

Housing Justice Roundtable

Second Submission to the Productivity Commission Inquiry into First Home Ownership: Response to Discussion Draft

February 2004

Introduction

The Discussion Draft has highlighted many important issues and provided evidence that adds to the understanding of some of the difficulties facing first home buyers, and by inference the difficulties and stresses facing people in private rental, in emergency housing awaiting a place in a secure tenure and those people that can be described as homeless.

We commend the Commission's effort in encouraging broad community and industry participation and in producing this evidence-based piece of work in the tight time frame set by the Government.

Our concerns however, are that the recommendations at this stage do not offer much in the way of solutions to the current housing crisis and particularly to those individuals and families that are currently missing out on secure and affordable housing.

Specifically, we would argue that the following matters have emerged from evidence both in the Commission's own work and in key submissions and should be addressed in the final report.

Exclusion of low and moderate-income families

1. The progressive exclusion of low and moderate-income families from entry into home ownership, demonstrated by their:
 - Low percentage participation in First Home Owners Scheme (FHOS)
 - Low percentage presence of first homebuyers in housing market.

For instance, an examination of Box 2.2 together with Figure 2.10 in the discussion draft indicates that the participation of low to moderate-income families as first homebuyers has declined from 10% to less than 5% in the period from 1992 to 2003.

Market dominance of investors

- 2 The dominance of investors and second-home buyers in the housing market:
 - There is strong evidence that investors and second-home buyers are dominating housing demand, significantly inflating prices and distorting the range of supply.
 - The Reserve Bank's analysis logically and coolly exposes the importance of the taxation regime to this scenario and in particular, the treatment of negative gearing and capital gains in maintaining high and inflating prices.
 - That Australia is out of step with other developed countries with similar markets in the extent of our investor assistance in comparison with assistance to first homebuyers.
3. The feasibility of making changes to the taxation regime without abandoning the concept or totally removing negative gearing.

The Commission in its discussion of taxation issues (pages 85-89) does not seem to appreciate the relevance to key terms of reference, namely:

“Identify any impediments to first home ownership, and assess the feasibility and implications of reducing or removing such impediments” and

“The inquiry will also identify and examine mechanisms available to improve the ability of households, particularly low income households, to benefit from owner-occupied housing.....”

Research and analysis by the Reserve Bank of Australia and others clearly points to the crowding out effect of investor activity on first homebuyers.

For example, the Reserve Bank notes:

“.....9. It is our view that the main impetus to the continued increases in house prices at present is from the third of the three possibilities noted in paragraph 5: an unusually strong desire by existing property owners for further exposure to residential property, either in their own home, or in an investment property.

.....

12. Thus, we find support for the view that investors have been contributing disproportionately to the increase in housing demand over recent years, with the effect that affordability, especially by first-home buyers, has been reduced.”

and *“....13. The dominant role played by investors in Australia in the current cycle is the result of interaction between:*

- *the desire of investors to earn capital gains from investing in rental property;*
- *the ease of obtaining finance to enter this activity; and*
- *the taxation treatment of investments in residential property.*

concluding

..... the most sensible area to look for moderation of demand is among investors.”

Reserve Bank Submission to PC Inquiry, Executive summary, pp3 to 6.

Clearly the Reserve Bank believes that the great bulk of investor activity relies on favorable taxation treatment and the expectation of capital gains in a rising market.

We agree, and would add that it is very inequitable that funds from the public purse are used to effectively block the entry of low and middle-income families into first home ownership.

This could also lead to an inherently unstable situation.

It would be better public policy to start to manage this activity now—and in the future—than to wait for a housing bust. The impact on the rest of the economy, of business cycles in the housing industry, is too great to ignore.

As indicated in our previous submission, we are not advocating a precipitate removal of the current (negative gearing/capital gains) regime but a scaling back to a less distorting set of arrangements. As a result of such measures, we expect there would be progressive savings to the Government that could be utilised to stimulate the supply of affordable housing. Many alternative financing options have been advocated to the Commission during the inquiry.

