HOUSING INDUSTRY ASSOCIATION

Submission to the
NSW Treasury

NSW Review of Federal Financial Relations

26 November 2019

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contents

Housing Industry Association contact:

David Bare
Executive Director
Housing Industry Association
4 Byfield St,
Macquarie Park

ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

As the voice of the residential building industry, HIA represents a membership of 60,000 across Australia. HIA members are involved in land development, detached home building, home renovations, low & medium-density housing, high-rise apartment buildings and building product manufacturing.

HIA members comprise a diverse mix of companies including residential volume builders, small to medium builders and renovators, residential developers, trade contractors, building product manufacturers and suppliers and allied building professionals that support the industry.

HIA members construct over 85 per cent of the nation's new building stock.

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

Contributing over $100 billion per annum and accounting for 5.8 per cent of Gross Domestic Product, the residential building industry employs over one million people, representing tens of thousands of small businesses and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

> *"promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct."*

HIA develops and advocates policy on behalf of members to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional committees before progressing to the National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.

The Association operates offices in 22 centres around the nation providing a wide range of advocacy, business support services and products for members, including legal, technical, planning, workplace health and safety and business compliance advice, along with training services, contracts and stationary, industry awards for excellence, and member only discounts on goods and services.

1. INTRODUCTION

In October, the NSW Treasury released the discussion paper *NSW Review of the Federal Financial Relations – Working together for a better future* (Discussion Paper).

HIA provides this initial submission to the Discussion Paper and hopes to contribute further as the Review progresses.

The Discussion Paper outlines 7 key issues:

1. *Which state taxes impact citizen and business choices the most?*
2. *How can the tax system work better for citizens and businesses and improve the economy for future generations, keeping in mind:*
    a. *the changing environment*
    b. *the increasing volatility to state tax revenue bases?*
3. *Is there a better way that the Commonwealth Government can ensure its revenue sources remain sustainable in a changing environment?*
4. *How can the states reduce their dependence on the Commonwealth?*
5. *How can Commonwealth – state relations encourage states to innovate and reform?*
6. *How can agreements between the Commonwealth and states ensure accountability for how the money is spent but allow flexibility to deliver the best outcomes for citizens?*
7. *How can governments work better together and learn from each other, putting citizens at the centre of decision making?*

HIA's submission is based on the notion that shelter is a staple of life. Without appropriate shelter, individuals are unable to participate in the economy and society to their full potential. However, housing affordability challenges are affecting an increasing number of individuals and families access long term housing tenure, whether as owners or renters. One of the major problems is ongoing supply of new housing at an acceptable price due to the level of taxation applied to residential development and new home construction.

As investment, productivity and participation are all heavily influenced by tax settings, tax reform is fundamental to ensuring the NSW economy is efficient and flexible. Reforming the Australian taxation system – including State and Territory Governments' current stamp duty arrangements – is considered a priority and we believe it would show that all Government's recognise the impact upfront and hidden taxes are having on housing supply and home ownership.

It is hoped that this Review will lead to an in-depth consideration of NSW's current and future taxation base and that recommendations offer a transparent review of policy options.

It is important that this Review also take into consideration the imposts imposed through Federal taxation arrangements. The compounding nature of Federal and state taxation arrangements can cause a 'cascading effect' and exacerbate the adverse impacts of taxation. The taxation of land and housing in Sydney is a perfect example of how taxes can be applied on top of other government taxes creating an unnecessary and costly tax burden for the end consumer.

From a housing market perspective, taxation can play a major role in terms of efficiency and affordability. Given that housing is already a highly-taxed commodity, and given the potential for the wrong taxation policy approaches and recommendations to introduce distortions in housing investment and the housing market, it is important that the Review carefully considers the implications of any changes as they relate to housing supply.

HIA supports the removal of inefficient and inequitable taxes such as payroll tax on new housing construction and the replacement of stamp duty applied to new housing construction and payroll taxes with broad based community taxes. In addition, HIA supports a restructuring of the GST so that (effectively) new housing construction is exempt and that the application of GST to new housing construction and existing housing is similar.

To that end, HIA considers that the following principles provide a solid framework against which any tax reform proposals should be assessed that affect the residential building industry:

- Meeting broad economic objectives of promoting industry efficiency and jobs.
- Simplification of the tax system.
- Reduction in compliance costs for business.
- Affordability of the industry's product.
- Fairness among taxpayers with adequate compensation measures for those disadvantaged by the tax changes.
- Provide no disadvantage for trade contracting arrangements.

It is timely to consider the impact that taxation and red tape is having on home ownership.

2. THE IMPACT OF TAX ON HOUSING

2.1 NSW NEEDS TO MOVE AWAY FROM ITS HEAVY RELIANCE ON HOUSING TAXATION

Housing is one of the most heavily taxed items in the economy behind the 'vice taxes' applied to tobacco, gambling and alcohol. The housing sector, via land tax, municipal rates, other taxes on immovable property and stamp duties, directly contributes around $51 billion in taxation revenue each year to state and local governments in Australia (about 10 per cent of the total revenue collected by all tiers of government).

New homes and existing homes are substitute products, any statutory taxes or regulatory costs that are imposed on new houses will also cause the price of existing housing to rise.

In Sydney, 50 per cent of the cost of a house and land package is incurred through red tape and taxes. In comparison Melbourne is 37 per cent and Brisbane is 32 per cent.

The majority of the increase in cost from taxes and regulations are transferred to the household.

In 2018 HIA commissioned the Centre for International Economics to inquire into these tax imposts. The potential to address the affordability challenge in NSW, as well as stimulate economic activity can be advanced by addressing the inefficient taxation of housing, in particular the taxes associated with red tape and productivity that add half of the 50 per cent to costs in Sydney.

An extract of this report is at **Attachment 1**.

2.2 STAMP DUTY ON HOUSING NEEDS TO BE REFORMED

HIA recognises that taxes from conveyancing are NSW's second highest grossing tax and are forecast to account for around 25 per cent of own-source revenue in 2022/23.

As Treasury would be aware, stamp duties on housing are a very inefficient tax as they: impede the efficient use of the existing housing stock; add to upfront house purchasing costs; and make it more difficult for home buyers to secure credit.

Stamp duty also penalises individuals at a time when they maybe facing other personal stress such as through divorce, death or disability and need to sell a home at a time which is not of their choosing. Stamp duty restricts the ability of the workforce to relocate in pursuit of employment or to undertake studies, and impacts on elderly people seeking to relocate in retirement.

Stamp duty is also an unreliable source of year on year revenue as demonstrated in the most recent property downturn which saw more than $10 billion lost from the forward estimates of NSW revenue.

In the context of this Review, HIA recognises that replacing such a significant source of revenue is clearly not a simple task. Therefore HIA would support an examination of the potential options to reduce or significantly decrease stamp duty on new homes in NSW as a first step towards future reforms.

The ACT Government is nearly half way through a 20 year plan to abolish stamp duty and it provides an option that is worth of consideration. Whilst the ACT taxation arrangements are unique, further exploration of alternative taxation measures is warranted to consider the complexities of the NSW taxation system. A critique of the ACT scheme is set out in HIA's Research Note – Analysis of ACT Tax Reform Initiative published in February 2018 **Attachment 2**.

An overview of the complexities and inefficiencies that arise from the imposition of stamp duty on housing is set out in HIA Stamp Duty Watch Winter 2019 **Attachment 3.**

As part of considering reforms to stamp duty in NSW, it would be appropriate to investigate the cascading impact of taxes on new housing and identify alternative methodologies to calculate these taxes which remove the duplication and remove the cross taxation of stamp duty on GST and vice versa.

2.3 FOREIGN INVESTOR SURCHARGES NEED TO BE REMOVED

Increased investment in housing is important in the context of Australia and the NSW economy, as the undersupply of housing for much of this century is the primary cause of the rapid deterioration in housing affordability. In addition, private investors have been the main source of new rental housing stock for decades in Australia and they play an important role in ensuring adequate supply of new housing for this part of the housing market.

Foreign investment attraction should be an objective of this Review as it plays an important role in economic growth and achieving housing supply which promotes more affordable housing stock. Foreign investment not only stimulates employment it also improves the supply of new homes into the market and helps reduce cyclical shortfalls in housing. This is particularly relevant to the apartment market where foreign investment is necessary to bring new projects to market. A shortfall of foreign investment in the housing market can exacerbate the cyclical nature of the market.

Punitive rates of stamp duty were introduced for foreign investors in 2016. This measure will most likely cause a delay in the construction of the next phase of new home building in NSW and lead to an unnecessary increase in the cost of renting a home in Sydney.

It is important to acknowledge that after almost two decades of significant housing undersupply, the NSW Government has made many changes to policy and tax settings which have assisted in increasing supply to be at the level necessary to meet housing demand and population growth. Indeed, house prices and rental prices had commenced to stabilise before this tax was introduced. A combination of events, including the introduction of the surcharge at a state and federal level, have now seen supply in Sydney, particular of apartment projects, begin to slow. HIA's Outlook for NSW reflects this decline and it is not clear at this stage when this part of the market may improve and what impact this may have on the detached home building market.

Whilst some may suggest that the surcharge has achieved its intended purpose to reduce foreign investment in the NSW housing market, and hence reduce house prices for other buyers, the overall implications of such an outcome on the delivery of new homes in the longer term, and hence other related state taxes, should not be underestimated.

2.4 PAYROLL TAX

Payroll tax is a tax on wages paid to employees and is a major cost impost on those businesses liable to pay the tax. Due to the definition of 'wages' and who is an 'employee' for payroll tax purposes payments made to independent contractors are often liable for payroll tax.

The application of payroll tax legislation to contractors is extremely complex. Payments made to contractors can be excluded but only if a convoluted set of exemptions based around days worked can be met. These exemptions do not reflect industry practice in the residential building industry where contractors are engaged and paid on a 'results' basis and days taken by a contractor to perform a task are irrelevant.

HIA has been supportive of the changes made in the May 2018 budget, especially in regard to the payroll tax threshold. For the 2018-2019 financial year, the threshold rose to $850,000 and will further increase to $900,000 in 2019-20, to $950,000 in 2020-21 and then to $1 million in the 2021-22 financial year.

In 2018 the NSW Productivity Commissioner released a report reviewing the administration of payroll tax. The review made 12 recommendations all of which the government has agreed to implement. Notable recommendations included:

- To shift Revenue NSW's regulatory model and effort towards a greater emphasis on early engagement, education and support.
- A penalty reduction program to encourage early compliance.
- A tiered compliance model that provides for less frequent payment calculations and/or lodgement of payroll tax returns.
- Clarification on which contractor arrangements are captured under payroll tax definitions including providing examples by sector.
- That an appropriate independent body investigate better aligning the different definitions of employee and contractor with those of other relevant government entities including:
- In the short term, engage with the State Insurance Regulatory Authority to more closely align employee and contractor definitions where applicable.
- In the longer term, work with other jurisdictions to explore opportunities to further align payroll tax definitions across jurisdictions, including employee and contractor definitions.

HIA looks forward to the implementation of those measures but is of the view that more can be done to relieve the burden of payroll tax on businesses to encourage growth and productivity.

3. OTHER MATTERS

It is imperative that any options arising from this Review are considered within the broader context and do not unduly interfere with existing business arrangements that are working well, for example:

- The 'gig and sharing economies' are not 'new'.

  Working arrangements via technological platforms are not new. Individuals have been freelancing and self-employed for decades. New forms of workplace arrangements have been a feature of the Australian economy for many years with celebrated court cases establishing the status of encyclopaedia salespeople, bicycle riding couriers and labour hire workers. Importantly all of these cases were settled using the long-standing distinction between common law employees and independent contractors: gig economy workers can and should be managed using these long-standing and well developed legal tools.

- The work of the Black Economy Taskforce (BET).

  The implementation of a range of recommendation arising from the BET is still underway. Proposals to expand the Taxable Payment Reporting System, for example, would see the capturing of better and more accurate information to ensure compliance with taxation obligation. Similarly, the introduction of an economy wide cash payment limit of $10,000 may also influence the collection of taxation and business arrangements.

- Current Commonwealth and state funding agreements.

  There will always, and should always be funding arrangements between the Commonwealth and the states. As long as these arrangements are managed and maintained the relationship should result in better outcomes for citizens. This is even more important when it comes to the delivery of housing either as a direct result of funding arrangements or as a by-product of infrastructure (or other construction) delivery. Properly designed and well-executed initiatives can make a positive contribution.

ATTACHMENT 1 - CIE REPORT

COMMERCIAL IN CONFIDENCE

SUMMARY AND METHODOLOGY OF THE FINAL RESEARCH REPORT

Taxation of the housing sector:

Prepared for
Housing Industry Association Ltd

26 June 2019

THE CENTRE FOR INTERNATIONAL ECONOMICS
www.TheCIE.com.au

The Centre for International Economics is a private economic research agency that provides professional, independent and timely analysis of international and domestic events and policies.

The CIE's professional staff arrange, undertake and publish commissioned economic research and analysis for industry, corporations, governments, international agencies and individuals.

CANBERRA

Centre for International Economics
Ground Floor, 11 Lancaster Place
Majura Park

Canberra ACT 2609
GPO Box 2203
Canberra ACT Australia 2601

Telephone +61 2 6245 7800
Facsimile +61 2 6245 7888
Email cie@TheCIE.com.au

Website www.TheCIE.com.au

SYDNEY

Centre for International Economics
Level 7, 8 Spring Street
Sydney NSW 2000

Telephone +61 2 9250 0800
Email ciesyd@TheCIE.com.au

Website www.TheCIE.com.au

Summary

Housing is one of the most heavily taxed sectors of the economy

- The housing sector, via land tax, municipal rates, other taxes on immovable property and stamp duties, directly contributes around $51 billion in taxation revenue each year to state and local governments in Australia (about 10 per cent of the total revenue collected by all tiers of government).
- Dwelling ownership and housing construction provide 14 per cent of total GST revenue, despite providing only 11 per cent of economy wide Gross Value Added.

