REIA

REAL ESTATE INSTITUTE OF AUSTRALIA

REIA PRE BUDGET SUBMISSION 2019-2020

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PREPARED BY

Real Estate Institute of Australia (REIA)

PO Box 234

DEAKIN WEST ACT 2600

Ph: 02 6282 4277

@REIANational

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REIA PRESENTS THE GOVERNMENT WITH PROPOSALS FOR THE 2019/20

FEDERAL BUDGET

The Real Estate Institute of Australia (REIA) is the peak national association for the real estate profession in Australia.

REIA's members are the State and Territory Real Estate Institutes, through which around 75% of real estate agencies are collectively represented. The 2011 Census records the Rental, Hiring and Real Estate Services Industry employment as sitting at a total of 117,880. Key data recorded by the Australian Bureau of Statistics (ABS) Census identified, by occupation, 64,699 business brokers, property managers, principals, real estate agents and representatives.

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.

Importantly, REIA represents an integral element of the small business sector. Some 99% of real estate agencies are small businesses and 11% of all small businesses in Australia are involved in real estate. Only 0.6% of businesses employ 50 or more persons.

REIA is committed to providing and assisting with research and well-informed advice to the Federal Government, Opposition, professional members of the real estate sector, media and the public on a range of issues affecting the property market.

Introduction

The Real Estate Institute of Australia (REIA) welcomes the opportunity to present the Government with proposals for the 2019/20 Federal Budget and in the context of its preparation, seeks Government consideration of five specific matters.

The two primary focuses of REIA's proposals are firstly taxation as it relates to property and the need for a holistic approach and secondly housing affordability for first home buyers.

The need for Government to recognise the importance of the property sector as a driver of economic growth by appointing a Minister of Property Services and to ensure the availability of reliable data to formulate policy are also addressed.

By addressing these key areas REIA's proposals are aimed at contributing to Australia's continuing economic development and productivity.

Economic Background

The economic circumstances whilst showing signs of improvement are not greatly different to what they were when the 2018-19 Budget was delivered: whilst unemployment has shown modest improvement wages growth is low; growth is still below trend; and business and consumer confidence are still low despite five years of record low interest rates.

In 2018, the recovery of the global economy continued, albeit at a slower-than-expected rate with growth in the economies of Australia's major trading partners being below their historical average.

The RBA's Minutes of its December 2018 Board meeting note that "growth in a number of economies had slowed this year; softer external demand, at least partly related to trade tensions and the associated uncertainty, had been a common driver of the slowdown" and "indicators of external demand, such as new export orders, had softened in the euro area, Japan and other parts of Asia".

September quarter 2018 National Accounts show that quarterly growth in Australian GDP slumped to 0.6 per cent in trend terms compared to 0.8 per cent in each of the previous three quarters. Falling home construction was a contributor to the outcome.

According to the World Economic Outlook presented by the International Monetary Fund (IMF) in October 2018 said, "the steady expansion under way since mid-2016 continues, with global growth for 2018–19 projected to remain at its 2017 level. At the same time, however, the expansion has become less balanced and may have peaked in some major economies. Downside risks to global growth have risen in the past six months and the potential for upside surprises has receded. Global growth is projected at 3.7 percent for 2018/19 —0.2 percentage points lower for both years than forecast in April 2018".a

In the Mid-Year Economic and Fiscal Outlook released by Treasury in late 2018, real GDP is forecast to grow by 3 per cent in fiscal 2020, down from the originally forecast 3.25 per cent. The update forecasts wages to grow at a slower rate than first thought - 2.5 per cent in fiscal 2019, down from the 2.75 per cent forecast in the May budget - and likely to slow consumption.

For a number of years now, as Australia's economy transitions from resource investment to other drivers of growth and economic activity, significant differences in economic performance across industries and regions have been a distinctive feature of the economy. Whilst it has been expected that the weakening Australian dollar would provide a much needed stimulus to a number of sectors the full impact of this is still some time away.