HJRt recommendation 15:

That the Commission point out these connections between taxation and increased housing demand/prices, to the Government and recommend, appropriate follow up processes to examine options. These options should be around the key taxation issues and could be presented in tabular form with comments on advantages and disadvantages, e.g. administrative ease, non housing specific, revenue implications, distributional impacts, targeting. These could also be categorised as housing specific or non-housing specific.

Thus the Housing Justice Roundtable ideas on negative gearing reform (a housing specific reform) could be presented as one recommended reform under a heading of Negative Gearing reforms with others, ranging from say abolition or quarantining negative gearing for housing, to the Productivity Commissions draft paper position which seems to call for an overall tax review of which the housing aspects of negative gearing are part.

We believe the Productivity Commission has not completed the evidenced based research to make a firm judgment about excluding or including a number of the proposed options and therefore putting them into the public and policy domain to help build knowledge and decision making capacity would be an important contribution. To call for a tax review without specifying the key questions and options to be addressed could be a formula for delay.

Action by the Commission is crucial. As these taxation issues are so politically and emotionally charged, it is doubtful that either major political party will move on reform without the benefit of objective and evidence-based encouragement from an independent body such as the Productivity Commission.

Connectivity of markets

Another key term of reference of the inquiry also deserves special mention. E.g. *...Pay particular attention "to the operation of the total housing market, with particular reference to the availability of a range of public and private housing types, the demand for housing, and the efficiency and use of the existing housing stock"*

This points to the need to consider the connectivity of home ownership and rental tenure within the housing market. The failure of potential first home buyers to participate in home purchase results in reduced affordability in the rental area, further disadvantaging low income individuals and families having to compete for less stock of affordable dwellings.

Mechanisms for increasing private investment in affordable rental housing have been comprehensively investigated and developed. They require some government support and subsidy to be effectively implemented and successful in facilitating the participation of families on low and moderate incomes. Such measures are arguably more economical and socially effective than current government expenditures through the FHOS and the current negative gearing arrangements.

Housing bond scheme

The bond scheme has wide support across industry, union and community sectors and could provide a vehicle for long-term housing investment as an alternative and more stable substitute for the 'Get rich quick schemes' that rely on the current tax concessions.

Modification of the FHOS to target benefits to low-income households purchasing lower-cost housing, already canvassed by the Commission, as well as modification, not removal, of negative gearing, could facilitate a near revenue neutral change that may stimulate an increase in the supply of affordable housing for first home buyers.

Stamp duty

Funding for such an initiative could be further enhanced if State Governments were encouraged to allocate a proportion of the revenue they obtain from Stamp Duty to this end.

We find it difficult to understand why the Commission is considering the substitution of other taxes for stamp duty yet is so reluctant to reform the much more significant taxation measures when it acknowledges—along with other informed researchers—that stamp duty has negligible influence on first homebuyer participation.

There is instead a strong case to be put to the states to direct stamp duty revenues towards affordable housing initiatives as well as public and community housing

This would seem particularly justified in the case of low-income households who have been displaced and had their access to secure and affordable housing reduced by the property boom.

The Commission has indicated that the rates of collection of stamp duty are progressive, but it is our contention that they could be adjusted to be more so and thereby, provide some assistance at the more affordable end of the market where low and middle income first home buyers are more likely to participate. We set out some revised scales in our previous submission.

It would be appropriate for the Commission to recommend that the States use it or a similar model to reform their Stamp duty collection. We have attached the Victorian analysis again for your attention.

Infrastructure

We ask the Commission to consider the value of National initiatives in infrastructure provision. While the 'horse has bolted' in terms of providing affordable housing in most of the high-cost, amenity-rich areas of our cities, many outer suburbs with lower housing prices lack the amenity that good public infrastructure can provide. It is in these areas that much future potential for strong communities for Australian families lies and we would urge the Commission to consider recommendations in its final report for a national initiative to stimulate infrastructure investment.

(Recommendation 6, first sub. refers)

National government capacity for analysis and policy advice

The current inquiry by the Productivity Commission is welcomed because it is providing an opportunity to review changes in housing markets and access to affordable housing by low and moderate income earners.