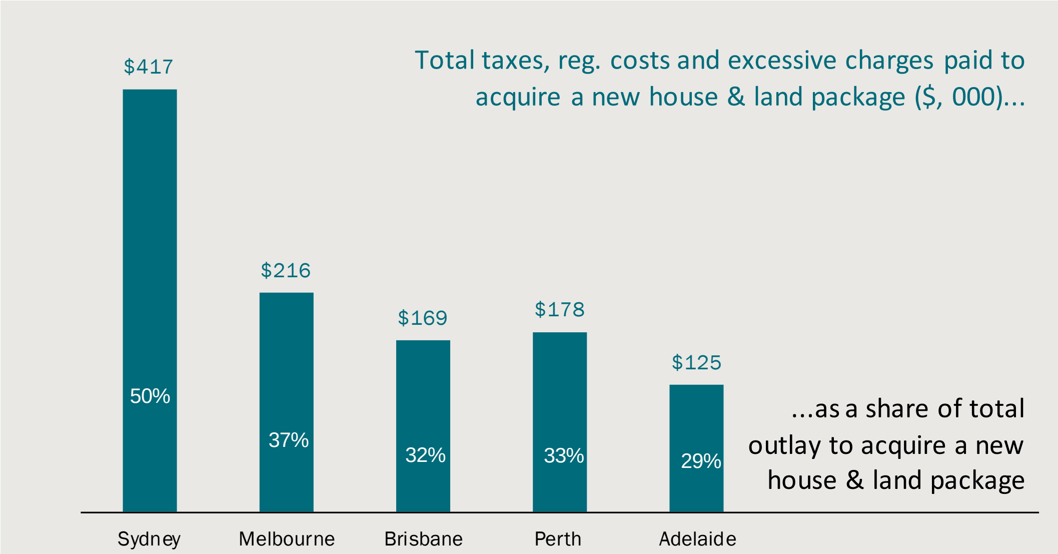
Taxes and regulatory costs add substantially to the cost of housing

- The total outlay made to acquire a new home includes: resource costs (the processes, materials and work that go into creating it), statutory taxes (GST, income taxes, stamp duties, etc.), regulatory costs (cost increases that are created when government policies restrict the supply of land and housing relative to demand), and excessive charges (where the price charged for government services or infrastructure is more than the resources required to provide these items).
- In 2016-17, in Sydney, we estimate that of the total outlay made to acquire a new house & land package in a Greenfield estate (about $841 000), only 50 per cent of this outlay reflects resource costs (about $424 000). The other 50 per cent (around $417 000) is made up of regulatory costs, statutory taxes and excessive charges (which are respectively: 26 per cent, 21 per cent and 2 per cent of the outlay).
- In other cities, as a share of the total outlay, we estimate the regulatory costs, statutory taxes and excessive charges are Melbourne: 37 per cent, Brisbane: 32 per cent, Perth: 33 per cent and Adelaide 29 per cent. See Chart 1.1.
- For new apartments in Infill developments, as a share of the total outlay, we estimate the regulatory costs, statutory taxes and excessive charges are Sydney: 37 per cent, Melbourne: 35 per cent, Brisbane: 34 per cent, Perth: 32 per cent and Adelaide: 28 per cent. See Chart 1.2.

Regulatory costs on land are driving differences across cities

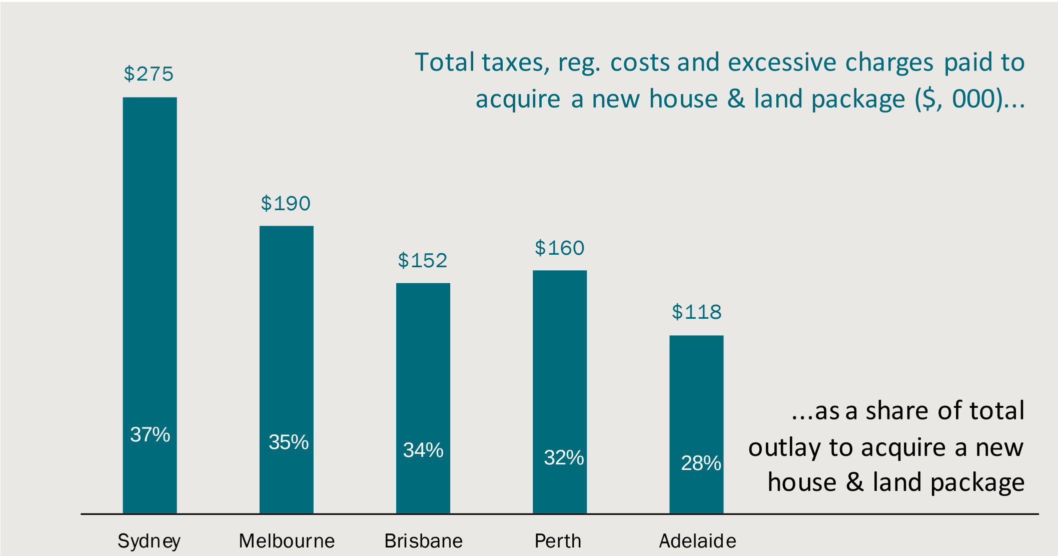
- We estimate the regulatory costs created by the system of zoning and associated development controls are more substantial in Sydney Greenfield development than in other cities, and higher in Greenfield development than in apartment development. This is the biggest factor driving differences in our results.

1.1 Total statutory taxes, regulatory costs and excessive charges paid within total outlay to acquire a new house & land package in a Greenfield estate (2016-17)



Data source: The CIE

1.2 Total statutory taxes, regulatory costs and excessive charges paid within total outlay to acquire a new apartment in an Infill development (2016-17)



Data source: The CIE

Most of the burden of costs is borne by consumers

- **Analysis with an economy-wide model suggests that the majority of the increase in costs from the taxes and regulations will be borne by consumers.**

1 Introduction

The Housing Industry Association (HIA Ltd) has commissioned The CIE to perform a bottom-up investigation of the magnitude of statutory taxes and regulatory costs in housing costs.

Most of this report is devoted to measuring the statutory taxes and regulatory costs in *new* homes (that is: new house & land packages and new apartments). But, as new housing and existing housing are substitutes, statutory taxes and regulatory costs that are imposed on new houses will, over time, also cause the price of existing housing to rise, which we discuss.

In addition to the bottom up analysis, we also provide a comparison of taxes paid by different industries to illustrate the relative burden in the case of the housing industry. Part of this analysis also includes model simulations to illustrate the incidence of housing cost increases.

This report

This report is structured as follows.

- **The remainder of this chapter** sets out the broad economic framework we adopt when considering the impact of taxes and regulation on the cost of housing.
- **Chapter 2** uses ABS data to compare how taxes on housing activity compare with taxes on other activities. This chapter includes a model-based analysis which expands this static picture by showing the comparative level of taxes generated by an expansion in some relatively highly taxed industries.
- **Chapter 3** provides and overview of our bottom up analysis.
- **Chapter 4** sets out our assumptions about the development process which provides a framework for gathering information and setting out the impacts of taxes and regulatory effects along the development process.
- **Chapter 5** presents the results of our financial analysis where we do a bottom-up calculation for the outlay homebuyers make to acquire a new house & land package and a new apartment.
- **Chapter 6** presents a cross-check on our high-level results.
- **Chapter 7** presents our economic analysis where we split the total outlay into resource costs, regulatory costs, statutory taxes and excessive charges.
- **Chapter 8** discusses the residual we calculate in the raw the land value, and the evidence we use to interpret this as regulatory cost on land.

- **Chapter 9** presents a model-based analysis of the incidence — who actually pays — the tax.

This project synthesises a very large amount of publicly available data and other evidence and presents this in an accessible and coherent framework. The goal is not to perform a cost-benefit analysis on any individual driver of housing costs or government policy. Costs identified in this report should be compared to any benefits created by the underlying policies.

Framework for new housing

Chart 1.1 shows our broad framework for considering the drivers of prices and costs for new housing.

The demand curve for new housing captures willingness of Australians to pay for new housing, driven by their preferences, the size of the economy (which determines the income of residents) and population. The demand curve is downward sloping because an increase in demand tends to push the price of housing up and/or the quantity traded up. Government policy influences demand for housing (for example, government can influence the size of the population via immigration). Consideration of these policies is beyond the scope of this paper. Therefore, we essentially treat demand for housing as fixed.

There is one statutory tax we consider – stamp duties on conveyances – that is levied on consumers. In our framework, stamp duty causes a difference between transfer price of the new house & land package or new apartment (labelled P-transfer) and the total outlay the purchaser must actually make to acquire the new house & land package or new apartment (labelled P-outlay). The total outlay equals the transfer price plus the stamp duty plus other transfer costs.

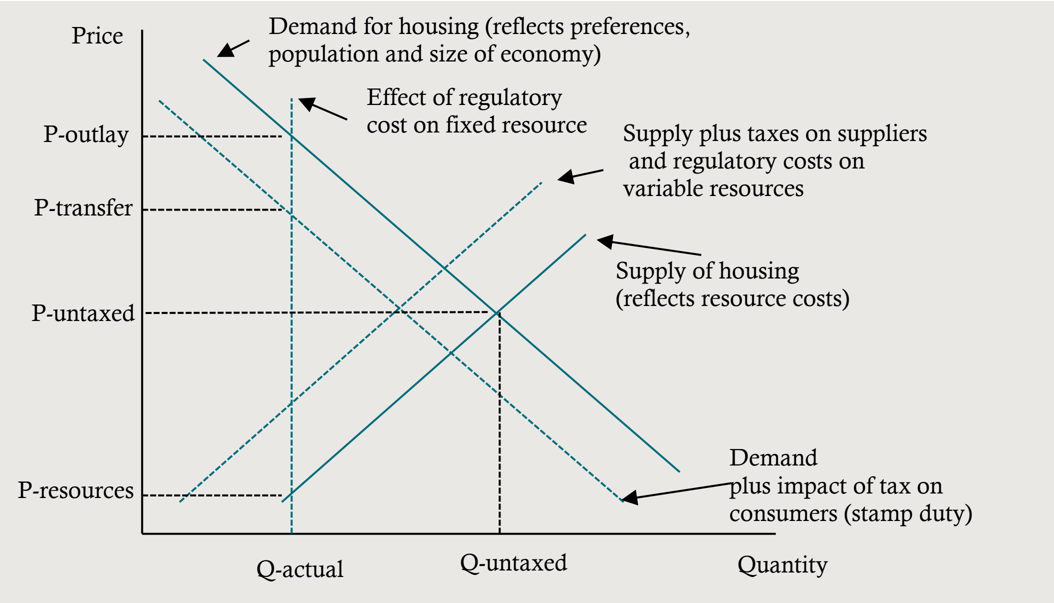
The supply curve for new housing captures the resource costs incurred by housing developers and builders to create and provide new housing. The supply curve is upward sloping because if resource costs increase, this tends to cause the price of housing to increase.

Governments levy various statutory taxes (and other revenue raising measures) on the supply of housing. These taxes include GST on new dwelling construction, income taxes levied on workers who provide labour to housing development, etc. In effect, these taxes add to the cost incurred to supply housing. Governments can also impose regulatory costs on variable resources. For example, if developers are forced to hold land for an unreasonably long period of time while they wait for appropriate approvals to commence development, this adds to their costs to finance the land holding (interest costs on debt). These statutory taxes on supply and regulatory costs on variable resources, in effect, add to the cost of supplying each new house. We capture these costs with a new supply curve, shifted up to reflect higher costs (see Chart 1.1). We present data, evidence and estimates on these costs in this paper.

Governments can also impose regulatory costs on land, the fixed resource in the supply of new housing. In this paper, we present data, evidence and estimates on these costs. In essence, the system of zoning and associated controls on land use and development, at any single point in time, acts like quota or upper limit on the amount of housing that can actually be supplied. If this quota is not adjusted appropriately, and demand runs ahead of it, this results in consumers competing for an inadequate amount of housing, which pushes up its price. The upper limit on the supply of housing at any given time, caused by the system of zoning and associated land and development controls, is captured with a vertical line in Figure 1.1, which sets an effective upper limit on the housing that can be supplied at Q-actual.

If the government policies that we consider in this paper (statutory taxes, other revenue raising measures and regulatory costs), were not enacted the price of new housing and quantity traded would be P-untaxed and Q-untaxed, respectively. As a result of the statutory taxes and regulatory costs created by the government, the quantity traded for new housing falls from Q-untaxed to Q-actual. The total (average) outlay made by purchasers of new housing is P-outlay. The cost of the resources used to create and provide new houses is P-resources (on average). In Chapter 7 we use our calculated results to add numbers to this diagram.

1.1 Framework for considering the drivers of prices and costs of new house & land packages and new apartments



Data source: The CIE

Interpreting the components of housing costs

Resource costs are the activities undertaken and the materials used to create and provide the new home. The developer's job is to source and coordinate these resources. Resource costs include a fair developer margin.

If a purchaser pays for more 'resource costs' they obtain a home that is larger, or is higher quality, etc. The beneficiary of resource costs is therefore the purchaser.

Statutory taxes and other revenue raising measures the government levies/imposes on the development process raise revenue that funds government operations and public services. If the government decides to increase these measures, this will cause the total outlay made by the new homebuyer to increase. The new homebuyer does not receive a larger or a higher quality home because of this increase in the outlay. Rather, it results in an increase in funding for government operations and public services; which the new homebuyer may benefit from.