Importantly, dwelling investment supported by historically low interest rates has been a significant contributor to growth in the Australian economy since 2013/14. Australia's property industry has been a main driver of economic growth and increased employment in the transition away from a decade-long reliance on mining.

Providing a stimulus to economic activity outside the mining sector, including the housing and building sectors, was amongst the main reasons for the RBA to keep the official cash rate at record low levels since August 2013.

New home building has been a crucial support to economic growth over the past three years. This however is now on the wane.

APRA credit restrictions, the Banking Royal Commission, difficulties borrowing against self-managed super funds (SMSFs), less foreign investors and fears of changes to negative gearing and capital gains tax following the next Federal election are having a major impact on the property market which in turn impacts on building activity and economic growth.

Credit growth across the housing market is the lowest it has been since the 1983 recession with growth in lending to investors being the lowest on record.

The Council of Financial Regulators at their meeting at the end of 2018 have noted this and expressed concern that a reduction in bank lending in response to the Royal Commission into Financial Services and tougher regulations will cut the flow of credit required to help the economy grow.

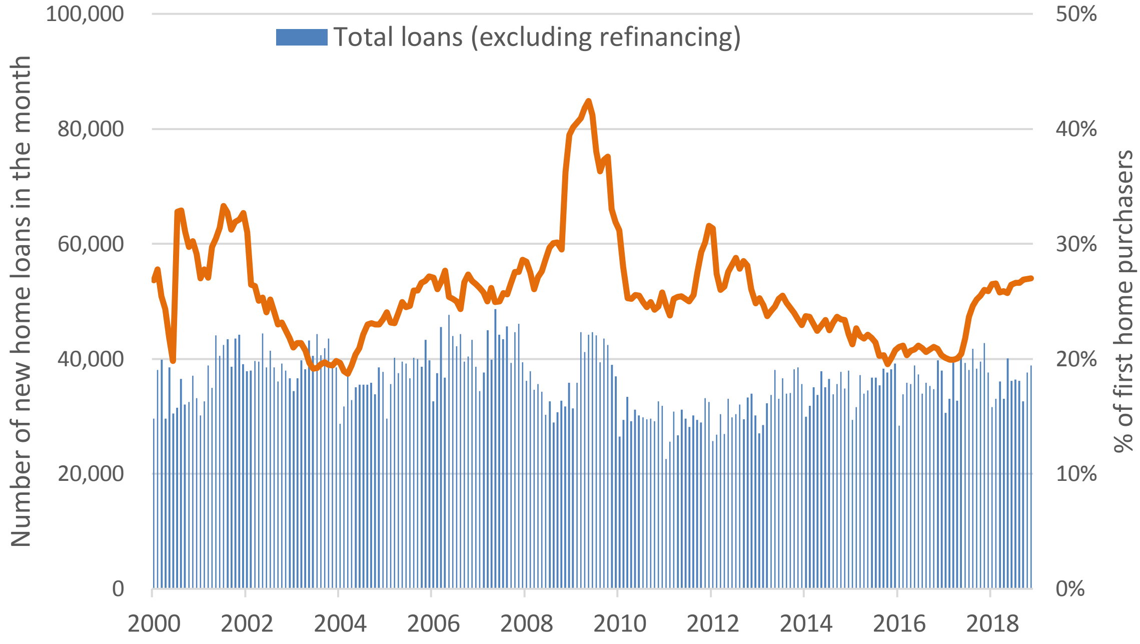
The challenge during 2019/20 will be to manage the transition to lower volumes of new home building.

It is against this background that REIA's Pre Budget Submission for 2018/19 is framed and seeks Government action to maintain activity in the property sector which is critical to the Australian economy.

Whilst investor activity in housing has in large part been responsible for the supply response from the building sector contributing to economic growth, this, up until recently, had been at the cost of first home buyers and their ability to enter the housing market.

The graph below shows the number of loans to home buyers (excluding refinancing) and the proportion of first home buyers in the housing finance commitments from November 2000. We can see that since April 2012, when official interest rates were 4.25 per cent compared to the current 1.5 per cent, the participation of first home buyers declined by 17 percent until a pick up in the last year. This decline is despite ten cuts in the official interest rate over that period.