But the inquiry is, in one sense, a reaction to an emerging crisis and to lobbying of Government by business and community groups. After the Productivity Commission reports to the Treasurer broadly it is quite possible that coordinated examination of housing markets at a national level could cease.

Part of the reason is that no agency or group within national government has the mandate or capacity to be proactive in this important area of policy analysis and advice. The dearth of submissions from Federal Government agencies to the inquiry, the RBA as an independent statutory authority being a notable exemption, amply testifies to a lack of a housing focus or coordinating capacity with respect to national housing policy.

Recommendation 16

The Housing Justice Roundtable recommends that:

- 1. The Productivity Commission support the reestablishment of a Housing Minister with the resources and mandate to provide policy advice on the operations of Australian urban and regional housing markets within national government. And**
- 2. That given the number of federal agencies whose actions and policies impinge on housing outcomes that a central coordinating capacity be established through a small secretariat in the Department of Prime Minister and Cabinet.**

Relevant tax recommendations from first HJRt submission)

Recommendation 1

Reform negative gearing

Reform negative gearing to encourage increased supply (construction) of affordable housing targeted to low to medium income households.

This would apply to new developments and redevelopment. The proposal is not anti-negative gearing. We accept that there are legitimate business costs that should be tax deductible. However residential property, unlike stock and shares, is a different kind of good with important social and urban form implications flowing from the product of that investment.

In a context of over investment in high-end rental housing and a contraction of supply of low cost rental housing we believe there is justification for some targeting in the application of negative gearing.

- a. For existing investments, no change in current tax arrangement.
- b. For new investments (post some nominated date) in existing (already constructed) housing, negative gearing *of the interest component of loan payments* to be phased down to 75%. Other expenses eg repairs, upgrades and maintenance, etc, at the full 100% deduction.
- c. For investments in newly constructed housing, a sliding scale from 125% of interest on loan payments at affordable end, for example under \$200,000 (detached house and land package) and other figure for multi-unit developments, indexed annually to 75% at expensive end (over \$500,000), to be indexed annually. The idea is to provide a greater incentive for landlords to invest in new and more affordable rental housing rather than turnover and inflate the price of existing property. Other expenses eg repairs and maintenance, etc, at the full 100% deduction.

The ideas here simply illustrate principles. Percentages and values can be modeled for most effective results in terms of revenue and housing outcomes.

Recommendation 2

Depreciation allowance

Increase the depreciation allowance for construction and upgrade of defined affordable accommodation, including multi unit development and other forms, in particular registered rooming houses.

Owners and operators of this kind of low-income housing are seldom able to use negative gearing to their financial advantage and current arrangements are driving them out of this tenure. In the absence of concerted federal and state government programs to bridge the gap, it is important to stabilise this accommodation in the medium term.

New scales could be arranged to be generally expenditure neutral for federal and state budgets.

Recommendation 3

Reform Capital Gains Tax

The 50% concession on the application of capital gain tax should be removed for non-home occupiers. The full concession for home occupiers would be retained for the principal place of residence. Savings from this reform could be directed to the supply of affordable housing.

Auditing procedures should be strengthened to reduce abuse of this exemption, in particular the length of time a property must be owned to be considered the principle place of residence.

Taxation Reform: Victorian State Government (and as a lead to other states)
Reforms to Stamp Duty
Recommendation 4
Reforming basis of collection

This tax adds to the expense of home purchase for many people on low or moderate incomes who wish to purchase a dwelling for their own use. Stamp duty scales could be restructured to provide relief at more affordable end of market and increased at the luxury end.

This will send a message to speculators and could be arranged to be revenue neutral. Additional relief to first home buyers could be easily incorporated with a threshold change. We have modeled the situation for metropolitan Melbourne and produced new schedules with the following features: (The methodology and computations are set out in Appendix 1)

Recommendation 5

Redirect the use of stamp duty revenue

The purpose and usefulness of this state tax could be made more transparent to the public if a proportion of the increased revenue was directed to relevant housing programs.