Regulatory costs are other government measures which increase costs in the development process, but which do not create more revenue for the government. For example, developers require various approvals from the government to proceed with new developments. Consultations with HIA suggest developers can face delays which are unreasonable in the government-controlled processes that generate these approvals. As developers generally use debt to finance land purchases, these unreasonable delays add to the interest costs they incur, which are passed on to new homebuyers via a commensurate increase in the transfer price the developer charges for the new home.

Again, the new homebuyer does not receive a better or a larger home if they are forced to pay for more regulatory costs. The government does not directly benefit either, as the measures do not explicitly raise revenue. In fact, the main beneficiaries of regulatory costs are existing home owners. This is because new homes and existing homes (to some extent) are substitute products. If the government creates a policy that imposes regulatory costs on the creation and provision of new homes, this will cause the price of these new homes to increase; it will also cause the price of existing homes to increase, as buyers who can no longer afford a new home will try to acquire an existing home, and their demand will push up the price of existing homes.

2 *Statutory taxes on housing, and how they compare to other industries*

Housing taxes are an important revenue source for governments

Just under 70 per cent of the tax revenue collected by Australian Governments (Federal, State and Local) is collected as taxes on income. Because this tax is levied on factors of production (labour and capital) and is not levied on producers, consumers or transactions, it is not targeted at particular industries or at particular forms of activity.

Around 13 per cent of revenue is GST revenue. In practice this does target particular forms of activity, as many industries (exports and other industries) are exempt. In 2014-15, dwelling ownership and housing construction provided 14 per cent of total GST collections, despite providing only 11 per cent of total Gross Value Added across industries.[1] Dwelling ownership and residential construction provides a relatively high amount of GST because its output is not GST exempt (output is not exported and it not subject to a specific exemption).

Taxes levied on land and housing (land tax, municipal rates, other taxes on immovable property and stamp duties on conveyances) are the largest of the taxes which target a particular form of activity or industry. These taxes generated $51 billion of revenue for governments in 2016-17 (10 per cent of revenue).

2.1 Tax revenue collected by Australian Federal, State and Local Governments

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Tax on income and super.	231	242	249	259	266	282
GST	50	51	57	58	62	64
Payroll	20	21	21	22	23	23
Taxes on land and housing [a]	32	35	40	43	48	51
Oil, petrol and fuel	17	18	18	18	18	18
International trade items	7	8	9	11	14	14
Motor vehicle taxes & fees	8	9	9	9	10	10
Insurance	5	5	5	6	6	6
Gambling	5	5	5	6	6	6
Other specific levies and taxes	15	21	22	14	14	15
Total	**391**	**416**	**436**	**446**	**466**	**489**

1 Data are taken from 20114-15 Input-Output Tables ABS Cat 5209.0

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Tax on income and super.	59%	58%	57%	58%	57%	58%
GST	13%	12%	13%	13%	13%	13%
Payroll	5%	5%	5%	5%	5%	5%
Taxes on land and housing	8%	8%	9%	10%	10%	10%
Oil, petrol and fuel	4%	4%	4%	4%	4%	4%
International trade items	2%	2%	2%	2%	3%	3%
Motor vehicle taxes & fees	2%	2%	2%	2%	2%	2%
Insurance	1%	1%	1%	1%	1%	1%
Gambling	1%	1%	1%	1%	1%	1%
Other specific levies and taxes	4%	5%	5%	3%	3%	3%

[a] Taxes on land and property include land tax, municipal rates, other taxes on immovable property and stamp duty on conveyances

Source: ABS Cat 5506

Activity in land and housing is taxed at a relatively high rate

The price that home owners and home buyers pay to own and build housing implicitly includes more statutory taxes than the price they pay for many other goods and services, because of the magnitude of taxes specifically levied on dwelling ownership and dwelling construction, and the relatively large amount of GST levied.

Data from the ABS Input-Output tables directly illustrates this. From these data tables, in 2014-15, taxes levied directly on production (in housing this includes: land taxes and municipal rates; across all industries this includes payroll tax) and products (in housing across this includes stamp duties; across all industries this includes GST) summed up to around 13 per cent of the value of sales,[2] which is higher than the industry wide average of 5 per cent.

For comparison: industries like the ‘wine, spirits and tobacco’ manufacturing industry and the gambling industry scored higher (taxes on production and products sum to 45 per cent and 30 per cent of sales, respectively), because of the specific taxes and excises levied on these industries, while various manufacturing and mining industries scored lower (significantly below 5 per cent) because governments generally do not levy taxes on production and products in these industries and they are generally GST exempt (as most of their output is sold overseas).

Overall, the clear conclusion from Input-Output tables is housing ownership and dwelling construction is heavily taxed with direct taxes relative to other industries. This

2 The data we quote here, and displayed in Table 2.2, are taxes less subsidies on production plus taxes less subsidies on products, divided by the value output at purchaser prices. Output at purchaser prices is a measure of what purchasers actually pay, including the effect of taxes: it is the sum of output at basic prices (what producers actually receive, after the effect of taxes) plus taxes less subsidies on production and products. We characterise ‘taxes less subsidies on products and production’ as ‘taxes on production and products’ because, at least in the case of ‘taxes less subsidies on products’, ‘subsidies’ equal zero in 106 of 115 industries, including for ownership of dwellings and residential construction. The ABS did not provide data on subsidies on production in response to our email enquiry.

means taxes create a significant wedge between the actual cost of suppliers for providing dwellings and construction, and the prices we pay to receive these services.

2.2 Relative tax burden of different industries in Input-Output Tables (top 8, industry-wide average and bottom 5)

Industry	Sales (measured at purchaser prices, which includes taxes)	Taxes on production and products
	$ million	*Share of sales*
Wine, Spirits and Tobacco	32 668	45%
Gambling	12 176	30%
Beer Manufacturing	11 755	28%
Petroleum and Coal Product Manufacturing	71 829	19%
Food and Beverage Services	75 489	16%
Insurance and Superannuation Funds	54 373	14%
Ownership of dwellings and residential construction	288 787	13%
Industry wide average	-	**5%**
Basic Non-Ferrous Metal Manufacturing	17 529	1%
Fruit and Vegetable Product Manufacturing	19 582	1%
Defence	30 384	1%
Iron Ore Mining	1 957	0%
Coal mining	12 802	0%

Note: Industries where sales are less than $10 000 million are excluded. Margins and subsidies make our calculation problematic in some smaller industries. We treat ownership of dwellings and residential construction as one joint industry in our table and analysis, because the data and email correspondence from the ABS suggests whole taxes are separated into these industries. For example: residential construction includes stamp duties, while ownership of dwellings includes municipal rates, land taxes, etc. For our purposes, which requires a picture of all taxes on housing and property, the best approach is to add these two industries together. See footnote in text for further explanation of data.

Source: ABS Input-Output Table Cat 5209 (2014-15)

Contribution to government revenues from economic growth

Using the CIE-REGIONS model it is possible to investigate the sectoral contribution to government taxation revenue in Australia. Six consumer goods or services were selected:

- Ownership of dwellings, that is housing;
- Textile, clothing and footwear (TCF);
- Road passenger transport;
- Food, beverage and tobacco;
- Electricity; and
- Petrol products.

For each sector, a $500 million increase in demand for each of the selected goods or service was simulated. In a general equilibrium framework, higher demand for one good or service creates complicated impacts on other sectors: it boosts those sectors which provide inputs to the production of the good or service with simulated higher demand; but it will in general depress the demand for goods and services from other sectors.

In order to measure the impact of higher demand on government taxation revenue as accurately as possible (that is, to offset the substitution effect on other sectors, while still maintaining the general equilibrium property of higher demand on the supply side), two scenarios were simulated:

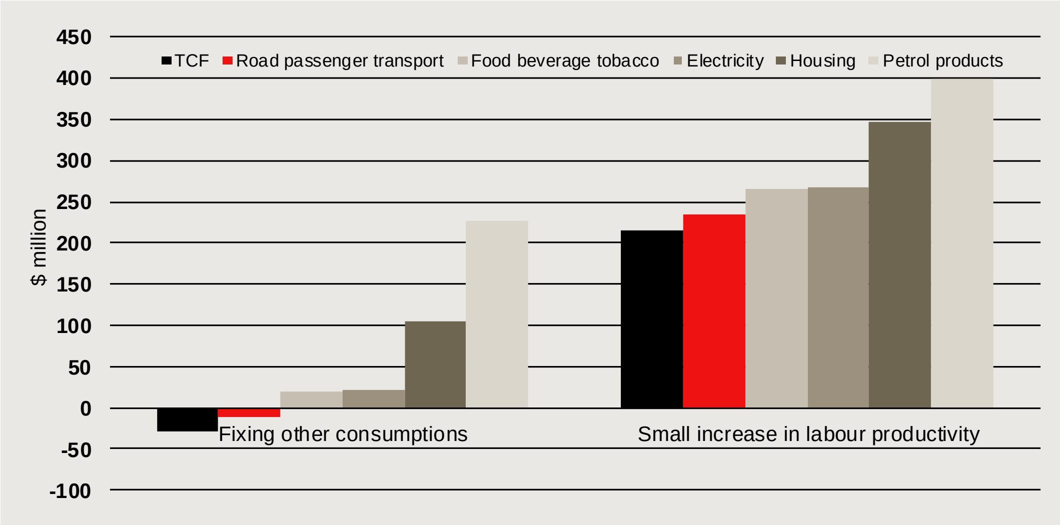
- household demand for other major goods and services remains fixed; and
- a small increase in labour supply (equivalent to a boost in immigration) which boosts the overall economy, thus offsetting the negative impact on other sectors.

The second scenario generates bigger impacts on taxation revenue than the first scenario because, with higher labour supply, the overall economy and total income level is boosted. By contrast, the income level under the first scenario remains unchanged. Therefore, we need to compare the impact on tax revenue of higher demand for various consumer goods under the same scenario, rather than comparing the impacts between the two scenarios.

Chart 5.7 reports the simulation results. It depicts the change in government taxation revenue of higher demand for one good or service. A $500 million increase in the demand for housing would generate about $105 million more in government taxation for the first scenario and about $346 million more revenue for the second scenario.

For the same amount of increase in demand, only higher demand for petrol products could generate more taxation revenue than the housing sector does. All other sectors would generate less taxation revenue than the housing sector. It is clear from the chart that the relativities of the impacts of higher demand from different commodities persist across the scenarios.

2.3 Change in taxation revenue by higher consumption in one sector relative to impact of higher consumption in housing



Data source: CIE-REGIONS model simulation

3 Methodology for the bottom up analysis

This chapters lays the groundwork for the bottom up analysis of housing costs by setting out the broad methodology by which the results are derived.

The Appendices (Appendix A for house & land packages, Appendix B for new infill apartments, Appendix C for income taxes) and Chapter 7 (for the price of raw land) provides detailed data sources, assumptions and explanations.

Strategy

We are trying to estimate and understand all the components in the total outlay a homebuyer makes to acquire a new home. We consider, separately, a new house & land package in a Greenfield estate, or a new apartment in an infill development. We consider 5 cities: Sydney, Melbourne, Brisbane, Perth and Adelaide. Our analysis is done for the financial year 2016-17, as there are considerable lags in the publishing of some data.

The creation and provision of a new house & land package in a Greenfield estate involves two processes: first, the developer buys raw land zoned for residential development, seeks and gains relevant approvals for subdivision, develops the land into blocks which are ready for the construction of a dwelling, and then sells this developed block to the homebuyer. Second, the homebuyer commissions a builder to construct a dwelling. After paying stamp duties and other transaction costs on the developed block of a land and new dwelling, the homebuyer owns a new house & land package.

We treat the creation and provision of a new apartment (in an infill development) as a single project undertaken by a developer. The developer buys raw land, seeks and gains relevant approvals, develops the land, commissions the construction of a construction building and incurs management costs for the whole project. The developer then sells a complete, new apartment to the homebuyer who owns this apartment after they have paid stamp duty and other transaction costs.

To calculate the stamp duty, we use applicable rates. We do not incorporate any discounts that are available to first homebuyers, to keep our results and analysis as simple as possible.

The transfer price paid by the homebuyer to the developer (and/or builder) is the sum of relevant costs, including a margin. The total outlay made by the homebuyer to acquire the new home is the transfer price (total costs), plus transaction costs.

We use a 3-step process to analyse the outlay made by the purchaser, as follows.

Description of each step

Step 1: calculate the total outlay made to acquire new housing (financial analysis)

New house & land packages

For new house & land packages, there is no publicly available data on 'average' sale prices. Therefore, we make our own estimate, by doing the following:

1. We identify and understand the separate steps, including their components, that are undertaken in the development process to create and provide a new house & land package.
2. We source, compile and synthesise publicly available data that allows us to estimate the costs of each step and component in the creation of a new house & land package. We add insights from consultations with HIA and assumptions where necessary. All data sources, insights form consultations and assumptions are explained in Appendices A and B.
3. We estimate the representative transfer price for a new house & land package by summing together the estimated cost of each component. The total outlay made to purchase the package is the cost of a developed block of land plus the cost of the dwelling plus transaction costs.

$$\begin{aligned}&Total\ outlay\ required\ to\ acquire\ a\ new\ dwelling\\&\qquad = Cost\ of\ a\ block\ of\ developed\ land\ + Construction\ cost\\&\qquad + transaction\ costs\end{aligned}$$

Note, because our estimates are not derived from averaging multiple observations for these costs, we do not call our estimates the 'average outlay' made to acquire a new house & land package. However, to estimate each cost we use average data: median cost for a developed block, average size of new houses, average construction cost, including an adjustment for economies of scale in Greenfield blocks. Therefore, while our estimates are not a calculated averages in the strict sense, they do provide an estimate for the central outlay made to acquire a new house & land package. We call our estimates 'representative'.

