Property Council of Australia
ABN 13 00847 4422

Level 1, 11 Barrack Street
Sydney NSW 2000

T. +61 2 9033 1900
E. info@propertycouncil.com.au

propertycouncil.com.au
@propertycouncil

Federal Pre-Budget Submission

2016-17

Let Property Grow the Economy:
Five ideas to grow the economy (and fix the budget)

Introduction and overview – Let Property Grow the Economy

Property touches the lives of all Australians. It creates prosperity, jobs and strong communities.

Property is both a major part of the household balance sheet and the Australian economy.

In the current economic climate, the property industry is a significant contributor to economic growth at a time where other sectors are stubbornly below trend.

It is crucial for the nation's fiscal position that property is nurtured and policy settings allow it to escalate its contribution to economic growth, investment and increased productivity.

There has never been a more important time to repair the budget and let property grow the economy.

- Property is Australia's biggest industry contributing $182.5 billion and 11.5 per cent gross domestic product, more than any other single industry;
- We employ 1.1 million Australians, more than mining and manufacturing combined;
- One in four wages are supported by the property industry either directly or indirectly;
- 14.1 million Australians have a stake in property through their superannuation funds; and
- Property contributes $72.1 billion in taxes to fund community services, more than 16% of all government taxation revenues.

It makes sense for policy makers at all levels to closely consider policies which are best placed to let property grow the economy.

Australia's fast growing population further highlights the central importance of a strong property and construction sector positioned to meet the nation's needs.

The 2016-17 Pre-Budget Submission supports specific policy settings for continued growth in the property industry in the following key areas:

1. Tax reform that can grow the economy;
2. Use competition policy to lift housing affordability;
3. Retain Negative Gearing and Capital Gains Tax (CGT) Discount;
4. Help seniors downsize by unlocking home equity; and
5. Creating more liveable and vibrant cities.

The Australian economy is still in transition and a strong property industry is required now more than ever.

Australian Economy in Transition

The Australian economy is in a low-growth phase – and the long-term forecasts suggest without change, will remain so.

The economy is in a transition with a downturn in the resources sector, manufacturing is enduring structural adjustment, and revenue growth is sluggish.

That represents a threat to the country's economic trajectory and the budget. This can only be reversed with a focus on areas of the economy like property that can yield a real dividend in economic growth.

The Mid-Year Economic and Fiscal Outlook (MYEFO) released in December 2015 forecasts a 2015-16 deficit of $37.4 billion; a $2.3 billion deterioration than what was forecast in the May 2015 budget. Figure 1 outlines the forward estimates and deterioration to 2018-19.

Figure 1 - Budget aggregates

Budget aggregates / Financial Year	2015-16	2016-17	2017-18	2018-19
Underlying cash balance($b) Budget	-$35.1	-$25.8	-$14.4	-$6.9
Underlying cash balance($b) MYEFO	-$37.4	-$33.7	-$23	-$14.2
Difference ($b)	$2.3	$7.9	$8.6	$7.3
Percentage difference	6.55%	30.62%	59.72%	105.80%

Source: Mid-Year Economic and Fiscal Outlook, Treasury.

The budget aggregates projected in 2015-16 budget compared to MYEFO in 2018-19 is a 105.80 per cent difference, demonstrating the challenge the overall budget faces in the short and long term.

In order to overcome the expenditure problem, the Government must implement saving measures. Since 2007 in real terms, spending has increased at an annual average rate of approximately 3.5 per cent resulting in it currently sitting at 25.9 per cent of GDP. This is at a rate of close to the post-GFC peak.

The budget revenue deterioration is due to weaker equity markets; a decline in commodity prices; and lower income tax receipts from a lower than expected working-age population growth and weaker wages growth.

What is also clear though is that only a return to a more positive trajectory for robust economic growth will shepherd Australia back to a sustainable fiscal climate.

Property can help fill that gap and help the economy. But there are challenges ahead.

As interest rates remain low and support economic demand, housing markets and construction is boosting growth and jobs. Low interest rates are also assisting and supporting commercial property prices.

The 2016-17 Pre-Budget Submission makes the case for harnessing momentum in the property industry to help sustain prosperity.