The Victorian Government could simply do this by legislating or at the least announcing as part of its annual budget the purposes for which a definite proportion of stamp duty was to be used. A number of important projects to increase the supply of affordable housing could be established and sustained in this way:

Community building, neighborhood renewal and area improvement activities in both country and metropolitan areas. This would be administered to involve local communities and local government in the development and implementation of projects.

Urban and regional infrastructure investment to foster the sustainability and diversity of housing development and redevelopment.

This funding line could support “housing affordability partnership projects” with local government

Directly assist the alleviation of homelessness with increased supply of public housing, youth housing and other low cost housing initiatives including housing for the aged.

Appendix 1

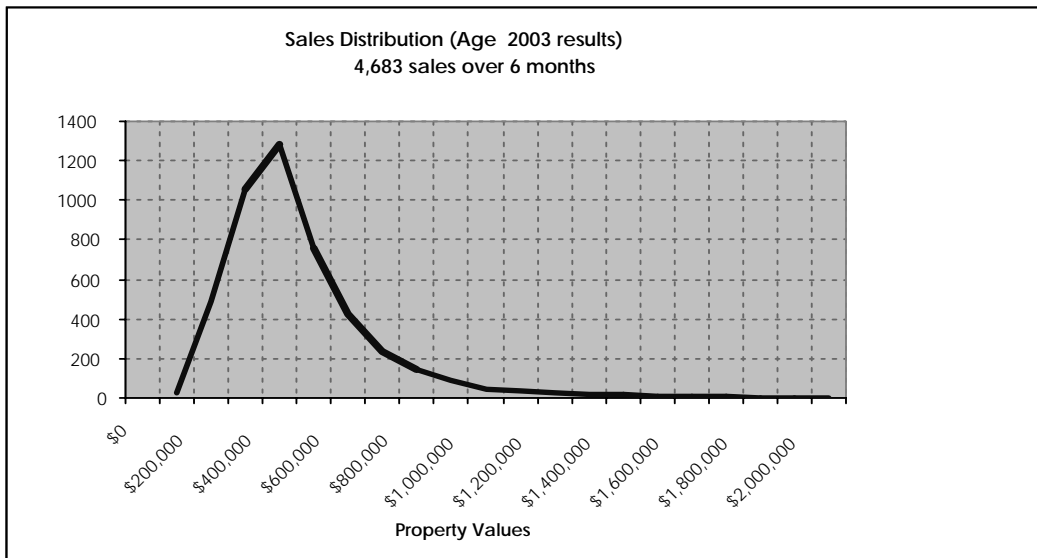
Collection of Stamp Duty on Residential Properties in Victoria

The task was to test the feasibility of adjusting the schedules currently used to assess stamp duty to meet two objectives

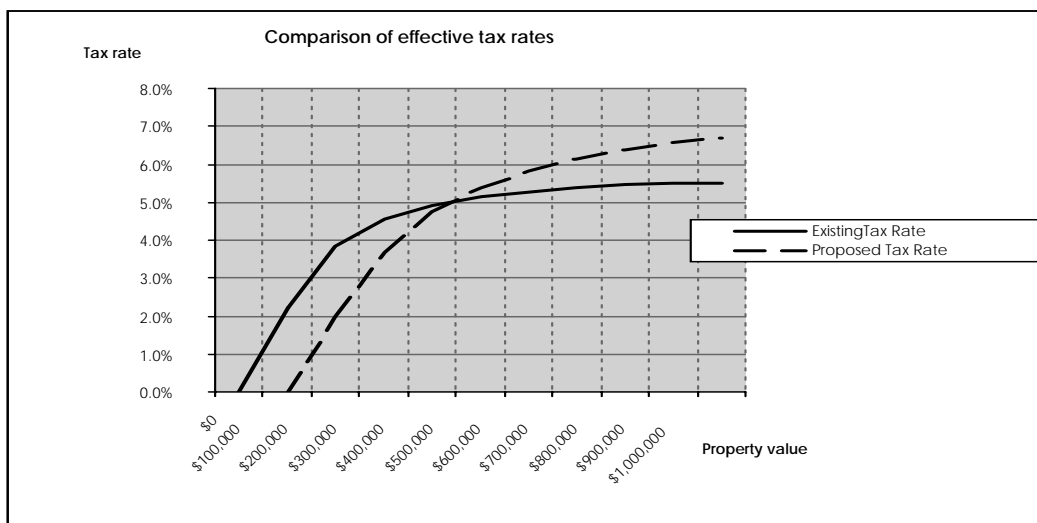
1. To reduce burden on first home buyers purchasing at the more affordable end of the price spectrum.
2. To maintain as far as possible a revenue neutral outcome for State finances