Finance Approvals and the Proportion of First Home Buyers (excluding refinancing)



Source: 5609 Housing Finance Australia 2000 – 2018 (ABS)

Whilst historically low interest rates may make mortgage payments achievable for first home buyers it is the deposit gap together with stamp duties that are the insurmountable hurdle.

With first home buyers finding it difficult to enter the housing market, home ownership in Australia is declining after four decades of stable levels. This drop is being evidenced across all states and territories and is most pronounced in the 35 to 44 age group. Research shows that it seems certain that the rate of home ownership will drop further. The National Housing Supply Council, in its 2012-13 report, pointed to this and more recently AHURI also identifies this.

Not with standing measures introduced in the 2017 Budget to address housing affordability by first home buyers the need to address supply of affordable housing as a priority policy issue continues.

At a roundtable discussion on housing affordability convened by the REIA in 2014 with participation by Government, including the then Minister for Social Services, the Hon Kevin Andrews, and industry leaders from real estate, construction, finance and community sectors, it was agreed that the availability of affordable housing is a goal that is shared by governments and all sectors of the community. It impacts on the functioning of the economy as well as the wellbeing of individuals and the cohesiveness of communities and society. The roundtable participants all agreed that a priority policy issue is to address the undersupply of housing.

Without addressing supply the gap between the supply and demand for housing will increase in the future, putting further pressure on housing prices.

Affordable housing is a complex issue, with a number of economic, social and infrastructure factors influencing it. These include: the deposit gap for first home buyers; demographic change; the effect of stamp duties and taxes; development application processes; skills shortages, and; lack of urban infrastructure.

The property sector needs to be a crucial and integral element of the 2019/20 Budget and housing affordability and the taxation of housing need to be addressed in a holistic manner rather than the often simplistic debate about negative gearing as if it's abolition is the panacea for all things.

Taxation and Housing Supply

Taxes are one of the factors determining investment in housing and thus housing supply and influencing housing affordability.

With increasing house prices in Australia's two largest capital cities over the past two years, there have been many claims that the current tax treatment of negative gearing and capital gains of residential property is exacerbating housing affordability issues. This is simply not the case. Indeed the public interest is being served and advanced through negative gearing and the treatment of CGT.

The current taxation arrangements provide many Australians with the opportunity to invest in property and augment their savings in particular their retirement savings and at the same time improve rental affordability through an increased supply of rental housing.

Independent research commissioned by the REIA shows that:

- Negative gearing is a tax deduction for investments in a variety of assets, including property investments, share investments and business ventures
- The ability of investors to gear and use debt is a crucial part of investing and fostering economic growth. It is a fundamental principle that taxpayers should be able to deduct the associated costs incurred in earning income from investments, including the cost of borrowing. The ability to deduct the cost of debt and losses against income is necessary to ensure that investments are not taxed punitively
- The rationale for the 50 per cent discount on capital gains is to ensure that only real capital gains are taxed (not nominal capital gains). This approach replaced the previous indexation of capital gains in 1999
- If nominal capital gains are taxed without discount then investors will be taxed on a gain they have not made
- Negative gearing is not a special concession for property — it is a legitimate deduction of expenses in the course of earning income from investments in all asset classes until the investment generates a positive income stream in the future
- Property is not the investment class that benefits the most from the CGT discount. The majority (around 60 per cent) of the capital gains are sourced from shares, while capital gains from real estate investments (which include residential and other types of property) represent approximately 26 per cent of the total capital gains of taxable individuals. Individuals across all income ranges benefit from the CGT discount. However, the highest proportion of taxable net capital gains income tends to be received by individuals at the higher end of the income distribution and hence these individuals receive a larger share of the benefits from the CGT discount