About the Property Council of Australia

The Property Council champions the interests of more than 2300 member companies that represent the full spectrum of the industry, including those who invest, own, manage and develop in all sectors of property.

Creating landmark projects and environments where people live, work, shop and play is core business for our members.

1. Tax reform: Change the tax mix to grow the economy

The primary purpose of tax reform must be to grow the economy.

This means reshaping Australia's tax mix to remove our most distorting taxes.

Australia’s tax system relies on highly inefficient taxes which hold back economic growth and productivity. With an economy in transition, anaemic productivity growth and long term fiscal pressures from demographic change, it is more urgent than ever that Australia adopts a tax system which facilitates economic growth, investment and jobs.

Property accounts for nine per cent of Australia's total tax take, compared to an OECD average of just five per cent.

The property industry is the nation's largest collective tax payer, contributing around $72 billion across the three tiers of government, equating to 16.0 per cent total rates, fees and charges revenues in 2013-14.

Stamp duties, land taxes, the GST and large development levies can make up as much as 26 per cent of the total cost of a finished house, and up to 21 per cent of the total cost of a finished apartment.

The Federal Treasury identifies conveyancing stamp duty as the tax with the highest "cost to living standards and economic growth". Stamp duty distorts business decisions, locks families out of housing choices, worsens housing affordability, suppresses economic activity and leaves governments with highly volatile revenue streams.

It has absolutely no economic relevance in our modern Australia.

New economic modelling by Deloitte Access Economics, *The economic impact of stamp duty*, commissioned by the Property Council of Australia, reveals the extent to which stamp duty holds back economic growth, jobs and makes our cities less efficient.

Replacing stamp duty revenue with a more efficient tax such as GST will:

- generate up to an extra 340,000 property transactions;
- increase Gross Domestic Product (GDP) by $3.3 billion – this is more than the GDP of Australia’s entire dairy industry, two thirds of the GDP of car manufacturing and one quarter of the impact of international tourism;
- boost consumption by $9.7 billion; equating to an extra $20 per week per household on average, more than half of household expenditure on fuel and power; and
- create 6,700 additional jobs.

Tax reform presents an opportunity to raise the same amount of revenue while driving economic growth, investment and jobs.

The 2016-17 Budget should…	Recommit the Government to releasing a Tax Green Paper and White Paper and deliver a holistic tax reform package that will grow the economy. Tax reform requires a package that relies less on inefficient taxes, such as conveyancing stamp duty that holds back economic growth, and replaces them with more efficient revenue sources such as increasing the GST.

2. Use competition policy to lift housing affordability

Housing affordability should matter to policymakers and requires national leadership.

Too many Australians still suffer from unacceptable levels of housing stress despite stronger levels of housing commencements and record low interest rates after a decade of housing undersupply. According to the Australian Bureau of Statistics (ABS), in the past 12 months to October 2015, 233,180 homes were approved nationally.

But a significant housing deficit remains due to a decade of undersupply and inaction by governments that only saw an annual average of 153,000 homes completed over the past decade. The household formation statistics show that 164,000 households are being formed each year from 2011 to 2016. This number is expected to be 172,000 per year from 2016.

This means a significant deficit of housing in Australia and one good year won't make up for a decade of underbuilding.

Despite the planning reform undertaken in various jurisdictions over the last decade, Australia has a significant lack of housing supply, both in terms of the volume of dwellings being delivered, but also the type and location of housing supply.

National Competition Policy (NCP) was instrumental in driving reforms in the 1990s that unlocked significant economic benefits for the country. Adopting a similar approach to drive reforms targeted at improving housing supply can improve affordability, create growth and generate jobs.

In November 2015, the Federal Government released its response to the National Competition Policy Review, indicating a willingness to consider payments to states and territories for reforms to planning and zoning that improve productivity and lead to economic growth.

Under a new competition style model, states and territories would receive incentive payments to reform their planning systems, turbocharge their housing supply pipelines and deliver innovative affordable housing solutions.

The Federal Government should play a role to make housing affordable for all Australian families.

The 2016-17 Budget should…	Implement a national competition policy style model, including incentive payments for states and territories, to address housing affordability. Payments should be used to encourage best practice reforms in planning, zoning and infrastructure delivery to increase housing supply.