The method used involved the following steps and assumptions:

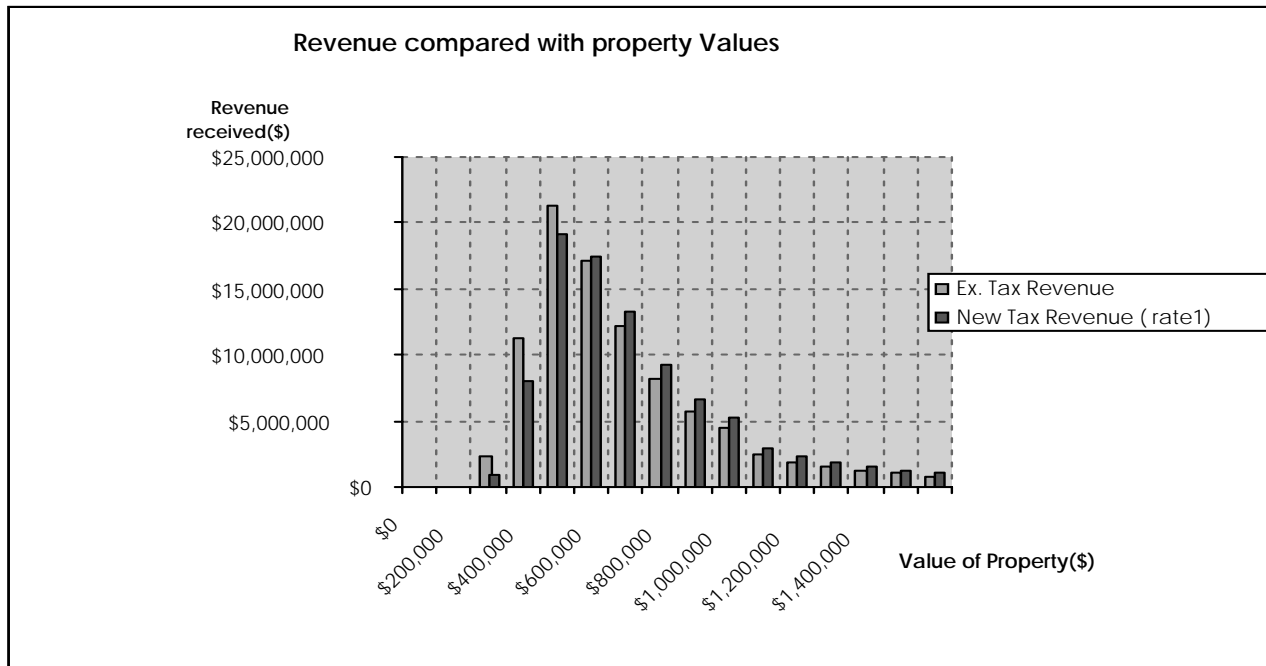
1. Records of house sales in metropolitan Melbourne were gathered from the Age Newspaper for the period April to September 2003.
2. These were plotted and as might be expected fell into a normal distribution around the median house price



3. The existing schedules were then applied to this sample to estimate the tax revenue obtained from these sales.
4. New scales were then created to meet the design criteria and adjusted to provide a comparable tax income.



- The change with respect to housing consumers in buying in different price ranges is illustrated in the following table:



- The main features are:
 Under the new schedules purchases up to \$200,000 have a minimum reduction of pay approximately half the current stamp duty equivalent to \$3,660
 At \$300,000 their payment is reduced by 20% equivalent to \$2,660.
 At \$400,000 it is reduced by about 4% equivalent to \$660.
 The schedule is progressive with regard to price so that for house purchases of \$1,000,000 the duty increases by 20%
- The following spreadsheet sets out the detailed calculations together with relevant assumptions

Melb. Metro.