New apartments

UDIA publish data on the median transfer price of new apartments in each city. From this end-point we work backwards to measure the cost of each component. The total outlay is the transfer price plus transaction costs.

This report

The results of step 1 are contained in Chapters 4 and 5 of this report.

Step 2: cross check our result for new house & land packages

Because our estimate for the representative transfer price for new house & land packages is derived by summing separate estimates for individual components, it is necessary to cross-check our estimate for the total against data for advertised prices on real-estate websites. As advertised house & land packages are quite heterogenous in terms of their characteristics (block sizes, house sizes, etc.) we convert our estimates into rates: cost of developed land against block size, total construction costs against house size. We then multiply these rates against the average for block size and dwelling size from advertised packages and compare the result to average price across advertised packages.

As a result of our initial cross-checks, we adjust our original assumptions to ensure our estimates broadly align with advertised prices. This cross-check is outlined in Chapter 6 of this report.

This cross-check is not necessary for new apartments, because we use reported data on the median price of new apartments.

Step 3: identify resource costs, statutory taxes and regulatory costs (economic analysis)

For each component of each estimate of the outlay made to acquire a new house & land package and a new apartment, we identify whether the component is a resource cost, a statutory tax (or another government revenue raising measure such as an excessive charge) or a regulatory cost.

For many components this is straight-forward. For example, the land tax the developer pays during land development, the GST charged on various costs, and stamp duties are statutory taxes. Further, we assume that reported construction costs (plus our adjustment for economies of scale in Greenfield development) are resource costs.

Some components require simple allocations into two sub-components, as the following example illustrates. We calculate total development charges, which are one component of the cost of a developed block of land. We make an estimate for the resource costs that would be incurred to provide appropriate roads, public space, etc. for new development. If the development charge is above this resource cost, the excess is a government revenue raising measure, which we treat similar to a statutory tax.

One component, the purchase price of raw land zoned for residential use requires a complicated allocation into a resource cost and regulatory cost. This is discussed in Chapter 8.

Finally, it is necessary to remove income taxes levied on underlying resources, which are statutory taxes. For example, calculated ‘construction costs’ include the cost of the income tax levied on the workers engaged by the builder. We make a final calculation to separate out income taxes in resource costs, so these can be allocated to statutory taxes. This is described in Appendix C.

We capture cascading costs

An important feature of the various components of the outlay required to buy a new home is their inter-dependency. For example, the land tax that is levied on developers during the development process is a statutory tax. This land tax is levied on the price the developer pays for the unimproved value of the block of raw land, which (we find) includes a component that is a regulatory cost. Therefore, the regulatory cost implicit in the raw land value causes the statutory tax to be larger. This is sometimes called the 'cascading effect' of government policy.

The model we have used for our analysis allows us to track and estimate these cascading effects. For some components, this requires us to use iteration, which is explained (see Chapter 8).

Within regulatory costs, we identify:

1 Regulatory costs on variable resources (which is the effect of delays in the approval process on developer finance costs, plus the effect of uncertainty in the approval process on developer margin)

2 Regulatory costs on the fixed resource land. We present evidence this is created by the system of zoning and associated land use and development controls.

Regulatory costs on variable resources are essentially inefficiencies in the planning system. Apart from directly adding to developer finance costs, these costs impact the GST collected on development and (via their impact on the final transfer price), the stamp duty paid by the purchaser. Because these effects on GST and stamp duty are relatively straightforward, and because governments periodically try to improve the processes where the underlying inefficiencies exist, we report the additional GST and stamp duty created within 'regulatory costs on variable resources', so the full impact of these costs can be understood.

Regulatory costs on land (the fixed resource) inflate the price the developer pays for raw land and therefore most statutory taxes that follow. It is calculated via iteration (see Chapter 8). Measuring all these cascading effects is more complicated. It is desirable to avoid this complication, because understanding this regulatory cost and the evidence that suggests it is created by the system of planning and associated land use and developed controls is also complicated. Therefore, we simply report this regulatory cost as a stand-alone item (regulatory cost on the fixed resource), and do not calculate its cascading effects on land tax, rates, GST, stamp duty, etc.

4 Assumptions about the development process

Process that results in the creation of a new house & land package

The process that results in the creation and provision of a new house & land package, including key sub-components, is described in Table 3.1. Further explanation of some details is provided in Appendix A.

4.1 The provision and creation of a new house & land package

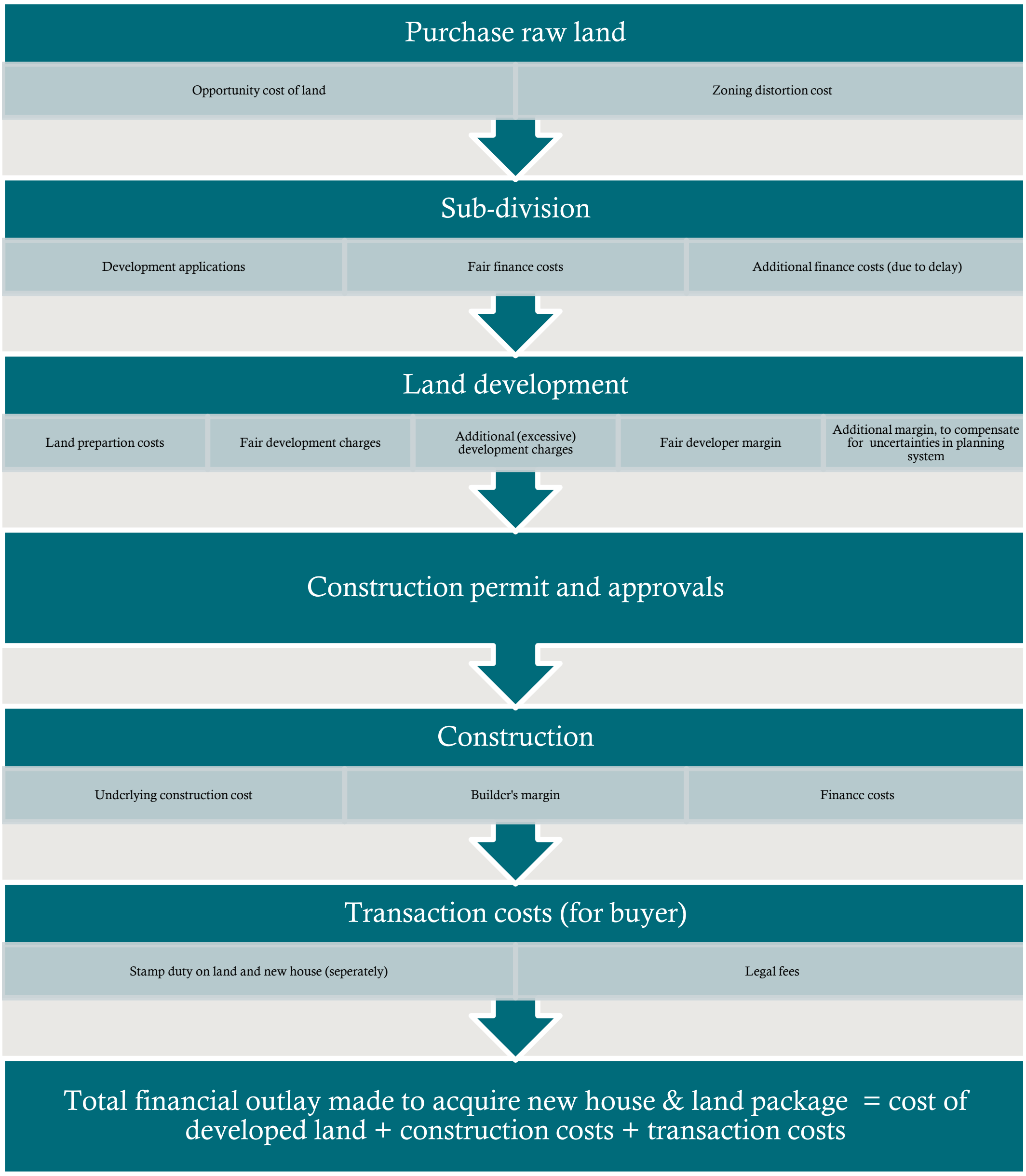
Step	Start	End	Time (Sydney Greenfield)
Raw land purchase	Developer uses debt to purchase a large parcel of raw land that is zoned for residential use on the city fringe	-	-
Development application and sub-division	Developer makes a DA that includes subdivision, masterplan, etc. While developer waits for DA to be granted, he/she incurs interest on land purchase costs	Local council grants relevant development applications Land now consists of individual blocks ready for development	15 months (necessary time of 8 months, plus delay of 7 months) [a]
Land development	Developer pays development charges to local council and state government (covers roads, public space, etc.) Developer incurs land preparation costs and other development costs	Individual blocks are ready for the construction of a dwelling Buyer of new house & land purchases a block	4 months (necessary time)
Development application and building application	Buyer of new house & land package applies for development application and building application	Relevant authorities issue approvals	
Construction	Buyer of new house & land package commissions builder to construct dwelling	Construction is complete	8 months (necessary time)
Transaction costs	Buyer of new house & land package pays stamp duty on developed block and new dwelling	Buyer or new house & land package takes ownership of completed project	Costs occur as they arise

[a] See discussion in this chapter of ‘necessary time’ and ‘delay’

Source: Consultations with HIA, The CIE

Process that results in the creation of a new apartment

4.2 The development process and its components



Data source: The CIE

In the process that results in the creation of a new apartment we do not assume a distinction between land development and construction. Rather we assume the developer purchases the raw land, seeks and obtains approval, develops the land and constructs the apartment block as a single project. At the end of this project, the buyer of the new apartment purchases a complete apartment. The result is an extra layer of costs: project management costs, which are incurred by the developer, and are added to the outlay made by the purchaser. The buyer of the new apartment pays stamp duty once, on the total price of the new apartment.

Assumptions for timing

It is necessary to make assumptions about the time taken in each step of the development process as these time periods drive the interest costs of the developer and builder (who use debt to finance costs), which are components that add to the total outlay made by the buyer of new house & land package and new apartment.

Within our calculations, the most important timing assumption we make is for the period of time for the granting of a development approval (the period of time between (1) the developer buying the raw land zoned for residential use and the submission of a development approval, and (2) the granting of this approval, which allows the developer to develop the land).

Public policy discussion implies that delays in the planning and approvals process can increase this period of time. Two examples of this discussion are as follows.

1 Garner, for the Planning Institute of Australia, notes: '*Not only do unnecessary delays in the development assessment process result in sometimes substantial delays in bringing land and housing to the market, but particularly in areas of high growth it can lead to higher development costs.'*[3]

2 The Productivity Commissions notes there are 'delays' in the process of land supply caused by: rezoning/planning scheme amendment, structure planning and dealing with community concerns.[4]

Of course, the vast majority of community members reasonably expect that new development is subject to some kind of administrative process, where developers are required to convince the relevant authorities that their particular development has merit and aligns with reasonable community expectations. This process (where developers have to seek and receive and approval for their development) requires some non-zero period of time. Therefore, for this project, we split the period of time for the granting of a development approval into two parts:

1 An initial period of time that the relevant authority requires to subject the development application to a level of scrutiny that is necessary, and which is consistent with reasonable community expectations. In Table 4.3 (below), we call this the 'necessary' component of the time taken for the development approval. Because this time period is necessary, the interest cost that accrues to the developer during this period is a resource cost.

2 An additional period of time that the relevant authority takes to grant the development approval, which is unnecessary, and which is additional to the period of time that is required to meet reasonable community expectations. We call this component of the time taken for the development approval an 'unreasonable delay'. Because this time period is not a necessary part of the development process, and because it created by government policies and decisions (in this case the 'decision' is

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3 Garner G O 2008, *The Impact of Planning Delays & Other Holding Costs on Housing Affordability,* Refereed submission to PIA QLD State conference, pg. 15 (see: https://www.planning.org.au/documents/item/1199, accessed April 2019)

4 Productivity Commission 2011, *Planning Zoning and Assessments*, pg. XXX

to unreasonably delay the development approval) the interest cost that accrues during this period is a regulatory cost.

There is no widely accepted data on the time period it takes to approve largescale Greenfield and infill development, nor on the component of this that reflects an unreasonable delay. Therefore, it is necessary for us to make a judgement. For this judgement, we undertook consultations, and arrived at the data in Table 4.3. Note, given the goal of this project is to pull together all available data and estimates on different parts of the development process, and present them in a coherent framework, the goal for individual timing assumptions is not to make a 'perfect' assumption. Rather, it is merely to make a plausible or reasonable assumption that is not inconsistent with the available public policy discussion.

4.3 Greenfield development: time taken for each step (months)

		Sydney	Melbourne	Brisbane	Perth	Adelaide
Time taken for development approval for subdivision	Necessary	8	8	8	8	8
	Unreasonable Delay	7	4	4	4	4
Land development process	Necessary	4	4	4	4	4
House construction	Necessary	8	8	8	8	8
Total time		**27**	**24**	**24**	**24**	**24**

Source: CIE consultations

4.4 Infill development: time taken for each step (months)

		Sydney	Melbourne	Brisbane	Perth	Adelaide
Time taken for development approval for building	Necessary	7	7	7	7	7
	Unreasonable Delay	9	5	5	5	5
Land development	Necessary	4	4	4	4	4
Apartment construction	Necessary	18	18	18	18	18
Total time		**38**	**34**	**34**	**34**	**34**

Source: CIE consultations

More details are provided Appendices A and B.

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ATTACHMENT 2 – ANALYSIS OF ACT TAX REFORM INITIATIVE

HIA Research Note – February 2018

This paper analyses the economic effects of the first five-year stage of reform across key variables of the housing market – prices, turnover and residential construction – and the effects on territory government revenues.

