

## 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<sup>1</sup>, by the Senate Select Committee on Housing Affordability in Australia in 2008<sup>2</sup>, and in the May 2015 report of the Senate Economics References Committee on housing affordability.<sup>3</sup> 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.<sup>4</sup>

- 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.'<sup>5</sup>
- 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.<sup>6</sup>
- 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.<sup>7</sup>
- 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.<sup>8</sup>
- 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.<sup>9</sup>
- 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.<sup>10</sup> 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

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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.<sup>11</sup>

- 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.<sup>12</sup>

- 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.<sup>13</sup>

- 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.<sup>14</sup>

- 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.<sup>15</sup> 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.<sup>16</sup>
- 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.<sup>17</sup>
- 2.16 As outlined by the ABA, dwelling ownership accounts for the majority of household assets (58%) in Australia.<sup>18</sup>
- 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.<sup>19</sup>
- 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.<sup>20</sup>
- 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.'<sup>21</sup> The Government has committed to early City Deals for Townsville, Launceston and Western Sydney.<sup>22</sup>
- 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'.<sup>23</sup>

## 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.<sup>24</sup>

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.<sup>25</sup>

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 cyclicity... 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

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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.<sup>26</sup>

- 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.<sup>27</sup>

- 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.<sup>28</sup>

- 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.<sup>29</sup>

- 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.<sup>30</sup>

- 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

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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].

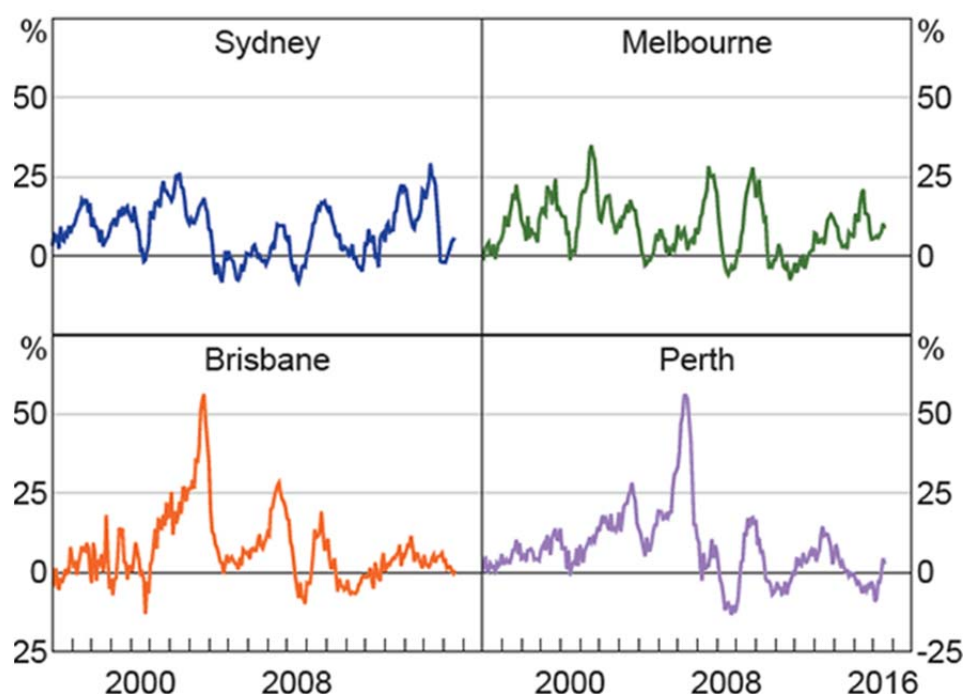
outstripped all economic fundamentals except for the expansion of household debt'.<sup>31</sup>

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.<sup>32</sup>

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.'<sup>33</sup> 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'.<sup>34</sup> 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.<sup>35</sup>

## 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.<sup>36</sup>
- 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.<sup>37</sup>
- 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.<sup>38</sup>
- 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.<sup>39</sup> 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'.<sup>40</sup>

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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.<sup>41</sup>
- 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.<sup>42</sup>
- 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.<sup>43</sup>
- 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.<sup>44</sup> 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.<sup>45</sup>
- 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.<sup>46</sup>