Sale price	Existing rates (1)	Proposed rates(2)
\$0	\$0	\$0
\$100,000	\$2,200	\$0
\$200,000	\$7,660	\$4,000
\$300,000	\$13,660	\$11,000
\$400,000	\$19,660	\$19,000
\$500,000	\$25,660	\$27,000
\$600,000	\$31,660	\$35,000
\$700,000	\$37,660	\$43,000
\$800,000	\$43,660	\$51,000
\$900,000	\$49,500	\$59,000
\$1,000,000	\$55,000	\$67,000
\$1,100,000	\$60,500	\$75,000
\$1,200,000	\$66,000	\$83,000
\$1,300,000	\$71,500	\$91,000
\$1,400,000	\$77,000	\$99,000
\$1,500,000	\$82,500	\$107,000
\$1,600,000	\$88,000	\$115,000
\$1,700,000	\$93,500	\$123,000
\$1,800,000	\$99,000	\$131,000
\$1,900,000	\$104,500	\$139,000
\$2,000,000	\$110,000	\$147,000

Tax revenue

Tax revenue

Sales distribution(3)	Ex Av Rate	Existing(4)	Av Rate I	Proposed(5)
23.0	\$1,100	\$25,300	\$0	\$0
492.0	\$4,930	\$2,425,560	\$2,000	\$984,000
1061.0	\$10,660	\$11,310,260	\$7,500	\$7,957,500
1279.0	\$16,660	\$21,308,140	\$15,000	\$19,185,000
759.0	\$22,660	\$17,198,940	\$23,000	\$17,457,000
425.7	\$28,660	\$12,200,562	\$31,000	\$13,196,700
236.5	\$34,660	\$8,197,090	\$39,000	\$9,223,500
141.9	\$40,660	\$5,769,654	\$47,000	\$6,669,300
94.6	\$46,580	\$4,406,468	\$55,000	\$5,203,000
47.3	\$52,250	\$2,471,425	\$63,000	\$2,979,900
33.3	\$57,750	\$1,923,075	\$71,000	\$2,364,300
24.3	\$63,250	\$1,536,975	\$79,000	\$1,919,700
18.3	\$68,750	\$1,258,125	\$87,000	\$1,592,100
13.8	\$74,250	\$1,024,650	\$95,000	\$1,311,000
10.3	\$79,750	\$821,425	\$103,000	\$1,060,900
7.8	\$85,250	\$664,950	\$111,000	\$865,800
5.8	\$90,750	\$526,350	\$119,000	\$690,200
4.3	\$96,250	\$413,875	\$127,000	\$546,100
3.3	\$101,750	\$335,775	\$135,000	\$445,500
2.3	\$107,250	\$246,675	\$143,000	\$328,900
4683.5				
Relative income		\$94,065,274		\$93,980,400
				-\$84,874

NOTES:

a. (1) Existing rates are 1.4% of the property value for first \$20,000 plus 2.4% of value in excess of \$20,000 to \$115,000 plus 6% of value above

\$115,000 to \$870,000. Above \$870,000 rate is 5.5% of total value of the property.

b. (2) Proposed rates are no charge for the first \$100,000, 4% of the value in excess of \$100,000 until \$200,000, plus 7% of the value in excess of

\$200,000 plus 8% of the value above \$300,000.

c. (3) This distribution is obtained from the actual sales in Metropolitan Melbourne as reported in the Melbourne Age for April-September 2003. The values

between \$500,000 and \$1,000,000 are interpolated using equal area and those in excess of \$1,000,000 extrapolated by progressive reduction.

d. (4)&(5) The relative tax revenues for existing and proposed scales are obtained by the product of the number of properties and the effective rate.

e. The 2003-04 budget estimate for financial and capital transactions is \$2,348.2 million.

The variation predicted by this model would be of the order of \$2 million downwards.

Given the volatility in the variables impinging on the calculation and that Treasury estimates have varied by several hundred million in recent years it is pointless to seek greater accuracy.