Hoarding property to flip for a (virtually) untaxed capital gain is the distortion that must be addressed.

8. Land Value Tax is the mechanism to tax away such incentives. The first Federal tax office established was the Federal Land Tax office (1910). Earlier generations understood that those who owned the earth had an advantage over anyone trying to run a business or earn a wage. Taxing away the unearned incomes was conducive to social cohesion. Unearned incomes in land increased a whopping $187 billion in the December 2013 quarter alone (ABS 6416). Total yearly dividends (2013), for investors engaged in risk, was recently reported at $84 billion - $103 billion less for an entire year.

   Why invest in small business or the ASX when one can earn more for less risk at a lower tax rate as a land speculator?

   Rebalancing economic incentives via a Land Tax will be controversial but so are two generations locked out of housing.

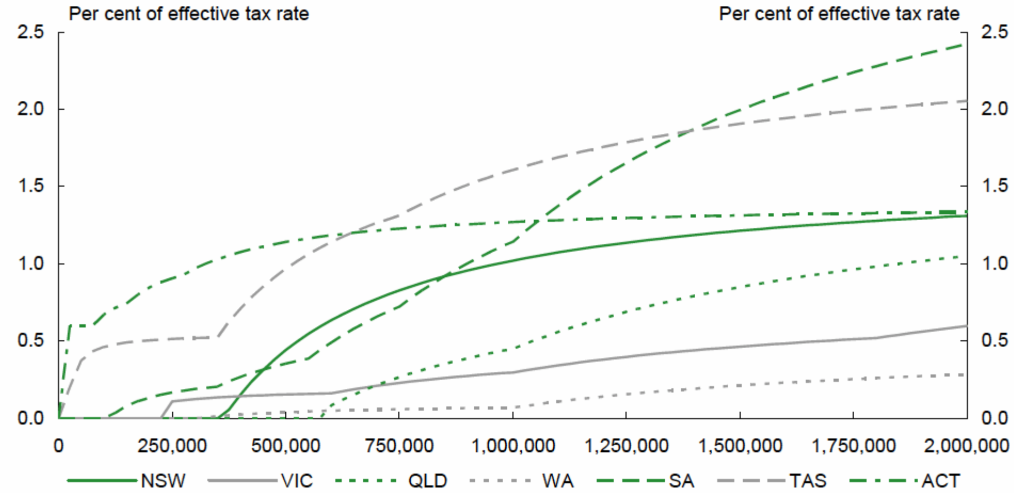
   There is no greater efficiency than basing a tax system on economic rents. Research by our parent body Prosper Australia has found a $66.3billion efficiency dividend if we were to transfer the tax base off the productive sector and onto economic rents.

   To reach this efficiency dividend politically, a significant tax shift must be made. A possible starting point – a 25% drop in income taxes and a 25% rise in the pension could be offset by a 1.2% Land Tax (assuming a $160bn income tax take and a $33 billion aged pension vis the $4.1 trillion land market).

   This implies the following improvements to the Land Tax system:
   1. annual land valuations
   2. a broadening of Land Tax to all residential land
   3. a higher but flatter rate in the dollar. Land in North Sydney is worth more than in Marrickville. By paying the same rate in the dollar, those with a greater capacity to pay do so based on their higher land value. This encourages economic justice, rather than wealth envy. There is no need for progressive land tax brackets. Further to this, agglomeration should be removed.
   4. zero Land Tax thresholds. The trend of state governments increasing Land Tax thresholds has allowed more of the unearned income to be captured. As we can see in the graph below (Australia's Future Tax System, Part 2, Volume 1 consolidated, p272 (PDF)), thresholds act to remove Land Taxes from where they are most needed – on affordable land. Queensland's threshold starts at $600,000.

      In Victoria, Land Tax thresholds have increased every two years from $85,000 (2001) to now $250,000. As economic theory would predict, land prices have risen in accordance with the unearned incomes allowed.

Chart C2–6: Thresholds and average rates of land tax



Note: Land tax in the ACT is determined on a value per property, not on aggregate holding.
Source: NSW Treasury (2009).

Some may argue that Land Taxes should first replace Stamp Duties. In terms of efficiency dividends, that may well be more amenable. However, Land Taxes need to send a signal to the market that they will be increased over time – that the days of unearned incomes in this age of entitlement are over.

9. Further impediments to affordability occur at the local council level. Traditionally council rates were levied on the site (land) value only. NSW & QLD wisely have this ensconced in their constitutions. However, much of Australia now endures a penalty for improving one's property via Capital Improved Valuations (or Net Annual Valuations). Install solar panels, a water tank or a renovation for an expanding family and municipal rates in Victoria, South Australia, Wester Australia and Tasmania will increase under CIV/ NAV valuations.

   This undermines respect for the rating system. It also discourages supply and amenity. The same pressures apply for the commercial sector.

   But how does this affect affordability?

   If an investor finds a traditional Aussie weatherboard on a large block in a good location, there is an immediate incentive to demolish the home (to remove the improvements that are taxed under CIV). Their investment plan is then to sit and wait for 2 – 7 years as the community develops around them.

   They have turned their investment into a tax haven from local council rates. The neighboring family home pays 10 – 40% more in rates than the investor (depending on their improvements). This difference is often more than any differential rate charged against vacant land (which should be discouraged re economic justice, above).

   Traditionally, the 'investors dream' weatherboard home was the bedrock to affordable rental.

The sooner the nation reverts to Site Value rating the better. Then bpoth investors and families are on a level playing field. Rate pegging and minimum rates are two other distortions to be reformed.

10. Data: the urgent need for more timely and accurate real estate data is essential. Continual cutbacks at the ABS have challenged this capacity. As suggested earlier, more of the 'data commons' – public data - is being privatised. This imposes upon the ability to analyse what is happening in our largest market, the land market. The land market sits at $4.1 trillion, the ASX at just $1.5 trillion.

    With RP Data, Australian Property Monitors and onthehouse gaining access to once publicly available data and applying their own selectivities to crucial information, the urgent need for an unbiased data set is required. With additional funding the ABS could expand their sample sizes.

    Part of the trouble with real estate data are the time lags found between different jurisdictions. The South Australian Valuation office releases its land valuations just one month after their collection. However, in Victoria the lag is 18 months. More needs to be done to assist this vital information.

    We ask that the Federal Government move for a 'Sale +3' requirement for all transactions. Three days after sale, typically when the money has been cleared, all property conveyors are to lodge final sales prices with a central registry such as the ABS.

    With a properly functioning data system, one could see the development of public policy tools such as AURIN are pioneering. In time, the affect on land values could be predicted from public developments such as schools, rail and broadband. This would greatly assist in the financing of infrastructure where the beneficiaries (rather than users) pay.

    A genuine sense of economic democracy could be engendered when a zoning approval could be sold to locals on the basis of lower overall council rates.

    This economic system would be helpful for farmers. In good years with timely rain and a productive harvest, they would contribute slightly more to government. However, when there was a drought, lower contributions would be required as their land is less productive. This flexibility is urgently needed.

Conclusion:

In time Land Taxes must be increased as the community realises they actually create land value. If nobody lived in Sydney, the value of land would fall. If everyone returned, land values would rise. Both social and technological developments add to locational value. For this reason it is the natural funding base for government, as both sides of government acknowledged in Australia's formative years.

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Further Reading:

The Total Resource Rents of Australia, Karl Fitzgerald, 2013.