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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.<sup>47</sup>
- 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.'<sup>48</sup>
- 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.<sup>49</sup>
- 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).<sup>50</sup>
- 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.<sup>51</sup>
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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.<sup>52</sup> 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.<sup>53</sup>
- 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.<sup>54</sup>
- 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.<sup>55</sup>
- 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.<sup>56</sup>
- 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.<sup>57</sup>

- 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.<sup>58</sup>

- 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.<sup>59</sup>

- 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.<sup>60</sup>

## 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.'<sup>61</sup>
- 2.50 HIA has also published figures showing improved affordability in most of the major capitals including Sydney for the September quarter of 2016.<sup>62</sup>
- 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

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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.<sup>63</sup>

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'.<sup>64</sup>

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.<sup>65</sup>

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.<sup>66</sup> This was in response to recommendations of the Draft White Paper on 'Reform of the Australian Tax System', published in June 1985.<sup>67</sup>

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.<sup>68</sup> Since 1987, negative gearing has continued to be allowed on all types of investments.<sup>69</sup>

## 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.<sup>70</sup>

- 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.<sup>71</sup>

- 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.<sup>72</sup>

- 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.<sup>73</sup>

- 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.<sup>74</sup>

- 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

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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.<sup>75</sup>

- 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<sup>76</sup> 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.<sup>77</sup>
- 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.<sup>78</sup>
- 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.<sup>79</sup>
- 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.'<sup>80</sup> 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.<sup>81</sup>

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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.<sup>82</sup>
- 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.<sup>83</sup>
- 2.70 Peak industry bodies such as HIA and the Property Council of Australia support the retention of negative gearing.<sup>84</sup> 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.<sup>85</sup>
- 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.'<sup>86</sup>
- 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<sup>87</sup> as revising such arrangements in isolation would create additional distortions and inefficiencies in taxation.<sup>88</sup>

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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<sup>89</sup> 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.’<sup>90</sup>

### 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.<sup>91</sup>

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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.<sup>92</sup>
- 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.<sup>93</sup>
- 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.<sup>94</sup>
- 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.

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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.<sup>95</sup>

- 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.<sup>96</sup>

## 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.

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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.<sup>97</sup>
- 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.<sup>98</sup>
- 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.<sup>99</sup>
- 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.<sup>100</sup>
- 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

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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.<sup>101</sup> The changes also aimed to reduce the tax bias towards asset retention, thereby promoting more efficient asset management and improving capital mobility.<sup>102</sup>

- 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'.<sup>103</sup>
- 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<sup>104</sup> 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.

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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.<sup>105</sup>

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.<sup>106</sup>

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.<sup>107</sup>

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.<sup>108</sup>

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.<sup>109</sup>

- 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.<sup>110</sup>

- 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.<sup>111</sup>

- 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'.<sup>112</sup> 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.<sup>113</sup>

- 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.<sup>114</sup>

- 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.’<sup>115</sup> 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.<sup>116</sup>

- 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.<sup>117</sup>

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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

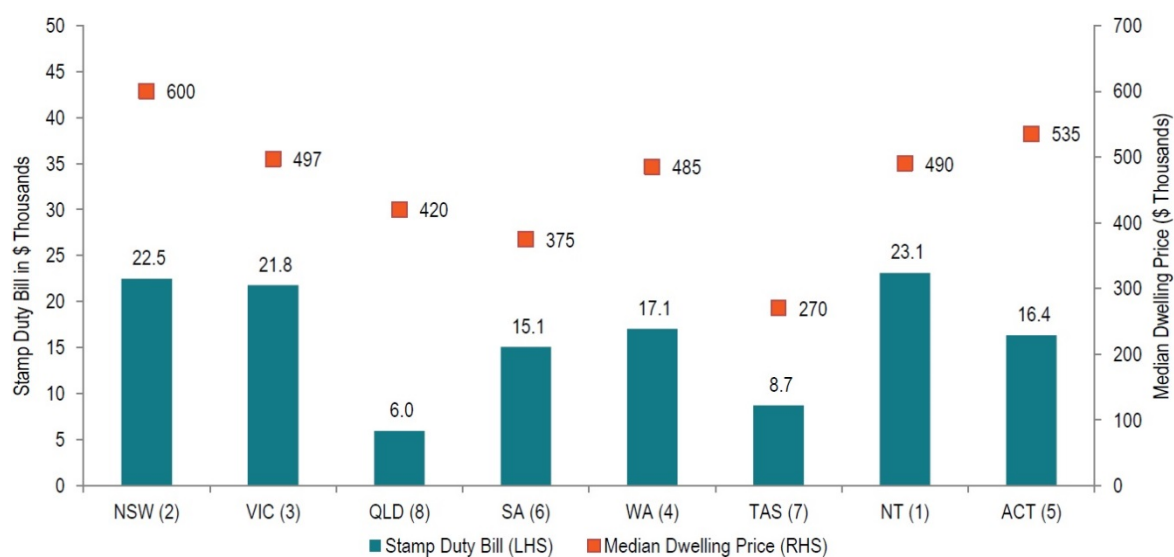
- 2.109 Stamp duty is a tax imposed by state and territory governments on certain types of written documents (known as 'instruments') and some transactions. Stamp duty is normally levied on motor vehicle registration and transfers, insurance policies, leases and mortgages, hire purchase agreements, and transfers of residential and commercial property.<sup>118</sup>
- 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.<sup>119</sup> 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).

