

REAL ESTATE INSTITUTE OF AUSTRALIA COMMONWEALTH GOVERNMENT BUDGET SUBMISSION 2011/2012

PURPOSE

In the context of the preparation of the 2011-2012 Budget the Real Estate Institute of Australia (REIA) seeks the Commonwealth Government's consideration of the following:

- Retention of current arrangements for negative gearing of property investments
- No Capital Gains Taxes on the family home
- No increase in Capital Gains Tax on property investments
- Removal of stamp duty on property transactions
- Review the amount of the First Home Owners Grant
- Allowing first home buyers access to their superannuation for the purchase of a home
- Monitor HAF and NRAS to observe its effects on housing supply and to conduct a review which considers additional measures to bridge the demand - supply imbalance.

BACKGROUND

The REIA is the peak national association for the real estate profession in Australia.

The REIA's members are the State and Territory Real Estate Institutes, through which around 80% of real estate agencies are collectively represented. The real estate industry employs approximately 80,000 persons. The REIA represents an important element of the broader property and construction sector which together makes a significant contribution to Australia's social climate and economic development. Property contributes \$300 billion annually in economic activity and played an integral role in the Government's response to the global financial crisis.

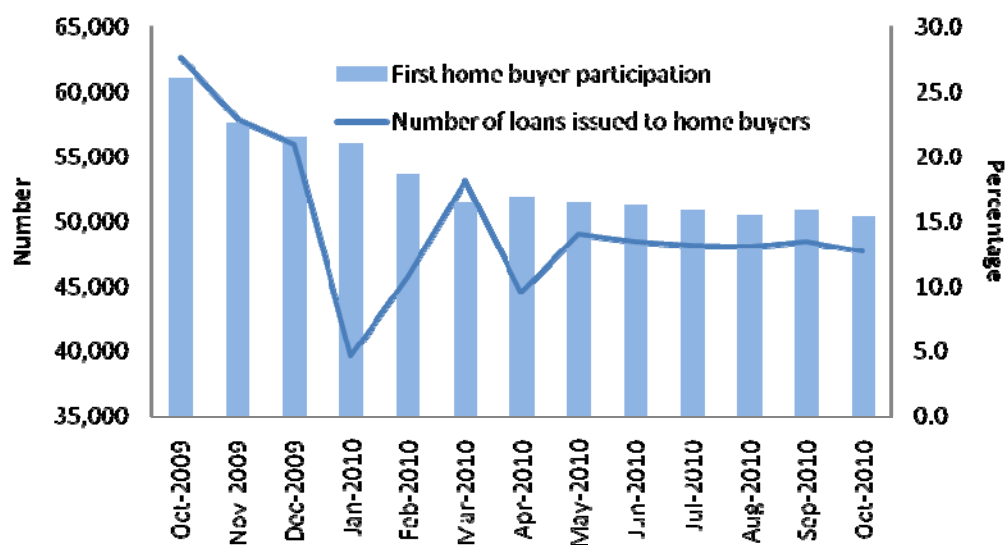
In responding to the devastation of the recent flooding throughout Australia the property sector will again play a pivotal role.

CONTEXT OF SUBMISSION

- Global economic recovery continued during 2010, although there are some concerns in relation to the resilience of this recovery particularly due to the