We conclude that the ACT Government's tax reform is likely to have supported elevated levels of residential construction for both new home building and renovations activity.

Critical to this analysis is the finding that the reforms in this first stage consisted of an increase in general rates with no material reductions in stamp duty. The effects of bracket creep exceeded the planned reduction in stamp duty rates resulting in a windfall gain for government revenues.

Collectively, the switch from stamp duty to land tax in the ACT has resulted in additional property taxes of $196.5 million. This is an increase of 38.0 per cent over four years.

Summary of ACT Tax Reform Initiative

In its 2012-13 Budget, the ACT Government announced an ambitious 20-year program to reform the territory's property taxation system. While the government set out a range of reforms, the focus of these was the abolition of stamp duty and a change in the way general rates are levied on both residential and commercial properties.

The phasing out of stamp duties and the phasing in of the new general rates system has been set out to coincide over 20 years (across four, five-year plans) to avoid a shock to the property market and to allow the policy to be 'revenue neutral'.

The figure below sets out the phasing-out of stamp duty and phasing-in of higher land tax during the first five-year period. The emboldened elements of the tables represent where the most change has occurred.

Lower-value homes (under $300,000) are the cohort that has experienced material stamp duty reductions, while the increases in general rates for these lower-value homes has been relatively modest. At the same time, higher value homes in the ACT have seen the applicable rates of stamp duty fall only modestly and general rates obligations increase substantially.

The average house price in Canberra exceed $670,000 in January 2018. The average price of units exceed $431,000. The majority of homes are also likely to have an unimproved land value exceeding $300,000.

Consequently, from the perspective of the overall market, the structure of the reform can more accurately be described as a process of first phasing in the new rates system and then phasing out stamp duties. The former has occurred (although not concluded) during this first stage of the reform program, while the latter has yet to occur in a material way.

1. Duties, %

Home value	2012/13	2013/14	2014/15	2015/16	2016/17
Up to 200,000	**2.40**	**2.20**	**2.00**	**1.80**	**1.48**
200,001 - 300,000	**3.75**	**3.70**	**3.50**	**3.00**	**2.50**
300,001 - 500,000	4.75	4.50	4.15	4.00	4.00
500,001 - 750,000	5.50	5.00	5.00	5.00	5.00
750,001 - 1,000,000	6.50	6.50	6.50	6.50	6.50
1,000,0001 - 1,454,999	7.25	7.00	7.00	7.00	7.00
1,455,000 and above			5.25	5.17	5.09

2. General rates, %

Unimproved land value	2012/13	2013/14	2014/15	2015/16	2016/17
Up to 150,000	0.2336	0.2306	0.2547	0.2746	0.2746
150,000 - 300,000	0.3136	0.3241	0.3571	0.3857	0.3900
300,000 - 450,000	**0.3736**	**0.3876**	**0.4287**	**0.4629**	**0.4800**
Above 450,000	**0.4136**	**0.4312**	**0.4873**	**0.5339**	**0.5400**

The economics of stamp duties and land tax [1]

Stamp duty is an inefficient tax. It impedes the smooth flow of the workforce to locations of high employment and restricts the opportunity for seeking education or health services. It hampers the ability for the population to move to alternative housing that suits their needs such as downsizing, or moving to housing that suits those in need of better care and support in their later years.

The inequity of stamp duty falls upon a relatively small cohort of taxpayers who need to move to find employment, training, health or for financial reasons. Consequently, stamp duty has a disproportionately high impact on households that are vulnerable due to changes in their circumstances including employment, health or other family related matters.

Stamp duty is also a volatile source of tax revenue as demonstrated after the economic shock in 2007/08. Across Australia, total stamp duty fell from $14.3 billion in 2007/08 to just $9.5 billion the following year – a fall of some 33.6 per cent in the space of 12 months. The ACT is not immune from these national trends or from its own isolated price corrections such as that experienced in the late 1990's when cuts to employment affected population growth and house prices.

Stamp duty is also notoriously bad for bracket creep. House prices rise over time therefore raising more revenue. In NSW, for example, the stamp duty rate structure has not been adjusted to take account of any house price increases since 1985 – a time when the average Sydney house was worth about $80,000.

In contrast, land tax is an efficient tax base because the asset being taxed – land – is deemed to be immobile. An increase in land tax does not provide an incentive to change behaviour (i.e. avoid buying or selling a home) to avoid the tax as this is not possible without relocating to another tax jurisdiction. A landowner can either pay the annual actual tax bill or sell the property.

As a consequence, if applied broadly and to the unimproved value of the land (not discriminating between different owners or uses), a land tax represents a relatively stable source of government revenue.

As stamp duty is an inefficient tax and land tax is a considerably more efficient tax with fewer distortions, the ACT Government's policy has been supported in principal by HIA. This progressive reform has the ability to lead to better economic outcomes over the long-term.

Home prices

An increase in land tax will result in the price of a home being lower than what it otherwise would have been. This statement cannot be tested in an isolated environment, but the impact can be inferred from a wider sample across the market.

The analysis of home price data provides evidence that prices have been affected by the ACT tax reform in its first stage. Namely, during this stage home prices are likely to have grown at a slower pace than what they otherwise would have.

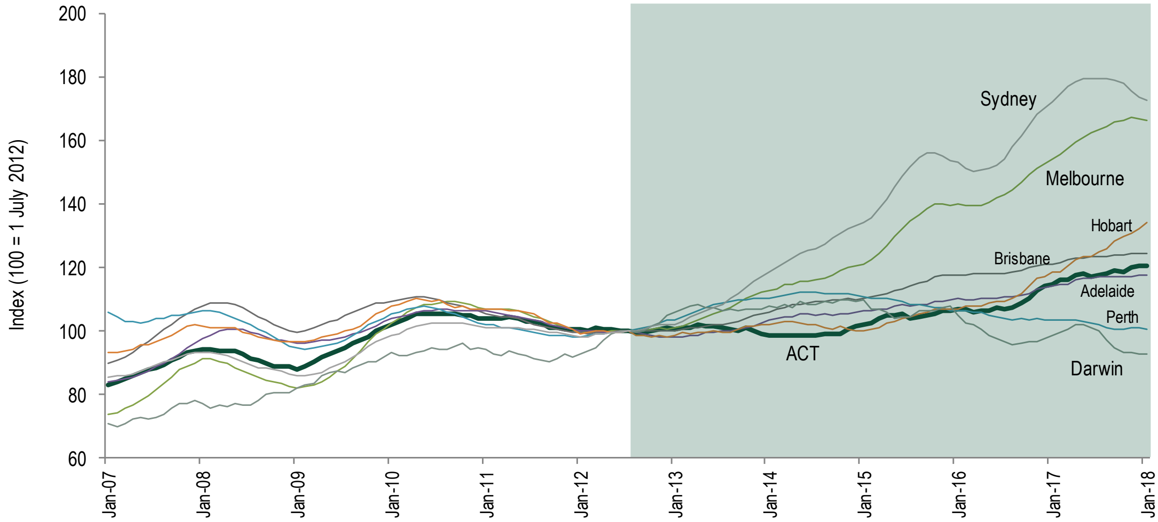
The charts below show that for houses in particular, prior to the reform, prices grew at around the national average. After 1 July 2012, the ACT becomes conspicuous for some years in the slow rate of price increase compared with most other capital cities. The changes in tax arrangements are not the only causational factors for this outcome.

Reductions in stamp duty would be expected to place upward pressure on home prices – buyers can pay more for a given home by the amount of the reduction in stamp duty. There is little if no evidence of such price pressures, given the narrow application of the stamp duty reductions in the first stage of reform.

[1] The ACT's new general rates system is in effect what economists typically refer to as a broad-based land tax. From here on the paper uses these terms interchangeably.

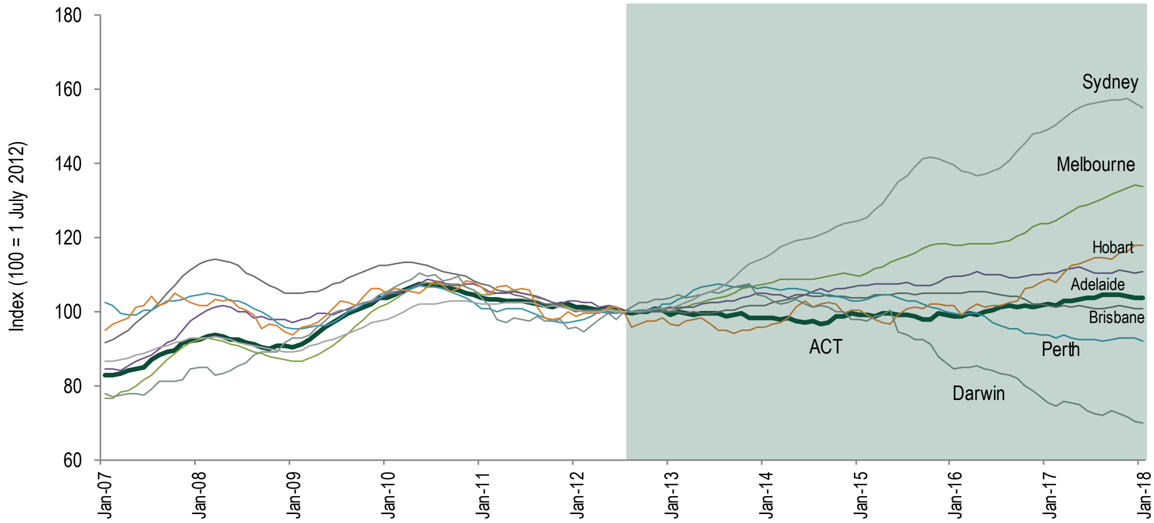
Capital city house prices, indexed to 100 =1 July 2012

Source: CoreLogic Hedonic Price Index



Capital city unit prices, indexed to 100 =1July 2012

Source: CoreLogic Hedonic Price Index



Housing market turnover

The ACT Government's stamp duty/land tax switch should, at least in theory, result in higher turnover of houses as the abolition of stamp duty will allow people to move houses more freely without the burden of a transfer tax.

This outcome is not evident in the ACT, at this stage of the reform process.

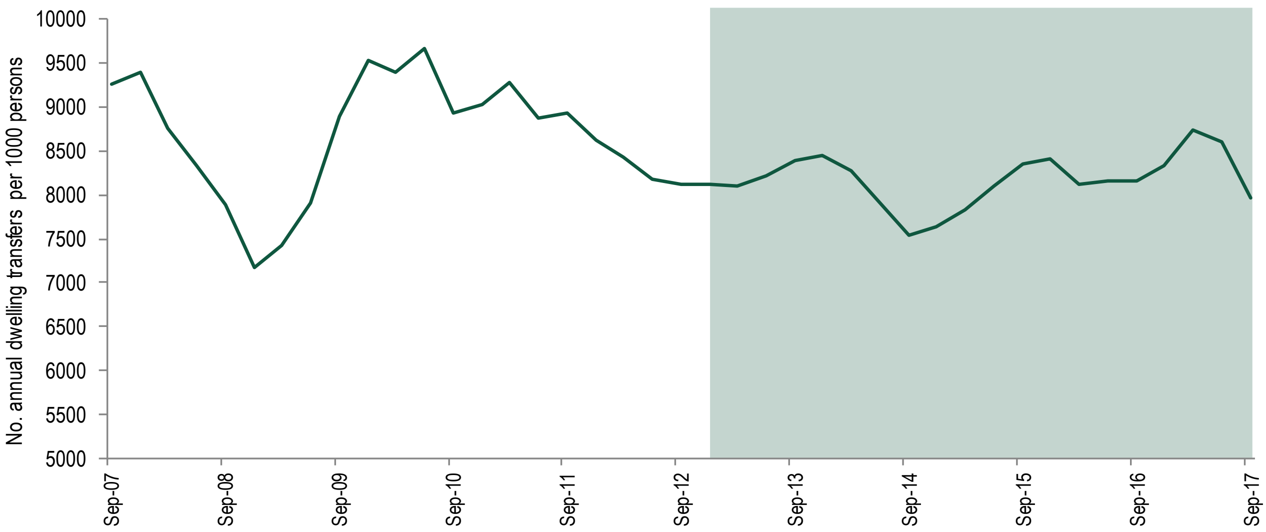
The volume of houses turned-over in the ACT was in decline for two years prior to the start of the tax reform initiative. The volume continued to decline for a further nine months after the start of the reform process. In fact, turnover reached a record low of just 19 dwellings per 1000 persons during the year to September 2014, a lower level of activity than in the immediate wake of the GFC when housing markets around the country temporarily froze.

The continued trend decline in turnover in the ACT is evident because of the narrow application of material stamp duty reductions in stage 1, which incurs predominantly on dwellings valued at under $300,000 and subsequently from houses priced under $500,000, have had an immaterial impact on the number of transactions.

The role of increasing land tax is also likely to be a factor in this trend. Increasing tax on the unimproved value of land deters speculative behaviour in the market – as landowners become subject to the tax they are encouraged to develop vacant or underused land to cover the increased cost of holding the property (the increased tax), or sell it.

The quantum of this change is impossible to estimate as there is no means of determining 'speculative behaviour'.

ACT annual dwelling transfers per 1000 persons
Source: ABS 6416.0



ACT dwelling transfers - moving annual total
Source: ABS 6416.0

There are two other factors worthy of note in relation to the tax reform initiative.

Firstly, the transition to a land tax does have another positive externality. The transition avoids unnecessary 'vacant land taxes' which are a poorly designed policy to address land speculation. Vacant land taxes have been introduced in a number of jurisdictions in response to very questionable data that suggested more than 10 per cent of houses in Australia were vacant.