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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.<sup>120</sup> The various concessions available, by state and territory, are summarised in Table 2.

<sup>120</sup> 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.<sup>121</sup> Stamp duties on conveyances are the second biggest source of state tax revenue, generating 24 per cent of state tax revenue.<sup>122</sup>
- 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.<sup>123</sup>

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.<sup>124</sup>
- 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.<sup>125</sup>
- 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.<sup>126</sup>
- 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.<sup>127</sup>
- 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.<sup>128</sup>
- 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.<sup>129</sup>

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.<sup>130</sup> 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.<sup>131</sup>

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.<sup>132</sup>

## 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.<sup>133</sup>
- 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.<sup>134</sup>
- 2.127 Many contributors to this inquiry support these recommendations.<sup>135</sup> 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.'<sup>136</sup>
- 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.<sup>137</sup>

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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.<sup>138</sup>

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.<sup>139</sup>

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.<sup>140</sup>

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.’<sup>141</sup>

## 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.<sup>142</sup>
- 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.<sup>143</sup>
- 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.<sup>144</sup>
- 2.139 The Treasury further commented that development activity has picked up more recently, particularly for medium-density dwellings.<sup>145</sup>
- 2.140 The ABA emphasises that land release in Australia is insufficient due to structural issues, commenting that Australia ranks poorly in international

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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.<sup>146</sup>

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.<sup>147</sup> 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.<sup>148</sup>

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.<sup>149</sup>

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,<sup>150</sup> 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)<sup>151</sup> on improving planning, development and rezoning processes, and the release of land.<sup>152</sup>

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.<sup>153</sup>

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.<sup>154</sup>

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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.<sup>155</sup>
- 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.<sup>156</sup>

## 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.<sup>157</sup>
- 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.<sup>158</sup> The HIA remarked that the longer term average of new dwellings each year needs to be 180 000 to 185 000.<sup>159</sup>
- 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.<sup>160</sup>
- 2.151 ABA submits that only supply side interventions, and not policies on the demand side, will resolve housing affordability issues.<sup>161</sup>

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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.<sup>162</sup>
- 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.<sup>163</sup>
- 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.<sup>164</sup> 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.<sup>165</sup>
- 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.<sup>166</sup>

## 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

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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.<sup>167</sup>

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.<sup>168</sup>

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.<sup>169</sup>

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.<sup>170</sup>

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.<sup>171</sup>

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.<sup>172</sup>

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

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.<sup>173</sup>

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.<sup>174</sup>

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.<sup>175</sup>

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.'<sup>176</sup> 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.<sup>177</sup>

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

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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’.<sup>178</sup>

## 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.<sup>179</sup>
- 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.<sup>180</sup>
- 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.<sup>181</sup>
- 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.<sup>182</sup>
- 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.<sup>183</sup>

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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.<sup>184</sup>

## 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.<sup>185</sup> The committee welcomes this important initiative.

**David Coleman MP**  
**Chair**  
**14 December 2016**

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<sup>184</sup> AHURI, *Submission 25*, p. 12.

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