- Negative gearing benefits a range of Australian households by providing all individuals with an opportunity to invest in property, not just those in higher income brackets. Seven out of ten property investors who benefit from negative gearing earn a taxable income of less than $80,001 a year. Furthermore, while individuals with incomes higher than $80,001 claim around 40 per cent of losses on investment property, those earning less than $80,001 a year claim the majority of rental losses (above 60 per cent of all losses).The data also shows that the majority of investors own only one property and this has not significantly changed over time
- Negative gearing contributes to the provision of new housing — total dwelling commencements have been on a growth trend since the 1950s. A significant proportion of these new dwellings have been financed by investors. Around a third of all new dwellings construction is financed by investors every year and the absolute amount of investor loans committed to new housing has increased by more than seven-fold since 1986
- An increase in rental supply means higher rental vacancies and lower rents than would otherwise be the case. The benefit to renters from improved rental affordability was directly recognised by the Henry Tax Review (2010) which noted that 'the current tax advantages available to highly geared investment can operate as a subsidy to renters by placing downward pressure on rents"
- Quarantining of expense deductions against corresponding income would primarily only affect the timing of tax payments, so would not result in large tax collection increase for the Government
- Limiting negative gearing to a maximum number of properties per taxpayer – as has been suggested by many commentators - would be highly distortionary, notwithstanding the practicality of determining an acceptable upper limit.

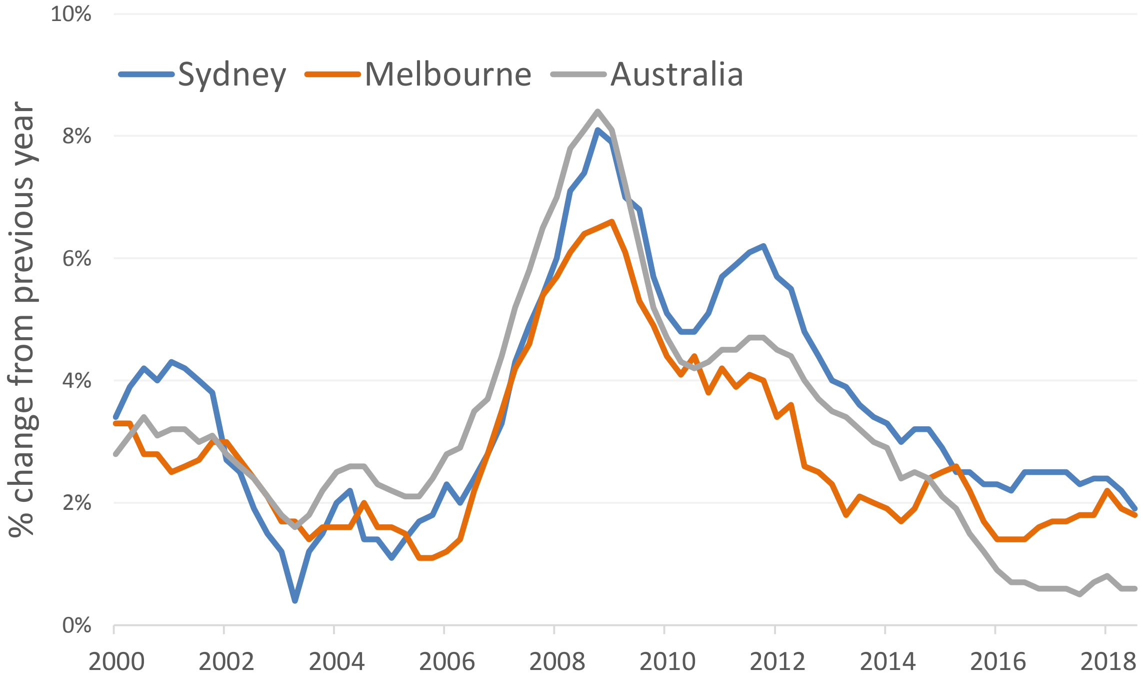
The repeal of the current arrangements would shrink savings and investment and see increases in rents and the need for greater government investment in social housing.

The graph below shows the impact of the increase in investment properties in Australia and in Sydney and Melbourne, where the greatest investment activity has occurred, has had on rents. From the end of 2011, when investment in housing started to pick up, the rate of increase in rents has plummeted.

