Urban Taskforce
AUSTRALIA

18 January 2008

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

E-mail: prebudgetsubs@treasury.gov.au

Dear Sir/Madam

RE: OUR 2007-08 FEDERAL PRE-BUDGET SUBMISSION

As you would be aware Urban Taskforce Australia is a property development industry group, representing Australia's most prominent property developers and equity financiers.

Owning your own home is the great Australian dream. Home ownership delivers a wide range of economic and social benefits – both to home owners and the communities in which they live. However, Australia has been experiencing declining levels of home ownership for some time.

The 2006 census shows how mortgage repayments have been spiralling out of control, when compared to wages. The average housing mortgage repayment to income ratio for typical first home mortgages has increased from 18 per cent in 1996 to 31 per cent today.

In 1996 the proportion of Australia's population who owned their own homes was 41 per cent – this fell to 33 per cent by the 2006 census. Over the same period the proportion of the community who were still paying off their home, rose from 26 per cent to 32 per cent.

Research organisation BIS Shrapnel's latest report *Building in Australia 2007 to 2022* predicts that the construction of new homes in NSW will fall short of what's needed for the next three years. In fact, next year alone there will be a national shortfall of 22,000 homes. If this analysis is correct Sydney's rents will continue to soar until 2010 unless urgent action is taken by the Federal Government.

The Urban Taskforce believes that Federal Government action needs to be taken on two broad fronts through:

- a more active involvement in infrastructure provision; and
- the creation of a National Affordable Housing Scheme.

<u>Infrastructure</u>

The cumulative impact of state and local government development charges is adding to the cost of development of land, especially on the outer edges of the major metropolitan areas. It means new home owners must fund the cost of infrastructure up-front. It is hardly equitable when compared to infrastructure funding methods paid by previous generations. The cost of new land and housing is now higher than the market for houses in the same area. This is severely restricting the supply of new housing land to the market. The cost of new land and housing is now unaffordable for a large segment of potential first home owners.

The cumulative impact of development charges is also impacting on the cost of production of new industrial/employment lands . This is limiting the supply of such land to the market.

It is clear to us, and increasingly clear to the wider community, that the housing affordability crisis requires national solutions. First and foremost that requires a much greater role for the Federal Government in infrastructure provision. The Urban Taskforce welcomes Mr Kevin Rudd's announcement in Opposition indicating that, as Prime Minister, he would establish a $500 million Housing Affordability Fund. While this is an excellent first step, a $500 million commitment will not ultimately be enough to meet the costs on infrastructure necessary to secure widespread land releases.

We urge the Federal Government to allocate more special infrastructure funding to:

- assist the States in the provision of infrastructure, especially infrastructure that is related to the production of residential land; and so
- reduce the cost of new housing which is presently being required to shoulder the cost burden of such infrastructure.

Such a commitment should not reduce the Federal Government's existing infrastructure responsibilities. In fact, residential housing in metropolitan areas will be more rapidly developed if significant commitments were to be made by the Federal Government under the existing programs, such as Auslink. For example:

- the construction of a public-private partnership (PPP) motorway (tunnel) connecting the M2 to the F3 – this would dramatically improve the lifestyle and employment opportunities of the people of Central Coast NSW; and
- the construction of the F6 motorways a PPP more fully connecting the Illawarra to Sydney.

This kind of infrastructure effectively increases the supply of housing for the metropolitan markets, by providing more realistic choices for those who aspire to live within a reasonable travelling time of the jobs located in metropolitan areas.

The costs of both of these projects can be reduced by tolling arrangements. History has shown that communities would willingly pay reasonable tolls when they receive significant benefits in terms of reduced travel time.

National Rental Affordability Scheme

We are very supportive of the new government's planned National Rental Affordability Scheme. We believe it should be introduced as soon as possible – provided appropriate industry consultation occurs first.

We understand the government's proposal to be as follows: The $603 million scheme will save 50,000 low-middle income families 20 per cent on their rental bills. The scheme will give a $6,000 Commonwealth tax incentive annually (for up to 10 years) to investors who construct new affordable rental accommodation. Access to the scheme will be dependant on a competitive process and at least an extra $2,000 a year in direct or in kind financial support from state governments.

We support the government's proposal that the incentive would only apply to newly constructed rental homes. This will help make sure that our proposed scheme leads to new supply, rather than diverting supply from the mainstream property market. Any significant diversion from the mainstream property market will inflate property values in that market.

In the spirit of being constructive, we would like to highlight an area where the proposal for a National Rental Affordability Scheme can be improved.

A flat federal subsidy of $6,000 per dwelling means the scheme will be more profitable in areas where the dwelling costs are lower. That is, the subsidy is not proportionate to the costs incurred by the developer, and therefore there is a reduced incentive for the developer to invest in housing in areas with higher, and/or escalating property values. These are the areas where the affordable housing will be most needed. As a result, bureaucratic, rather than market mechanisms will be needed to allocate which projects receive the subsidy. This is likely to be less efficient, more costly and less equitable than a system that, by its very structure, ensures federal money flows to the right kind of projects.

Instead of a flats subsidy controlled by bureaucratic rules, we recommend that the Federal Government change the tax rules discriminating <u>against</u> rental housing and renters.