3. Retain Negative Gearing and Capital Gains Tax (CGT) Discount

Retain Negative Gearing

Negative gearing is nothing more than the ability to deduct legitimate expenses against income. It has been part of our tax system for 100 years.

The ability to gear and use debt for all asset classes (not just property) is a crucial part of investing and fostering economic growth. The majority of negative gearing benefits flow to middle income Australia which in turn provides a steady supply of essential, affordable housing for low income families.

Investors have been crucial in supporting new developments, with approximately one-third of all new developments financed by investors – helping projects move from conception to construction.

Negative gearing in Australia is primarily used by average workers, 73% of whom own only one investment property, with another 18% only owning two.

These are ordinary Australians saving for their retirement.

There are 840,000 Australians with taxable incomes below $80,000 a year who negative gear.

This includes:
- 53,800 teachers;
- 52,000 retail workers;
- 35,900 nurses and midwives;
- 22,600 hospitality workers; and
- 10,400 emergency services workers.

To make changes to negative gearing would risk the development of new housing, push up prices and rents that will undermine retirement savings.

Capital Gains Tax (CGT) Discount

The 50% CGT discount ensures that governments only tax real gains – it is designed to remove the impact of inflation. Instead of calculating inflation impacts for each year of ownership (which was considered to be administratively complex), the discount was set at a rate of 50%.

The fundamental principle of not taxing inflation needs to be retained in any review of CGT.

Any wholesale removal of negative gearing or the CGT discount that discriminates against property would significantly harm investment, diminish rental supply and ensure that in the short to medium term, rents and property prices will increase.

The 2016-17 Budget should…	Retain Negative Gearing and carefully canvass any changes to the CGT discount for property investment.

4. Help seniors downsize by unlocking home equity

The age pension asset test acts as a strong disincentive for pensioners who wish to downsize and unlock some of their home equity.

This policy change would keep more money in pensioners' pockets.

The benefits of such a scheme include:

- pensioners can choose housing that is more suitable to their needs, prolonging independent living years and reducing the demand for (federally funded) residential aged care; and

- housing stock can be made available for families and first home buyers – easing housing supply and affordability pressures.

Capping the quarantined amount at $100,000 per eligible pensioner would cost the budget around $38.4 million per annum. This increases to $96 million for a cap of $150,000, and $173 million for a cap of $200,000, according to PwC modelling.

Impacts on pension expenditure would be offset by savings in health and aged care spending. (The PwC research shows that living in a retirement village delays an older person's entry into federally-funded residential aged care by five years).

There are also significant productivity improvements associated with increased housing supply of larger homes in established suburbs.

The 2016-17 Budget should…	Allow full-rate home-owning age pensioners aged 75+ who downsize their home to have part of the sale proceeds exempt from the pension asset test.

5. Creating more liveable and vibrant cities

Cities have become the engines of Australia's economic prosperity and the home to the bulk of our population; the location of our most productive businesses; and the generators of much of our wealth.

Our cities are not just our best economic assets but should be liveable and vibrant places. We need to ensure that every level of government works together to have competitiveness and progress.

The Infrastructure Australia audit released in May 2015 reveals the Australian population is expected to grow from 22.3 million in 2011 to 30.5 million in 2031, with three quarters of this growth in our cities. In our four major cities of Sydney, Melbourne, Brisbane and Perth, population will increase by around 5.8 million, or by 45 per cent to 2031.

The audit found that without action or investment in infrastructure, the cost of congestion would escalate from $13.7 billion per year today to $53 billion a year by 2031.

The Property Council of Australia has a five point plan for our cities:

1. Better data and information;
2. Better infrastructure decision making;
3. Use competition policy to lift housing affordability (see above);
4. Tax Increment Financing (TIF) to fund infrastructure in Australia; and
5. Adopt a trial UK city deal for an Australian city.

Better data and information

To successfully invest in liveable and vibrant cities, you need evidence based policy through data collection and transparent reporting.

This includes a dedicated public sector unit for cities with publications, including the report *State of Australian Cities*. This report was first released in 2010 and continued since, is important in reporting progress being made in Australian cities.

A dedicated public sector unit will ensure ongoing policy development, reporting, coordination and consultation with stakeholders including local government, states as well as government departments.