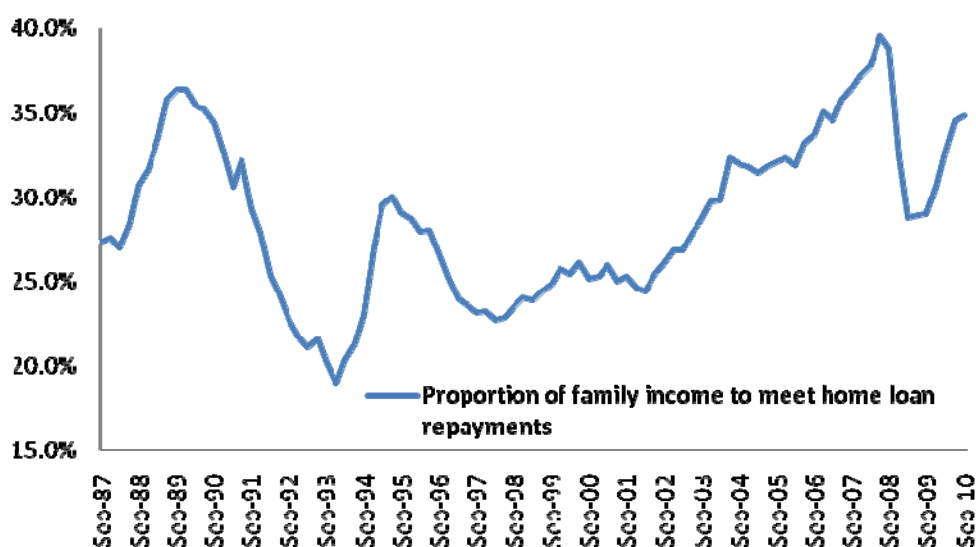
continuing high unemployment rate levels observed in the United States, the high sovereign debt ratios in some European economies and the removal of fiscal and monetary stimuli that were supporting economic activity during and after the GFC.

- Australia's economic performance has stood out amongst other advanced economies; the high level of commodity prices and terms of trade, and strong public investment have been contributing significantly to Australia's economic growth, boosting national income and demand. Economies in China and East Asia have signalled strong performances, which whilst benefitting the Australian economy has implications on monetary policy and at times adverse consequences on the non-traded sectors of the Australian economy such as housing. Conditions across industries vary considerably, with the mining sector showing a very strong performance while activity in the construction industry has as the stimulus-related public building activity runs down.
- Due, in large part, to the impact of the high level of commodity prices and the improving terms of trade on nominal income, the official cash rate was raised 75 percentage points over 2010/2011 to avoid inflationary pressures. Increases in the cash rate have had counterproductive impacts on the construction sector and the property market.
- Residential building activity weakened across Australia during 2010 as a consequence of higher financing costs and restrictions on the access of credit and consequently exacerbated the already acute housing supply imbalance. Higher borrowing costs also slowed down the number of housing loans commitments, added to deteriorating housing affordability and almost halved the number of first home buyers.
- The graph below shows the number of loans issued to home buyers and the participation of first home buyers of all dwellings finance from October 2009 to October 2010. During this period, the number of home loans issued to home buyers decreased 24.9 percent while the participation of first home buyers dropped to 15.4 percent, the lowest monthly participation observed since August 2004.



Source: Australian Bureau of Statistics (ABS)

- The tighter monetary policy over the past year put pressure on housing affordability. The REIA Deposit Power/Housing Affordability report shows that in September 2010, the proportion of family income to meet monthly loan repayments increased to 34.8 percent from 28.8 percent in March 2009. This means that, on average, a household with a mortgage allocates an additional six percent of its income to meet monthly home loan repayments, that is \$500 more per month approximately. If, as some analysts forecast, in the incoming year mortgage rates reach 8.0 percent as a result of even tighter monetary policy, it is likely that 38.0 percent of family income will be needed to meet home loan repayments – approaching the record level of 39.5 percent in June 2008.



Source: Real Estate Institute of Australia (REIA) Deposit Power Housing Affordability report

- Over the last year, the average loan size increased 9.5 percent, while monthly loan repayments grew 26.2 percent.
- The outlook for the Australian economy is positive, underpinned by a strong growth in investment in the resources sector and high commodity prices. Yet, there is uncertainty around how the benefits from high commodity prices and terms of trade are distributed throughout the economy, in particular what impact these have on the non-traded goods and services sectors.
- The measures taken by the Government and the Reserve Bank in the latter stages of 2008 in response to the global financial crisis helped to improve housing affordability in Australia. However, the recent and expected future increases of mortgage interest rates will decrease housing affordability and could increase mortgage stress on households. Lack of housing supply will put additional pressure on housing affordability.

- The REIA seeks Government consideration of seven specific matters as part of the preparation of the Federal Budget 2011/2012. These are aimed at contributing to Australia's continuing economic development, addressing the supply of rental housing, improving affordability, and ensuring adequate access to housing finance.