Why is there a shortage in supply, with predictions that the shortage will not ease for several more years? The answer is that residential housing is a generic asset – able to be used either for rental housing or owner occupiers. Hence these assets trade in a single market, where the major influence on the asset price, in the long term, is exercised by owner-occupiers, rather than investors. However, the tax treatment of owner-occupied homes is radically different from that of investors. Rental properties are subject to capital gains tax, while owner-occupied homes are exempt.

As an asset class, housing is less risky than commercial property, but at yields of 2.5 per cent it does not represent a viable investment when compared to a cash rate of 6.75 per cent. As a result, investment in residential property is only viable for individuals facing high marginal tax rates who are able to negative gear. The market is therefore very attractive to individuals during periods where there are rapid increases in property values and becomes correspondingly very unattractive during periods of flat or declining property values. This creates a distorted market overly prone to booms and busts.

Renters are paying more than they should because their homes are more heavily taxed than owner-occupied dwellings. The taxation of rental properties means they are less attractive for investors – leading to a shortage of new properties. Renters are effectively paying at least part of their landlord's capital gains tax bill through higher rents.

The structure of the current tax system creates distortions that prevent the market responding appropriately to meet supply shortfalls in the housing market.

The solution is to create a distinct market for a special class of rental properties that trade only as such, and not as generic housing assets. Such a market can be created by reforming the tax treatment of investment of rental housing for <u>new</u> homes that are offered at a special "affordable rent". This rent would be lower than the market rent for a local residential property market (in a city the size of Sydney, Melbourne or Brisbane, at least several distinct regional property markets can be identified). Tenancies would only be available to low income earners (to be defined by the government), possibly with a preference being given to workers in key occupations.

It's important that any financial incentives be tied to the size, scale and risks of the investment. For that reason, a flat or capped payment is undesirable as it will distort investment decisions; in particular, it will reduce investment in higher value suburbs and cities (where affordable housing is needed most). The Urban Taskforce submits that the tax benefit should, for individuals, be a waiver of capital gains tax, and for others, an equivalent tax credit. This will link the benefit appropriately to the scale and risk of the investment.

The proposal has two key features that prevent it from being inflationary:

- In order to benefit from the special tax treatment the asset will be unable to be used for owner-occupied housing and must be set aside for "affordable" for a period – say 25 years.
- Only newly constructed housing would be able to participate in the scheme – ensuring that the scheme leads to new supply and does not divert supply from the mainstream housing market. To reinforce this, state governments could be encouraged to enact complementary planning policies recognising this special class of affordable housing.

At the beginning, these rental homes will trade at a discount to owner-occupied housing, but in the long term (say 15 to 25 years) their price will be allied to that of owner-occupied housing. An investment over this timeframe will be attractive to institutional and corporate investors seeking returns over a much longer-time frame than that currently available.

This policy will see a stream of money going into new residential rental housing and reduce the upward pressure on rents. The proposal will help house the next generation of nurses, teachers and child care workers where they're needed in the expensive inner suburbs.

The social benefits of this proposal are enormous. It will help retain a diverse social mix across our major cities. Families currently suffering because the bread winners are travelling two to three hours a day would be given an alternative.

There are some key similarities between our proposal and the policy discussed by the Labor Party prior to the election.

However the Urban Taskforce wishes to highlight important differences between our proposal and the plans the government announced when it was in Opposition:

Labor's Policy Announced in Opposition	**Urban Taskforce's Proposal**
There may be some preference for making subsidies available through non-profit housing organisation, who in turn would call for tenders to supply affordable housing.	It should not be mandatory for an investor to work through a non-profit housing organisation. Such organisations are relatively underdeveloped in Australia and lack the entrepreneurial skills to identify and assemble projects on a large scale. The Urban Taskforce's proposal makes the tax benefits available to the risk-taker, who in turn <u>may</u> seek out a non-profit organisation to manage tenancies. Giving the existing non-profit organisations a monopoly on access to the scheme will stifle innovation and enterprise.
The Federal Government would allocate a fixed amount subsidies ($603 million) to be apportioned in proportion to population across the states and territories, or to areas of high housing need.	The Federal Government should be able to make projections about the cost of the scheme, but for the scheme to work on a sufficiently large scale to be meaningful, artificial caps on the size of the scheme should not be imposed. Additionally the scheme, as proposed by the Urban Taskforce, will lead to investment in housing in areas with higher, and/or escalating property values, which will be the areas where the affordable housing will be most needed. The market will therefore be a more effective mechanism to determine which parts of Australia receive investment under the scheme. It's important to note that the cost of the Urban Taskforce's scheme will be minimal over the next four years. A liability for the capital gains tax that would have otherwise been payable would typically not arise until five to ten years after the initial investment.

Conclusion

The Urban Taskforce welcomes the renewed interest in affordable housing at a federal level. Now more than ever national leadership can make a real difference. Housing affordability is one of the great challengers for Australia in the early 21st century. We believe industry can work well with government to address this problem, but it will require a serious commitment for the long-haul.

Yours sincerely
Urban Taskforce Australia

Aaron Gadiel
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