It will measure areas such as linking population, housing, employment and infrastructure to the overall economic productivity. This will ensure evidence based reporting will guide best practice policy outcomes for our cities.

Better Infrastructure Decision Making

Long-term infrastructure planning has been recognised in the past decade with the establishment of Infrastructure Australia.

Infrastructure delivery is key in linking where people live and work that will directly boost housing affordability and wider economic growth and productivity.

The Property Council supports Infrastructure Australia's upcoming 15 year Australian Infrastructure Plan that includes an updated infrastructure priority list, and recommends the Government fund infrastructure on that priority list. This includes funding to both road and rail projects on this list.

Clear infrastructure priorities have not been set due to a lack of political consensus on major projects in federal/state relations.

This has led to lost or wasted investment opportunities and undermines investor confidence.

Infrastructure Australia has repeatedly warned that the greatest infrastructure risk facing the country is that scarce public funds are squandered on projects that may not deliver the most optimal benefits to the community.

This remains an ever-present risk without substantial expert consensus on infrastructure priorities.

Tax Increment Financing to fund infrastructure in Australia

There is an enormous task involved in providing the infrastructure that will support the inevitable growth of global cities. We need to look to financing solutions that help governments meet the future demand for infrastructure.

Tax Increment Financing (TIF) meets that challenge. They bridge the divide between infrastructure and land use – and in doing so, will gift us economic growth and sustainable communities. It will ensure infrastructure and land use planning is coordinated with a view to delivering economic prosperity.

It disciplines government to guarantee the timely and rigorous provision of infrastructure. The model has been used in the United States for over 50 years and is now widely activated to help cities and communities accelerate growth.

TIF can be tailored to suit development needs and governance arrangements here. It works by:

- Identify a suitable area (or TIF district) and establish a TIF authority;
- Prepare a growth plan for the area outlining its infrastructure needs and estimating the cost;
- Calculate the property tax revenues currently derived from the area;
- Issue bonds to fund the infrastructure works for the area (bonds can be government-backed or not);
- Repay the bonds from the incremental increase in property taxes (above the revenue previously collected) generated by the new infrastructure and development in the area; and
- Once the bonds are repaid, all property tax revenue for the area returns to the Government.

TIF is a transparent approach to infrastructure selection and provision that is a sustained commitment to infrastructure provision which is not subject to the vagaries of the electoral cycle.

Adopt a trial UK city deal for an Australian city

The UK Government's City Deals model is a new approach to infrastructure investment that is performance-based.

A City Deal is an incentive scheme which directs infrastructure funding to projects that boost productivity, employment and economic growth. It also establishes a secure stream of funding that would then allow for inefficient taxes to be eradicated.

A contract is established with a federal government, state government and a region to set a budget for infrastructure delivery. State and local funds are pooled for investment in priority infrastructure and matched by the central authority.

The City Deal contract sets targets for the economic performance of the region using measures including Gross Value Added (a local GDP), employment and productivity growth.

Regions are fiscally rewarded for exceeding their growth budget – with the central government returning a share of the windfall tax arising from additional economic growth.

The deal is overseen by Treasury as an independent authority with special financing vehicles monitored under strict governance arrangements.

The 2016-17 Budget should…	Ensure annual data and reporting by a dedicated public sector cities unit. Implement a national competition policy style model, including incentive payments for states and territories, to address housing affordability. Identify opportunities to implement Tax Increment Financing (TIF) to fund infrastructure in Australia. Support Infrastructure Australia's 15 year infrastructure plan and fund infrastructure on that priority list. This includes funding to both road and rail projects on this list. Adopt a trial UK city deal for an Australian city.

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propertycouncil.com.au
@propertycouncil

Contacts

Glenn Byres
Chief of Policy and Housing
Property Council of Australia
Phone: +61 2 9033 1952
Email: gbyres@propertycouncil.com.au

Belinda Ngo
Director of Tax Policy
Property Council of Australia
Phone: +61 2 9033 1929
Email: bngo@propertycouncil.com.au

Matthew Cross
Government Relations Manager
Property Council of Australia
Phone: +61 (0)402 155 372
Email: mcross@propertycouncil.com.au