RETENTION OF CURRENT ARRANGEMENTS FOR NEGATIVE GEARING OF PROPERTY INVESTMENTS

Proposal

- Negative gearing in its current form for the purpose of property investment is complementary to the goals of the Housing Affordability Fund (HAF) in addressing the supply of rental accommodation.
- The Henry Review proposed the replacement of current negative gearing arrangements with the introduction of a 40.0 percent discount for income from rental properties. This means that deductions are also discounted by 40 percent. The argument stated by the review is that the current structure of tax income from savings creates distortions, causing misallocation of savings in particular in the rental property market and leads to investors taking on excessive debt. The Henry Tax Review considers the introduction of a broad 40 percent discount for income from rental properties would mitigate those distortions.
- According to the taxation statistics 2007-08 the total number of rental property schedules was 2,382,560; 78% of the total number of rental property schedules paid a total amount of \$19,364 million interests on loan which represents 62% of the total rental property expenses and an average interest expense of \$10,649 per rental property schedule. The average loss across all the schedules, not just negative geared property is \$3,526.

Taxation Statistics 2007-2008

Rental property Schedules	No.	2,382,560
Rental Income	No.	2,318,110
	\$	22,686,265,587
Other rental Income	No.	328,665
	\$	168,980,524
Interest on loan	No.	1,818,445
	\$	19,364,931,885
Total rental property expenses	No.	18,795,780
	\$	31,208,699,259
Net rental income	No.	2,368,990
	\$	-8,353,453,129

- The table below quantifies the impact of the Henry Review recommendation for rental properties. We see that for an investor with an annual income of \$80,000 (some sources suggest that taxpayers who earn this annual income own 80% of all loss-making properties) and using the average loss of \$3,526 from the taxation statistics we see that the average property investor pays an additional \$635 in tax. This represents a rent increase of roughly \$13 per week or 4 percent of the median house rent for three bedroom houses. The impact on many investors and their properties will be greater than this. In an already tight rental market – with an average vacancy rate of just 2.2 percent ranging from 0.8 percent in Adelaide to 3.4 percent in Brisbane and Perth in September 2010 – the impact on renters will be dramatic.

With Negative Gearing		With 40% discount on savings	
Personal Income	\$80,000	Personal Income	\$80,000
Average loss on net rental income	\$3,526	Average loss on net rental income	\$3,526
Taxable income	\$76,474	Taxable income	\$77,884
Taxes	\$16,792	Taxes	\$17,427

- ***The REIA proposes that negative gearing be retained in its current form for the purpose of property investment.***

NO CAPITAL GAINS TAX ON THE FAMILY HOME

Proposal

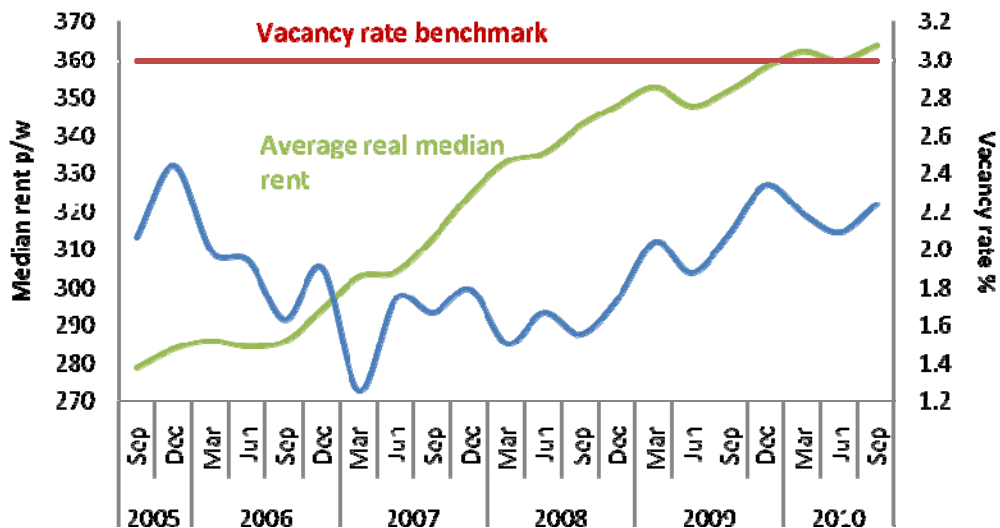
- Some submissions to the Henry Review have argued that the current structure of property taxes is inequitable and brings about overinvestment in the family home. Many have proposed the introduction of a capital gain tax on properties above a certain value - \$1 million is a popular proposed trigger point.
- The Henry Review proposed owner-occupied housing is tax-exempted or close to exempt in practice. This is because taxing long-term gains on owner occupied housing, could create a bias against this type of savings penalising those taxpayers who choose to defer consumption by saving for a house.
- The cost of administering an annual CGT payment on family homes also needs to be considered. A way of valuing subject property would be required. A general movement in prices would not be sufficient or equitable. Houses are not a homogeneous product. There are many differences in the attributes of houses and their condition and maintenance. It is these differences that determine why one property is worth more than another even when they are next door to each other. Not only are there differences in the characteristics determining the base line valuation but improvements to the property such as renovated kitchens, extensions and landscaping need to be reviewed on an annual basis if an accurate assessment is to occur. An appeal mechanism will also need to be in place to allow house owners across Australia to dispute Government valuations.