Secondly, as the employment centres in the ACT are close to the NSW border it is possible to avoid the tax changes by relocating across state borders. If NSW does not change the application of stamp duty retains rate capping, interest rates remain low and the ACT continues to increase rates then there will be a point at which the tax burden on households could create an incentive to avoid ACT property taxes, in preference for NSW based property taxes. For example, the annual cost of borrowing $20,000 over 25 years to incur NSW stamp duty to purchase a $550,000 home, will be less than the annual increase in ACT rates.

This means that for households that do not need to live close to the centre of Canberra, there could eventually be a tax advantage to relocate into NSW to avoid the relative high annual rates in the ACT by incurring the cost up-front imposed by NSW stamp duty.

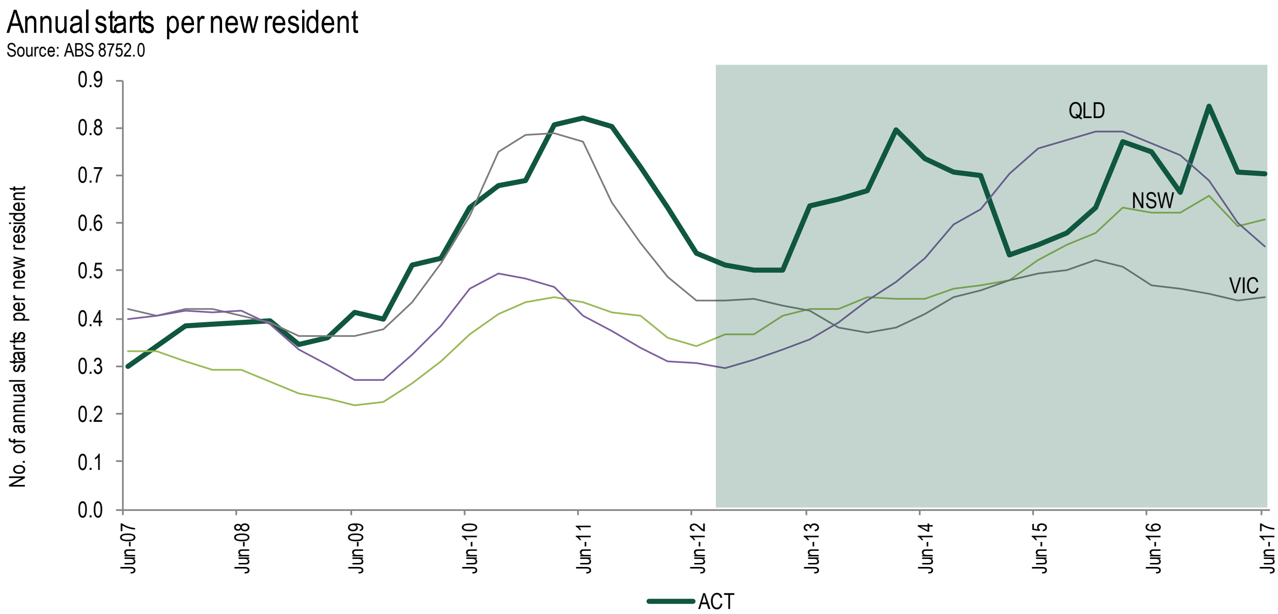
Residential construction – new home building and renovations activity

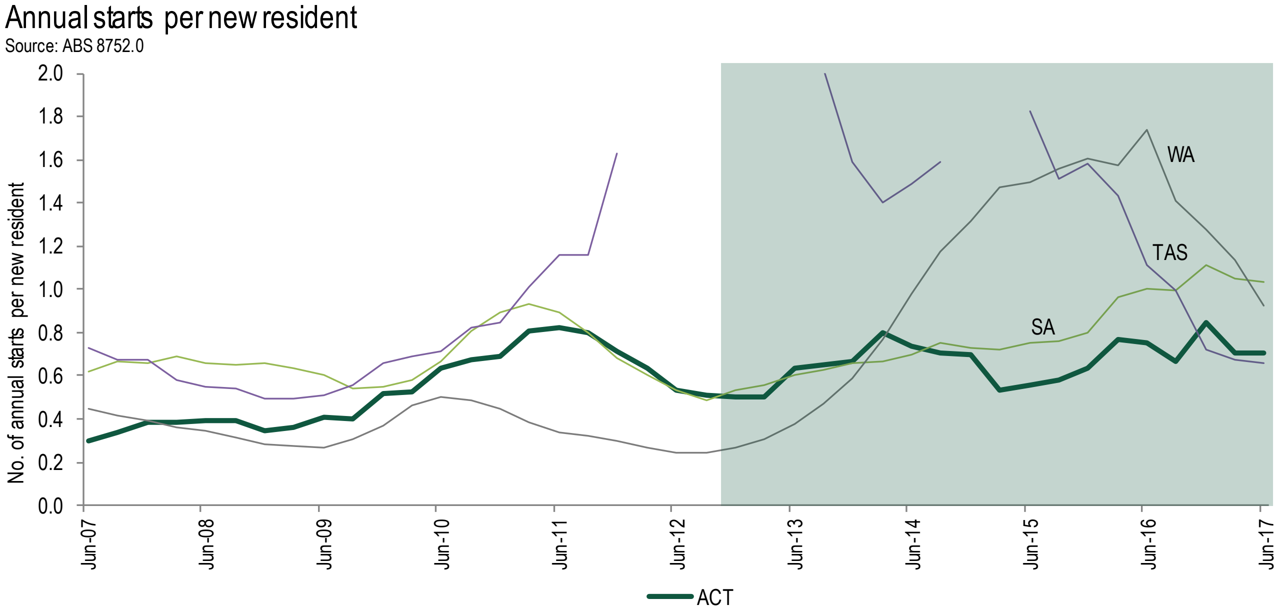
The ACT's tax reform initiative is likely to have supported elevated levels of residential construction – both new home building and renovations activity. Land taxes should encourage landowners to develop vacant or underused land or property to cover the increased cost of holding the property (the increased tax), or sell it.

New home building activity in the ACT (on a per new resident basis) – had been declining for a year before the tax reform initiative commenced. The decline in activity continued for a further nine months after the tax reform process commenced.

Since then overall activity has increased and has fluctuated around a relatively elevated level in the following years. Even when measured on a 'per-resident basis' and therefore taking into account the ACT's rising population, the impact on home building has been positive.

The ACT has also been adding more stock per additional new resident compared with the other eastern seaboard states. This is a quite a compelling result given the very high levels of building occurring in New South Wales and Victoria in recent years. While on a per-new resident basis, building activity in Queensland briefly exceeded the levels in the ACT, this is largely accounted for by slowing population growth associated with a major downturn in the resources sector.

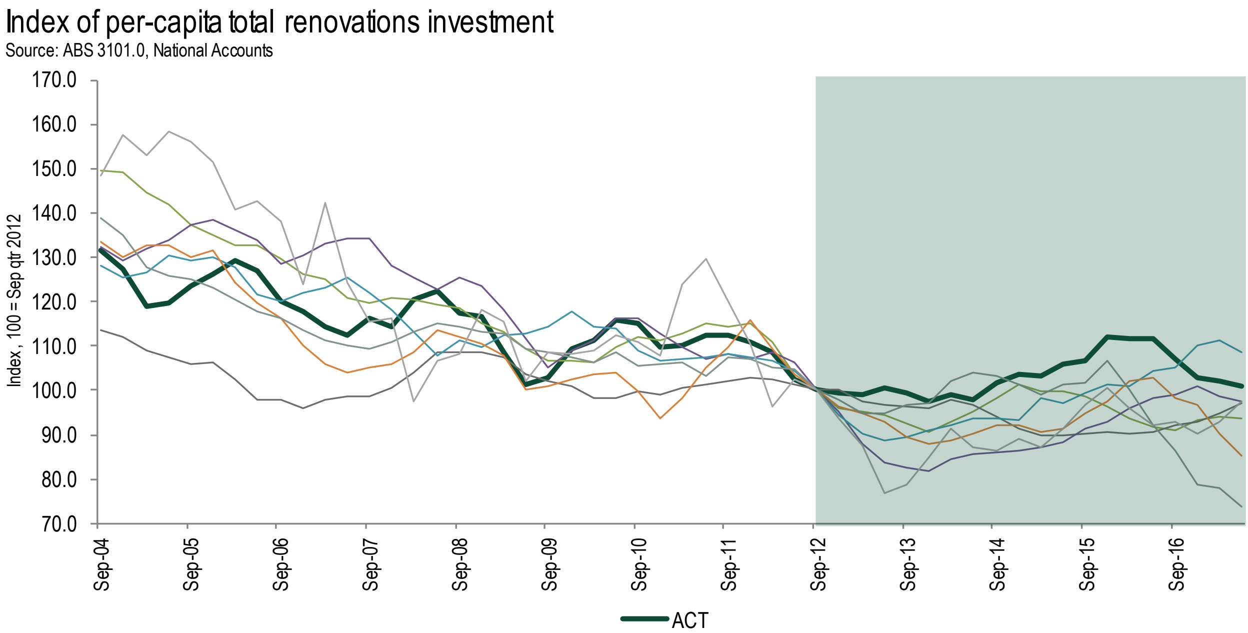




While the results in the renovations market do not appear as strong, there is still evidence that the reform has been supportive of this part of residential construction amid difficult market conditions across the country for renovations. The mechanism for this support for renovations is much the same as for new home building. That is, the imposition of the land tax encourages property owners to develop or improve underused land, or sell the land to avoid the tax liability.

Per-capita levels of renovations activity in the ACT continued their decade-long trend of decline for about two years after the introduction of the tax reform. The pace of this decline did moderate and growth materialised during the two years to September 2016. The latest level of renovations investment per capita in the ACT is just higher than where it was at in mid-2012, when the reforms commenced.

Given the difficult trading conditions facing the renovations market nationwide, most jurisdictions have seen renovations activity continue to decline to levels below where they were in mid-2012. Land tax in the ACT appears to have provided support to the renovations market through the aforementioned incentives and contributed to the ACT's out performance of most other jurisdictions.



ACT Government Revenues

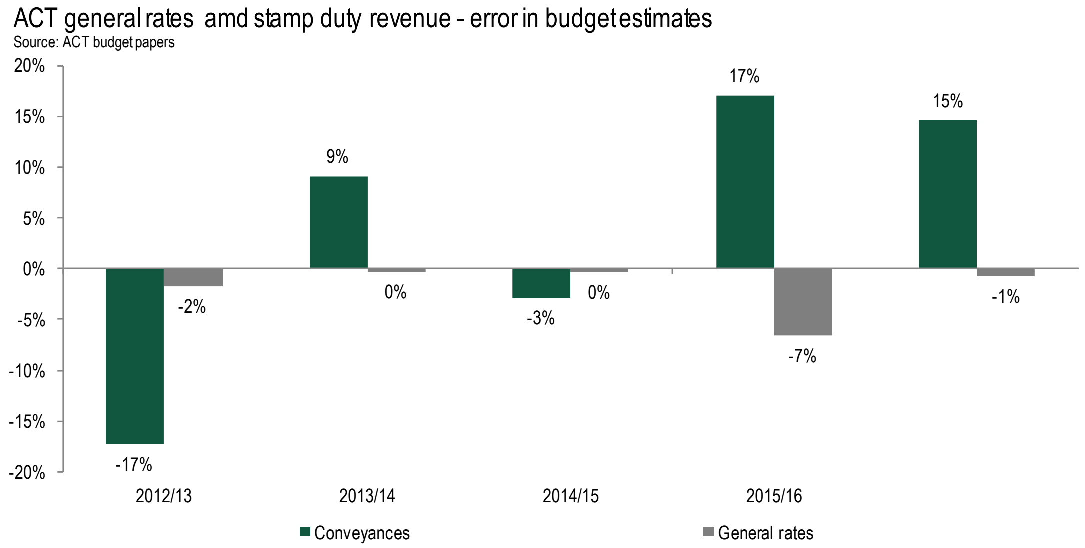
An outcome of the tax reform initiative is a more reliable source of revenue for the ACT Government. Stamp duty revenues are volatile because they are determined by housing prices and market turnover that are themselves subject to significant swings. In contrast, a broad-based land tax represents a much more stable source of revenue given the inability of avoiding the tax.

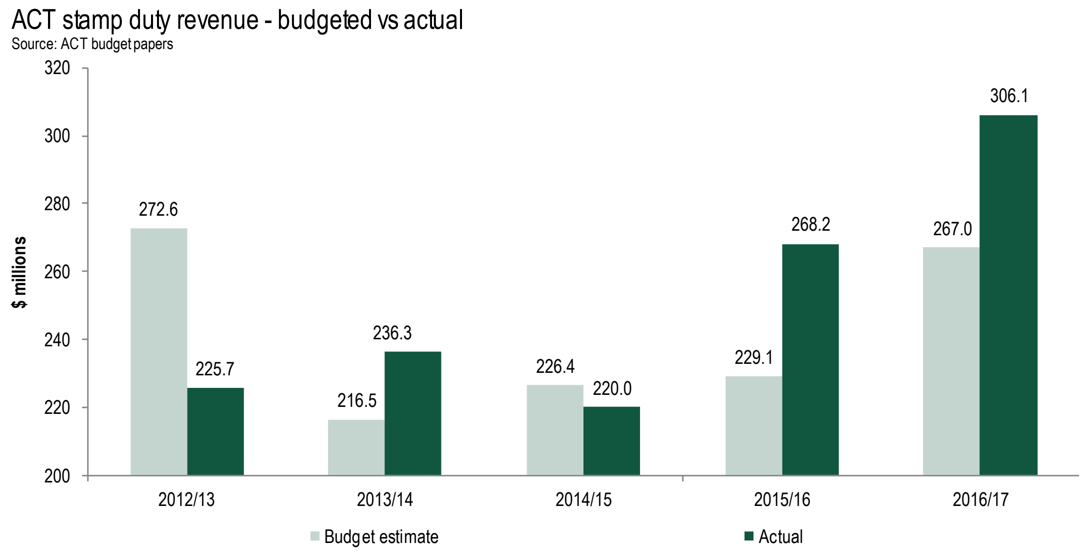
The first chart below illustrates the unpredictability of stamp duty revenues during the first stage of tax reform – which demonstrate relatively large errors between budgeted and actual revenues. This contrasts with the accurately estimated rates revenues during the same time.