The September 2018 CPI figures show that rents increased by 0.4% for the quarter and increased by just 1.6% for the year. This is the lowest annual increase in rents since December 1998. In Sydney and Melbourne, where much of the investor activity has been focused, the increase in rents in the past twelve months has been 1.9 per cent and 1.8 per cent respectively.

The CPI figures show that the increased investment in housing has kept growth in rents lower than they have been historically and is clear testament that the current taxation arrangements benefit renters and that any change in the treatment of negative gearing and capital gains tax would see an increase in rents.

ANNUAL CHANGE IN RENTS: AUSTRALIA, SYDNEY AND MELBOURNE



Source: 6401.0 Consumer Price Index, Australia 2000 – 2018 (ABS)

Both Re-think and the Henry Review, note that stamp duties are some of the most inefficient taxes levied in Australia. Re-think goes on to say whilst stamp duties on the transfer of property are the second-largest source of state tax revenue (generating 24 per cent of state tax revenue) they are a highly volatile tax, with revenue fluctuating by over 50 per cent in previous years. Stamp duties also impact on consumers by increasing the cost of buying and selling houses. As house prices increase over time, unadjusted progressive tax rates also increase the tax burden associated with stamp duty. This adds to transaction costs and contributes to the high costs of moving which discourage mobility, impedes economic growth and leads to an underutilisation of the housing stock as older residents are reluctant to downsize.

Stamp duty is also inequitable for those who move more frequently, for work related reasons for example, than those that do not as they face higher costs even if their circumstances are otherwise similar. Choices between renting and buying and between moving house and renovating are also distorted by stamp duties.

According to the Henry Review "stamp duties on conveyances are inconsistent with the needs of a modern tax system …..and should be replaced with a more efficient means of raising revenue".

State governments cannot eliminate inefficient taxes without going into deficit or having to reduce expenditure substantially. Hence cooperation between the Australian Government and the States is needed to undertake reform of inefficient state taxes.

Economic analysis shows that economic activity in Australia can be lifted by just shifting the composition of taxes from high economic cost State taxes to lower cost Australia-wide taxes, without changing the overall level of tax revenues. The Centre of International Economics in its report, State Business Tax Reform in 2009 showed that the abolition of stamp duties on residential and non-residential property, removal of insurance duties and reform of land taxes and payroll taxes is projected to increase long run GDP by 1.7 per cent per year and investment by 4.4 per cent per year.

Stamp duties are also a major hurdle for first home buyers and older home owners. For first home buyers stamp duty often makes the difference between the ability to buy and not to. For older home owners considering down sizing to accommodation more suited to their needs in retirement stamp duty is frequently given as the reason preventing such a move. Stamp duties are thus preventing a more efficient use of the housing stock and could be exacerbating the supply problem.

A study by AHURI on taxation reform comparing reform of stamp duties, capital gains tax and changes to negative gearing in terms of their economic and social impact and on affordability concludes that state tax reform delivers greater benefits than changes to CGT and negative gearing.

The Federal Government needs to show leadership in addressing housing affordability by taking a coordinated and holistic approach of all levels of government in objectively addressing all property taxes.

REIA recommends that the Australian Government take a leadership role in taking a coordinated and holistic approach of all levels of government in objectively addressing all property taxes.

REIA recommends that until a coordinated and holistic approach in objectively addressing all property taxes is undertaken that negative gearing and capital gains tax on property investments are retained in its current form.

First Home Buyers

Housing affordability is an acute issue for first home buyers. The easing in monetary policy commenced in November 2011 has since seen a 300 basis points reduction in the official interest rate which has, albeit with a longer lag than expected, resulted in an increase in housing finance approvals.

Based on ABS data for November 2018 the proportion of first home buyers, as part of the total owner-occupied housing finance commitments, was 18.3 per cent. The current rate is higher than the historically low point of 12.9 per cent in March 2016 but is in contrast to the high of 31.4 per cent in May 2009 when the Government increased the First Home Owner Grant (FHOG) as part of its GFC measures, indicating the urgent need to address the issue.