- *The REIA proposes that a capital gains tax is not imposed on the family home.*

NO INCREASE IN CAPITAL GAINS TAX ON PROPERTY INVESTMENTS

Proposal

- Again, many submissions to the Henry Review called for the doubling of CGT on rental properties.
- The Henry Review proposed a 40 percent discount for income from capital gains of rental properties, eliminating the current CGT discounts on rental properties held by twelve months or more and thereby increasing the amount of tax paid by real estate investors.
- The Henry Review proposal would have major consequences on the supply of rental housing in a market that already has tight vacancy ratios. Over the period 2005-2010, the vacancy rate in Australia has remained below the 3.0 percent benchmark and is currently situated just above 2.0 percent. During the same period, the average real median rent increased 30.5 percent.



Source: REIA

- The Henry Review proposal would increase the tax paid on capital gains which will discourage investors to allocate financial resources in the property market, exacerbating the already low levels of vacant rental properties and consequently pushing rents up further.
- The impacts on rents could be similar to the situation in 1985 when the Hawke Government denied many investors tax deductibility of interest payments. With a market response that led to an undersupply of rental property and escalating rents before the decision was reversed less than 24 months later. The REIA believes that any increase in capital gains tax arrangements for rental property, would lead to a similar response to that in 1985.

- ***The REIA proposes that capital gains tax on property investments is not increased.***

ABOLITION OF STAMP DUTY ON PROPERTY TRANSACTIONS

Proposal

- Whilst stamp duties are a state tax and are thus not determined by the Federal Government states will not act unilaterally on the matter unless leadership is shown by the Federal Government. The Henry Review identified stamp duties as a most inefficient tax.
- Stamp duties represent additional costs to property transactions, thereby discouraging turnover of housing and distorting choices between renting and buying, and between moving house and renovating. Individuals who move more frequently would pay more taxes than those who move less. Others, who would have to buy or sell if they changed jobs, could be deterred by these costs thus reducing labour mobility. These distortions lead to a sub optimal outcomes, reduce investment in the property market and impede labour mobility.
- An Australian National University research paper by Andrew Leigh, “how do stamp duties affect the housing market”, shows that increases in stamp duties lower turnover in the short and medium run. Specifically, a 10 percent increase in stamp duty diminished housing turnover by between 2 and 5 percent.
- Similarly a just released OECD report, “Going for Growth in 2011”, also notes that lower transaction costs such as stamp duties encourages mobility.
- From the fiscal revenue perspective, stamp duties are a major source of revenue for states. Revenue from conveyance stamp duties is however highly volatile, unreliable and unpredictable.
- According to the Henry Review “stamp duties on conveyances are inconsistent with the needs of a modern tax system. While a significant source of state tax revenue, they are volatile and highly inefficient and should be replaced with a more efficient means of raising revenue”.
- ***The REIA proposes conveyance stamp duties be abolished and replaced by an efficient source of revenue for states and territories.***