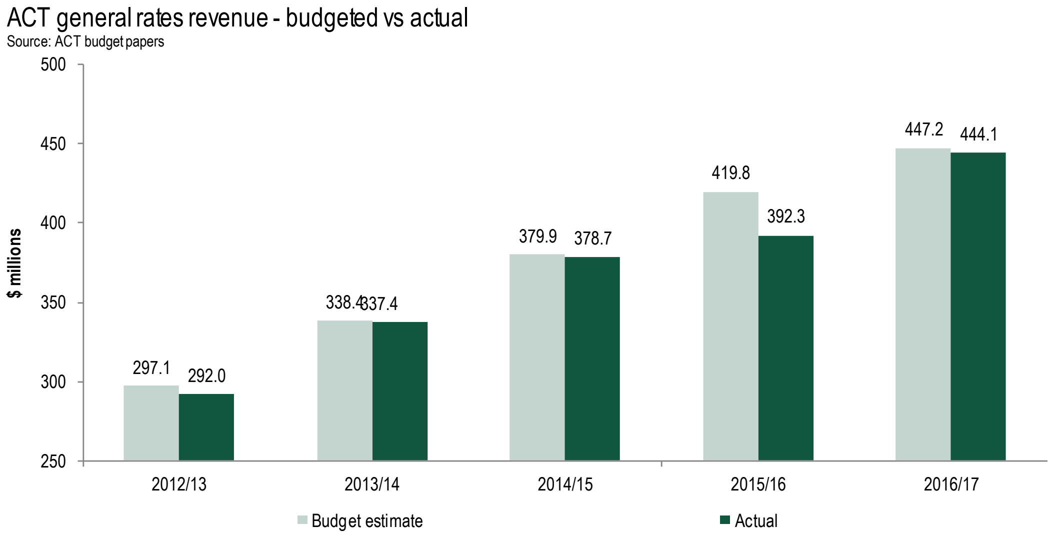
The ultimate goal of the reform is to switch the ACT's revenue base away from inefficient stamp duties however, this tax still accounted for a growing amount of tax revenue during the first phase. This is a result of windfall gains associated with house price increases and the consequent bracket creep in to higher stamp duty obligations.

The Budget estimated stamp duty revenue to decline by $5.6 million over the period 2012/13 to 2016/17. Instead it has increased by $80.4 million.

This growth in the value of stamp duty was less than the growth in other revenues and consequently the ACT Governments reliance on stamp duty has fallen. Over the decade to 2011/12, conveyance stamp duty accounted for 22.9 per cent of tax revenue in the ACT. Since then (from 2012/13 to 2015/16), the share has been 17.5 per cent. This is partly due to the rise in revenue from land taxes, but also other non-property related revenue.







Progressive exemptions to stamp duty and First Home Owner Grants

First Home Owner Grants are an important component to a national housing policy as the most significant barrier to entering the market continues to be obtaining a deposit. Mortgage repayments tend to be a lower barrier to ownership than jumping that big initial deposit hurdle. This initial deposit is eroded by the imposition of punitive taxes including stamp duty on a house and on the mortgage.

A well-designed First Home Owner Grant will encourage the construction of more new homes, therefore increasing the stock of housing and lowering affordability pressures. A poorly designed scheme encourages buyers towards the existing stock, therefore restricting the growth in supply and forcing up affordability pressures.

For this reason the ACT initiative of abolishing stamp duty across all categories and price brackets is a better option than progressive exemptions to stamp duty for first home buyers.

Conclusion

Stamp duty is an inefficient tax. Land tax on the other hand provides a more reliable source of revenue. In the case study provided by the ACT Government, at this early stage, the reform is having the anticipated positive impact on the economy.

There are significant risks in pursuing these reforms. Most notable of these is that the reform agenda is abandoned, or paused, before stamp duty is abolished. As is most evident in NSW, if stamp duty rates are not adjusted every year, its burden, inefficiencies and inequities compound. Without the complete abolition of stamp duty, the tax will again grow to be a punitive tax on house transfers.

For the ACT, these risks will increase during the second phase of the tax reforms as the Government begins to experience a decline in revenue from stamp duty.

Stamp duty Dependence

Stamp duty revenues depend on two main factors, dwelling prices and the number of transactions occurring in the market. When the market is going well, house prices are going up, there are lots of people buying and selling property and as a result, stamp duty revenues increase. Until recently it appeared that house prices could only go up with prices rising strongly since 2012. Even state governments seem to have forgotten the age-old saying that what goes up must come down, pricing these trends into their revenue forecasts. House prices are now in decline. Sydney prices have declined by 16.2 per cent and NSW by 7.6 per cent since their peak in 2017. Consequently, stamp duty revenues in NSW are now in decline.

The chart below highlights that house prices and sales volumes often move in tandem. Falling house prices tend to cause people to become more reluctant to sell their house in the hopes that they will get a better price if they hold off. Buyers are also disinclined to purchase a dwelling in case they have misjudged the bottom of the market and house prices fall further.

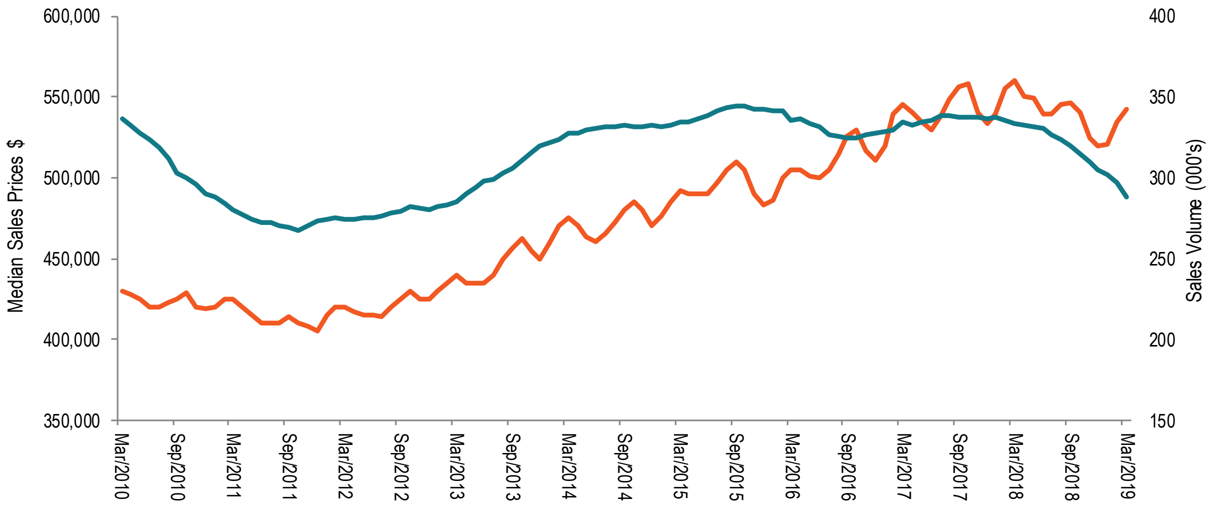
Over the past two months, the states and territories have revealed their budgets for the 2019/20 financial year. The majority of states have had to severely downgrade their stamp duty revenue forecasts compared to previous budgets. Revenue from stamp duty across Australia in 2018/19 is estimated to exceed $18.9 billion. While this is down from $21.3 billion in 2017/18, the revenue raised is still more than double what it was in 2008/09.

The majority of the increase in stamp duty revenue over the past two decades has been due to increases in dwelling prices forcing purchasers into a higher stamp duty bracket.

In New South Wales, for example, the brackets have remained relatively unchanged since 1986 despite rapid increases in property prices. As shown in the chart below, the median dwelling price in NSW in 1986 was $75,000, which would have been in the third lowest price bracket for stamp duty. The current median dwelling price in NSW is $630,000, which places it in the second highest price bracket.

NSW is taking a step in the right direction and will be indexing the current brackets to the rate of inflation from July 2019.

House Prices and Sales Volume Australia

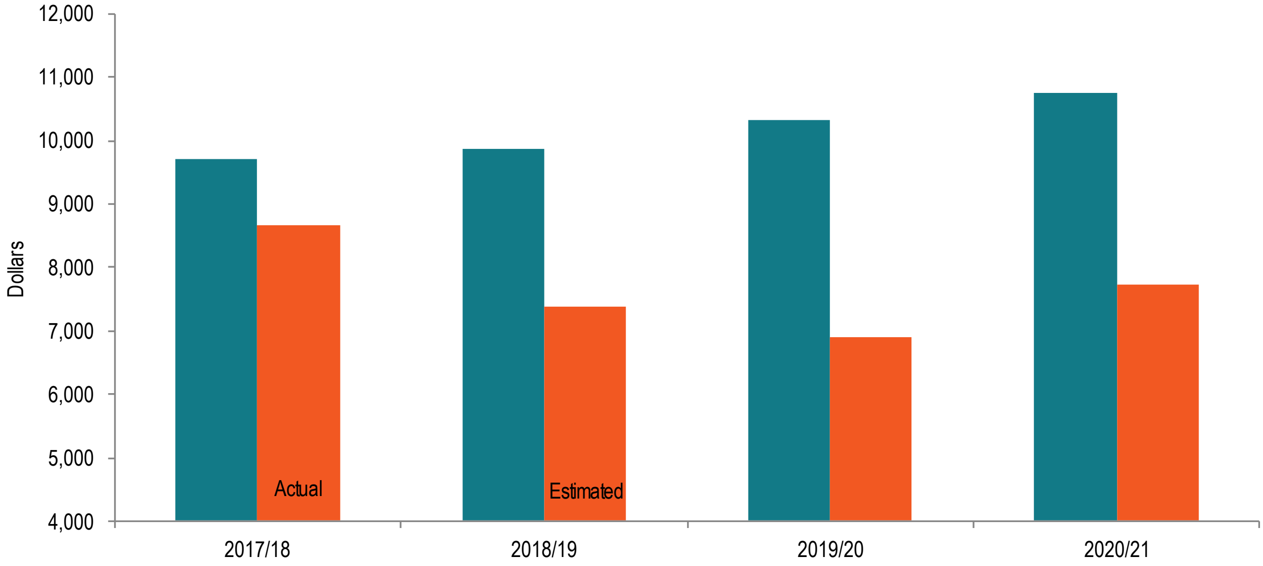


Source: CoreLogic

NSW Standard Transfer Duty Rates 1986 – 30/06/2019	
Property Value	**Transfer Duty Rate**
$0 to $14,000	$1.25 for every $100 (the minimum is $10)
$14,001 to $30,000	$175 plus $1.50 for every $100 over $14,000
$30,001 to $80,000	$415 plus $1.75 for every $100 over $30,000
$80,001 to $300,000	$1,290 plus $3.50 for every $100 over $80,000
$300,001 to $1 million	$8,990 plus $4.50 for every $100 over $300,000
Over $1 million	$40,490 plus $5.50 for every $100 over $1 million

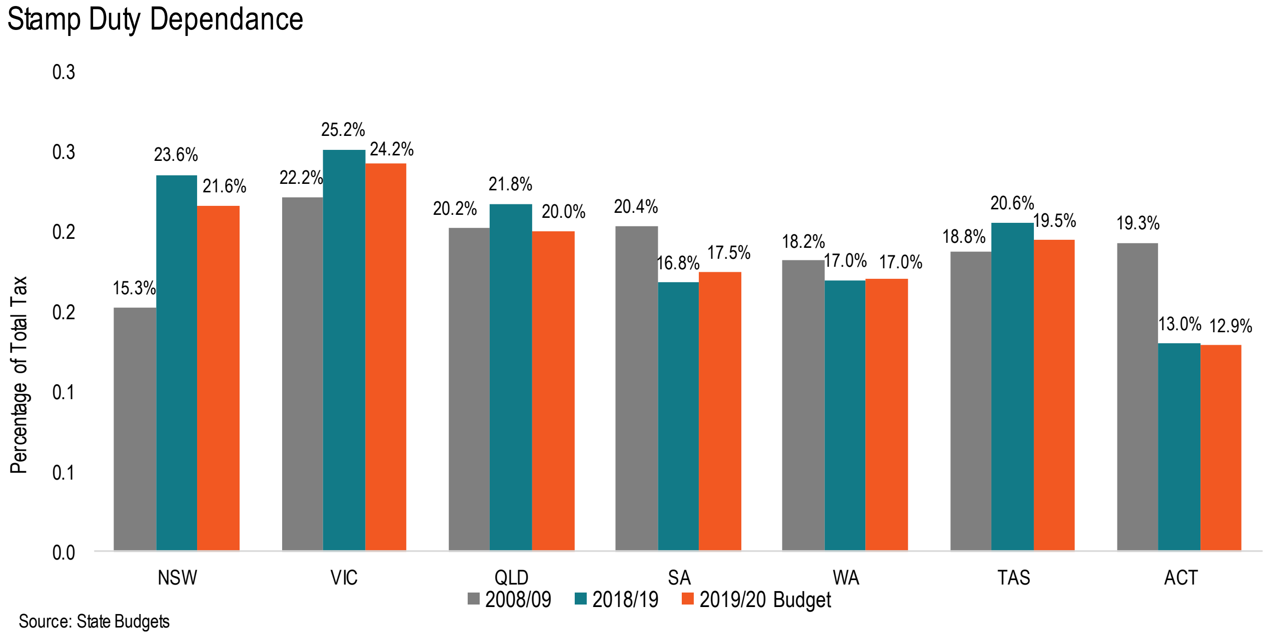
In NSW the downturn in the property market is estimated to cost approximately $10.6 billion over the forward estimates in lost revenue. Similarly in Victoria where the decline in house prices has been more modest, revenue from stamp duty has been revised downwards by $5.2 billion. This sharp drop in revenues underscores the unreliability of stamp duty as a source of revenue.