With three quarters of Australian first home buyers having less than a 20% deposit and thus incurring mortgage insurance, it is critical that first home buyers have an additional way of supplementing their deposit savings.

REIA believes in the benefits of continuing the high ownership level in Australia, particularly as the population ages, and strongly encourages the Commonwealth Government to help implement solutions that will assist aspiring first home buyers. Such assistance should be uniform and should not discriminate between buyers of new or established housing.

Superannuation is an important financial asset of Australian households. Aside from home ownership it is the second most important financial asset with 82.1% of all Australian households holding at least some savings in their superannuation account and the average value across all households at $142,429 (HILDA Survey).

Superannuation and home ownership are both components of a retiree's "nest egg" and not competing products. By buying earlier in life retirees have every prospect of having a higher equity on retirement and a larger "nest egg" on downsizing. Too much attention has been focused on the accumulation of a nest egg through superannuation at the expense of other more practical considerations which not only improve the quality of life at an earlier age but result in a greater retirement "nest egg".

Furthermore, access to superannuation for the purchase of a first home could help reverse the trend of falling home ownership and address the looming significant policy problem of a large numbers of long-term renters aged 45 years and over remaining in the rental sector and possibly requiring rental support in later years.

The 2017 Budget measure of allowing first home buyers to apply to withdraw voluntary contributions made to super after 1 July 2017 for a home deposit recognises this and is a welcome initiative.

Allowing access to a pre 1 July 2017 voluntary contributions to superannuation funds would help prospective buyers to save for a deposit faster. The mechanism for accessing these funds has already been established by the 2017 Budget initiative of the First Home Super Saver (FHSS) Scheme.

The use of retirement savings for a first home purchase has already proven to be successful in Canada, New Zealand and Singapore.

The REIA proposes that the Commonwealth Government extend the current First Home Super Saver (FHSS) Scheme to allow first home buyers to have access to their pre 1 July 2017 voluntary superannuation contributions, including earnings, for the purpose of raising a deposit for a home.

Appointment of Minister of Property Services

The property sector is one of the largest sectors in the Australian economy in terms of employment, GDP and investment. It has been the driver of economic growth since the decline in investment in the mining sector commenced. No matter what changes occur in the composition of sources of growth, property will continue to be a major source of employment and investment for decades to come as well as the major asset class for the majority of Australians.

Despite this, at both a state and federal level there is no single entity and/or elected official responsible for all aspects of property.

Recognising the importance that the property sector plays in the economy as well as in policy with taxation of property and housing affordability being at the forefront of public policy debate REIA advocates the appointment of a Minister for Property Services.

The REIA proposes the appointment of a Minister for Property Services.

The Availability of Reliable Data on Housing

The National Housing Supply Council – that was established in 2008 to monitor housing demand, supply and affordability in Australia and to identify gaps between housing supply and demand - was abolished at the end of 2013.

With housing affordability recognised as a policy priority, it is imperative that the information contained in the Council's State of Supply Report continues to be available. The document provided valuable information, not only to Government policy makers but also to industry.

The availability of reliable data, including first home buyers, to formulate appropriate policies and then to monitor their effectiveness is crucial to this and the REIA would like to contribute to the dialogue and offer assistance to such a forum.

The REIA proposes that the Government establishes a mechanism to ensure the availability of reliable data on housing demand and supply in order to formulate appropriate policies and to monitor their effectiveness.

REIA Recommendations

In summary, REIA asks the Commonwealth Government to consider the following:

- **Take a leadership role in taking a coordinated and holistic approach of all levels of government in objectively addressing all property taxes**
- **Until a coordinated and holistic approach in objectively addressing all property taxes is undertaken that negative gearing and capital gains tax on property investments are retained in its current form.**
- **Extend the current First Home Super Saver (FHSS) Scheme to allow first home buyers to have access to their pre 1 July 2017 voluntary superannuation contributions, including earnings, for the purpose of raising a deposit for a home.**
- **The appointment of a Minister for Property Services.**
- **Establish a mechanism to ensure the availability of reliable data on housing demand and supply in order to formulate appropriate policies and to monitor their effectiveness.**