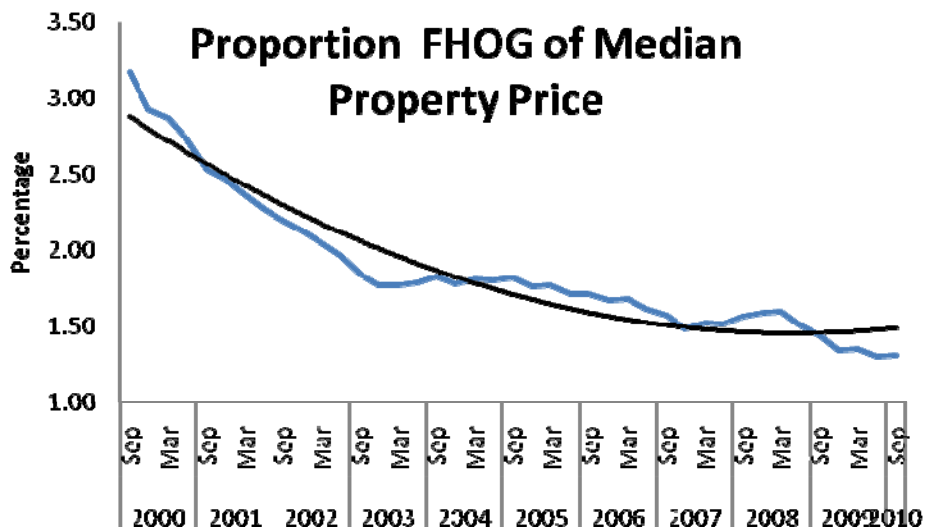
REVIEW THE AMOUNT OF THE FIRST HOME OWNERS GRANT

Proposal

- One of the most important housing policy instruments in assisting first home buyers with housing affordability is the First Home Owners Grant (FHOG), which was introduced in July 2000.
- The REIA urges Government to review the amount currently provided as the relative size of the grant has declined markedly in relation to house prices. When the FHOG

was introduced in July 2000, the Australian quarterly weighted average median house price was \$220,443. The Australian weighted average median house prices in the most recent quarter for which data is available, September 2010, was \$533,447.

- The graph below shows the contribution of the grant towards the purchase price has more than halved from 3.2% to 1.3% over the period. The proportion of FHOG in median house prices exhibits a downward trend since the introduction of the grant. Except in those states/territories which have stamp duty concessions for first home buyers, when stamp duties are taken into account the decline is even more marked.



Source: REIA

- Coincidentally with the introduction of the Boost in October 2008 the FHOG, for an established dwelling, had in essence retained parity with the time it was introduced.
- ***The REIA proposes that the FHOG be set at \$15,000 for all housing, new and established, and that it be indexed to median house price movements annually.***

ALLOW FIRST HOME BUYERS ACCESS TO THEIR SUPERANNUATION FOR THE PURCHASE OF A HOME

Proposal

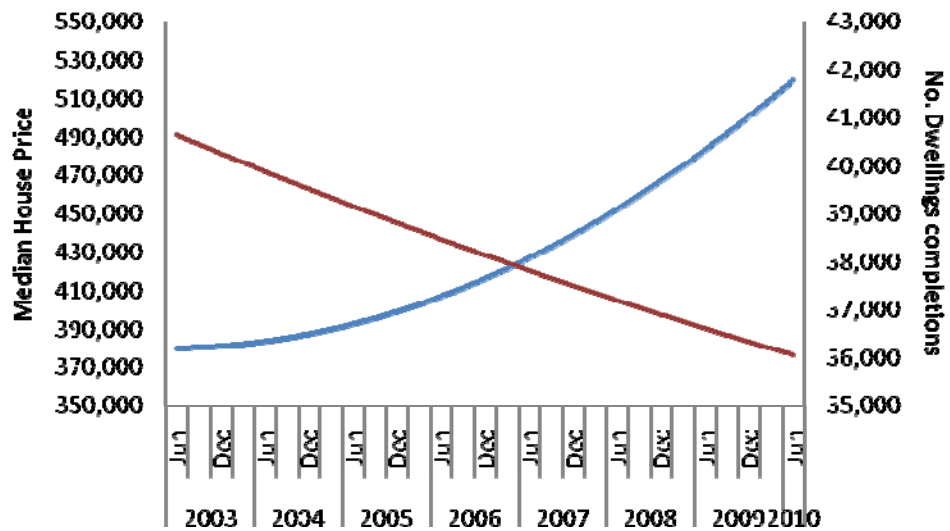
- Notwithstanding the response by first home buyers to the Boost the REIA is concerned that the overall level of homeownership in Australia has not shown significant improvements since 1995 and that first home buyers find it increasingly difficult to enter the housing market. Although the Boost has helped the participation of first home buyers in the market, it was a short term measure and does not provide first home buyers long term support.