NSW Budget Estimates Comparison 2017/18 and 2019/20

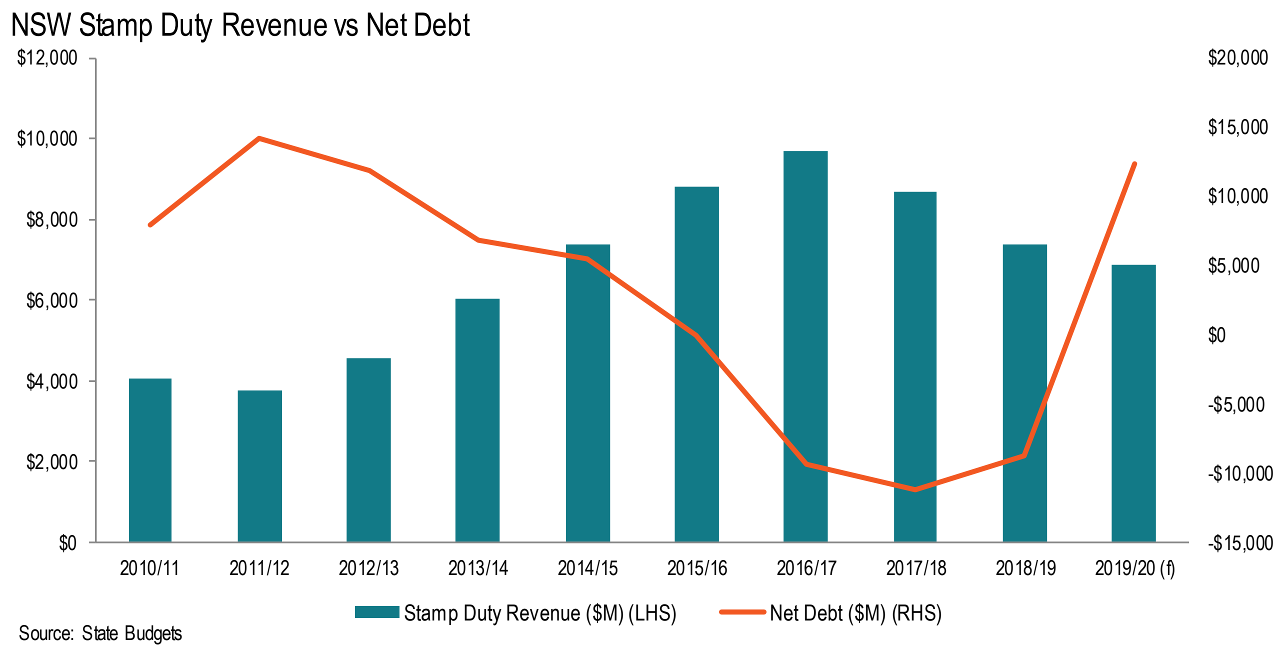


Source: State Budgets

In 2018/19 stamp duty revenues made up over one-fifth of all taxation revenue raised in New South Wales, Victoria, Queensland and Tasmania. Victoria was the highest with 25.2 per cent followed by New South Wales with 23.6 per cent. NSW had the biggest increase in their dependence on stamp duty, increasing from 15.3 per cent in 2008/09.



As states have become increasingly reliant on stamp duty, any change in stamp duty revenue often translates to a change in net debt. The ACT, which is in the process of completing major tax reforms to replace stamp duty with a broad-based land tax, had the lowest dependence on stamp duty revenues in 2018/19 of 13.0 per cent of total taxation. Residential stamp duty revenues were even lower in the ACT at 9.7 per cent of total taxation revenue.



Should the states be so reliant on a revenue source that is at the mercy of market conditions?

Stamp duty is an inefficient tax and HIA has promoted the need for it to be replaced with a broad-based tax such as a land tax for many years. A land tax applied to the unimproved value of the land, for example, would tax everyone that owns land, not just those transacting in the market. The revenue stream would be more consistent and reliable.

As demonstrated by the ACT's move away from stamp duty to a land tax that started in 2012, the transition is more complicated than just replacing one tax with another. If this were to happen it would be extremely inequitable as there would be tax payers that get hit with paying both the full amount of stamp duty and the full amount of the land tax.

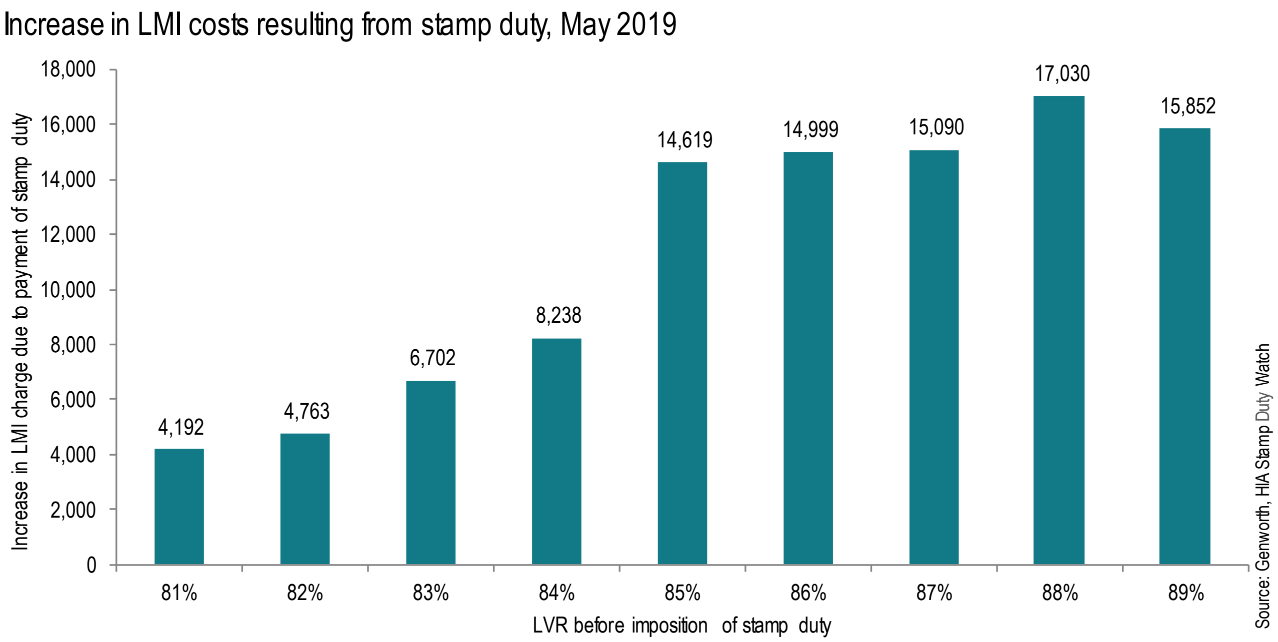
Stamp Duty and Lenders Mortgage Insurance

The imposition of stamp duty also has serious knock-on ramifications. Stamp duty increases the absolute value of the loan, which in turn increases the LVR. Both of these factors increase the likelihood for Lenders Mortgage Insurance (LMI) premiums on the loan.

LMI is an insurance policy that lenders take out against borrowers to protect them in the event that the borrower defaults. If the borrower defaults on the loan and the property is sold for less than the outstanding amount on the loan then the LMI provider will reimburse any shortfalls. For most lenders, LMI is required when the Loan to Value Ratio (LVR) is greater than 80 per cent as these are considered riskier loans. LMI only covers the lender in the event of the borrower defaulting and should not be confused with mortgage protection insurance. Even though the insurance covers the lender, most lenders pass on the cost to the borrower.

The cost of LMI varies in proportion to the size of the loan and the LVR. Unlike other insurance premiums, LMI is a one-off lump sum cost. Some lenders allow the cost of LMI to be added to the loan, which increases the amount of interest paid over the life of the loan.

The chart below shows the typical ramifications of stamp duty on LMI charged at different LVR thresholds based on the purchase price of $650,000. For example, an original LVR of 85 per cent (a 15 per cent deposit) would have LMI charge of $7,411. Once you add in stamp duty, the LVR increases to 90.2 per cent and the LMI charge increases to $22,030 – a difference of $14,619.



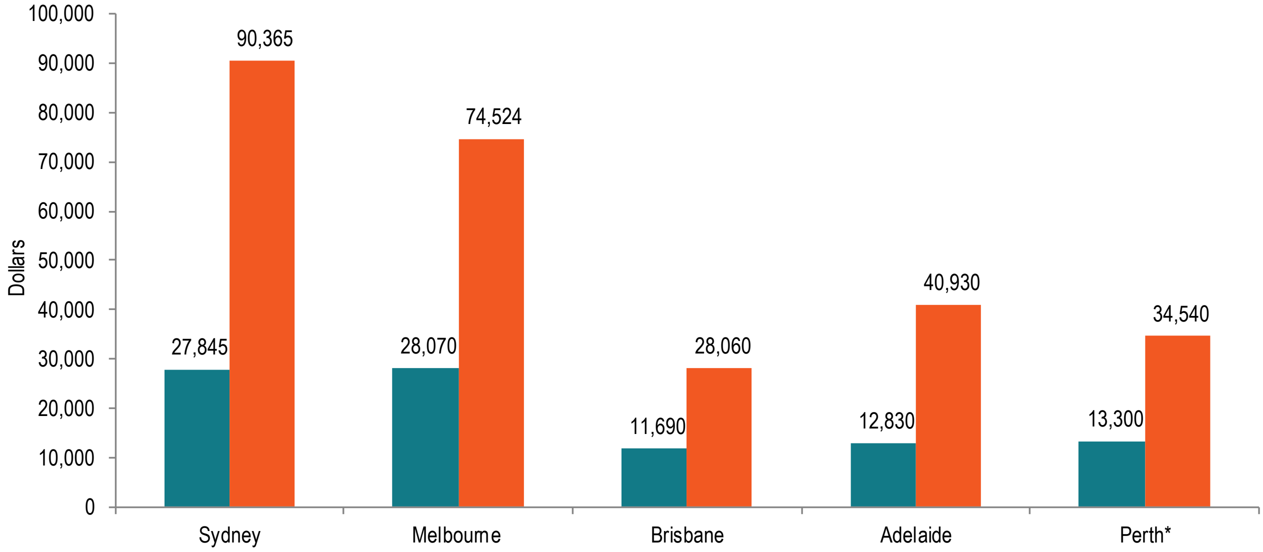
Stamp Duty and Foreign Buyers

Foreign buyers of real estate are generally restricted to the purchase of newly built dwellings. This well-designed policy has the effect of expanding the national housing stock. Ultimately, many of the foreign-owned dwellings are made available the rental market, something which is an important link in the economic chain. An ample supply of rental housing stock is key to facilitating expansion in the labour supply and economic activity.

Over recent years a number of state governments have moved to erect higher hurdles to foreign buyer participation in the housing market by imposing surcharges on top of the existing stamp duty charges faced by other investors. The current effect of these is illustrated in the chart below in each of the capital cities, based on the purchase of a unit at the median market price during May 2018.

The burden of the stamp duty for foreign buyers in Sydney is severe, with the total cost coming to $90,365 on the purchase of a unit for $719,000 (a 12.6 per cent tax burden). In Melbourne, foreign buyers typically face stamp duty bills of almost $75,000. The equivalent cost is $43,200 in Brisbane and $40,930 in Adelaide. A stamp duty surcharge of 7 per cent is set to take effect in WA in January 2019. This will result in foreign investor charges totalling $46,760 on the acquisition of a $406,000 unit in WA's capital – a burden equivalent to 11.5 per cent of the dwelling's value. The timing of this intervention is particularly unfortunate given that there are tentative signs that WA's new home building downturn is coming to an end. Imposing such a punitive tax at this stage risks stifling any recovery.

Comparison of Transaction Taxes for Investors in Dwelling Units - May 2018



Source: State Budgets; CoreLogic, HIA
*Foreign Investor surcharge scheduled to take effect in January 2019

Population growth and job creation are strong both in Sydney and Melbourne and migrant labour plays an important role in sustaining this. The ability of these cities to continue to grow will rely on being able to house their populations adequately. Foreign buyer surcharges obstruct the supply of new dwellings in all markets where they are levied and reduce the likelihood of being able to meet long term housing needs.

Monthly Cost of Investor Stamp Duty on Unit Purchase - May 2018

Source: State Budgets; CoreLogic, HIA
*Foreign Investor surcharge scheduled to take effect in January

The strain that these surcharges are placing on the rental markets in Australia's capital cities can best be appreciated by assessing the monthly cost of stamp duty in terms of how it increases the value of mortgage repayments, as the chart above demonstrates. In Sydney, foreign buyer stamp duty adds $522 to the monthly cost of supplying a unit to the rental market with a cost of $430 per month on a unit in Melbourne. It is important to note that these costs are on top of the purchase price for the unit itself.

Rental vacancy rates in Sydney and Melbourne are relatively low (below 3 per cent) and impeding the delivery of new units of rental stock risks leading to a situation whereby the ability of both cities to accommodate future economic expansion is compromised. In the case of SA and WA, residential building activity has struggled in recent years and increasing the tax burden on residential building in both markets reduces the likelihood of recovery taking hold.