- The REIA notes that the Treasurer has recently released for public consultation an exposure draft of legislation that will increase the flexibility of First Home Saver Accounts. The proposed changes should encourage new participants to open First Home Saver Accounts. In its submission on the draft legislation the REIA welcomed and supported the proposed changes. Whilst the changes are welcome the REIA believes that further changes would make the scheme more attractive to first home buyers and thus make the scheme more effective and equitable in achieving its objective.
- As part of a package of measures to address the affordability problem, the REIA proposes that the Commonwealth Government should establish a scheme which would encourage young Australians to contribute to voluntary superannuation by allowing access to these resources for the purposes of raising a deposit for a first home.
- The scheme would be an adjunct to the First Home Savers Account but would allow flexibility for the saver to decide whether all or part of the voluntary superannuation payments was needed to augment the home purchase.
- The integrity of compulsory superannuation would be maintained by limiting the scheme to the voluntary superannuation contributions of first home buyers.
- ***The REIA proposes that first home buyers have access to their voluntary superannuation contributions for the purchase of a home.***

MONITOR HAF AND NRAS

Proposal

- One of the factors that contributes to increases in house prices is the under supply of housing. Supply has been unable to keep pace with demand due to constraints on land availability, lengthy planning delays, skill shortages and lower yields stemming from the increased cost of entering the property investment market.
- The graph below shows the trends of median house prices and the number of new dwelling completions over the period Jun03-Jun10. There is an inverse relationship between median house and the number of dwellings completed: the upward trend in median house prices is associated with a downward trend in the number of dwelling completions.



Sources: ABS, REIA

- In July 2008, the Federal Government established the Housing Affordability Fund to address housing supply problems, particularly the holding costs incurred by developers as a result of long planning and approval waiting times and infrastructure costs. It also targets infill and greenfield developments.
- The REIA is acutely aware that housing affordability is a major issue to be addressed and is supportive of the Federal Government's housing supply strategy including the National Rental Affordability Scheme and the Housing Affordability Fund.
- According to the National Housing Supply Council the gap between the supply and demand for housing will increase in the next eight years, which will put further pressure on house prices.

Date	Cumulative Demand-Supply gap
2008	85,000
2009	108,000
2010	131,000
2012	179,000
2014	226,000
2018	316,000

Source: National Housing Supply Council, State of Supply report

- REIA considers it is important to not only monitor the impact of the National Rental Affordability Scheme and the Housing Affordability Fund on housing supply to

gauge whether its objectives are being met but to also conduct a review which considers additional measures to bridge the demand- supply imbalance.

- ***The REIA proposes that Federal Government's HAF and NRAS programs be monitored to observe its effects on housing supply and to conduct a review which considers additional measures to bridge the demand - supply imbalance.***

CONCLUDING COMMENT

- The REIA welcomes the opportunity to present the Government with proposals for the 2011/2012 Federal Budget which are aimed at contributing to Australia's continuing strong economic development, addressing the supply of rental housing and improving housing affordability.
- The REIA proposes that
 - ***Negative gearing be retained in its current form for the purpose of property investment.***
 - ***A capital gains tax is not imposed on the family home.***
 - ***Capital gains tax on property investments is not increased.***
 - ***Conveyance stamp duties be abolished and replaced by an efficient source of revenue for states and territories.***
 - ***The FHOG be set at \$15,000 for all housing, new and established, and that it be indexed to median house price movements annually.***
 - ***First home buyers have access to their voluntary superannuation contributions for the purchase of a home.***
 - ***The Federal Government's HAF and NRAS programs be monitored to observe its effects on housing supply and to conduct a review which considers additional measures to bridge the demand - supply imbalance.***

PREPARED BY

Real Estate Institute of Australia

January 2011