10 December 2024

The Road to Recovery: Property Council 7-Point Victorian Taxation and Housing Plan

2024 has been an extraordinarily challenging year for the property industry. The economic pressures being felt by so many in the community continue to be present throughout our industry and directly impact capacity to develop new products across residential and commercial sectors.

This can be directly seen in the stagnant level of new dwelling approvals. Australian Bureau of Statistics (ABS) figures for the past four quarters show new dwelling approvals at historic lows declining to less than 52,500, compared to 55,000 in the 12 months before. In addition, the Procore/Property Council Sentiment Survey shows industry sentiment continues to be the lowest in the country as of September 2024, which is reflective of the ongoing and deepening difficulty of the operating environment.

Property owners started 2024 with significant land tax increases, while those seeking new development opportunities are now forced to factor in the windfall gains tax, increased Absentee Owner Surcharges, and an unstable policy environment, which is deterring much needed investment into the state.

The Victorian Government chose not to adopt peak industry body recommendations in the 2024/25 Budget, and the consequences of that are apparent, and reflected in the lack of investment in Victoria for housing, with housing being built elsewhere both domestically and internationally. While we were pleased to see a key recommendation picked up in October 2024 with the reintroduction of expanded off-the-plan stamp duty concessions to drive pre-sales that underpin supply, much more can and needs to be done to fully restore the industry's capacity for delivery.

More than 12 months on from the launch of the Victorian Government's Housing Statement, deeper action is required to attract investment, which will activate the market to deliver an increased supply of housing. This action should be designed to complement the ongoing planning reform work in the Housing Statement, which is vitally important for the industry, but its benefits will be felt in the longer term.

To support informed policy development, the Property Council has developed a '7-Point Victorian Taxation and Housing Plan' focusing on how tax settings should be adjusted to support the feasibility of new housing development and investment.

A different approach is needed on tax to support the government and industry's shared housing aspiration. Given the domestic market relies heavily on foreign capital to support development, taxation policy should support and promote Victoria as a destination for placement of that capital.

Further, the government must address the cost of construction, the impact of an unregulated industrial market, and the corresponding impact on domestic residential project feasibility as high labour costs and low productivity impair the market.

The government's focus ahead of the 2025-26 Victorian Budget should be on:

1. Putting our apartment and townhouse market back on the road to recovery by extending the currently temporary expansion of off-the-plan concessions.
2. Restore consumer confidence in Victoria and drive short-term demand for greenfield housing with temporary and targeted increase to the first homeowner's grant;
3. Providing relief for developers building housing at scale with carve outs from recently introduced and increased taxes;
4. Leveraging the benefits of increased investment into our living sectors through measures that drive growth of student accommodation, retirement and seniors' communities, and build-to-rent housing;
5. Maximising the benefits of upcoming planning initiatives by implementing special economic zones in defined activity centres and precincts;
6. Supporting the economic growth of our state by reducing land tax for commercial property owners; and
7. Bridging the feasibility gap with tax incentives during active development phases of residential projects.

This 7-Point Plan was developed to inform the government of the taxation policy changes the Property Council believes could play a significant role in activating the sector. The initiatives outlined herein have the potential to drive the construction of new dwellings and deliver new housing stock - thereby alleviating much of the affordability crisis impacting Victorians.

It is essential that any changes to tax policy must have at the forefront of analysis, alignment with the commercial requirements of the development industry to deliver an appropriate return on investment having regard to the inherent risks of development, the unstable economic environment driving high costs of construction, labour constraints and increasing cost of capital. Without this as the primary focus for policy, development will not occur, and we will not meet our supply targets.

Cath Evans
Executive Director, Victoria
Property Council of Australia

About the Property Council and property industry

The Property Council of Australia is the leading advocate for Australia's property industry. In AEC Group's recently updated analysis for the Property Council completed in October 2023, they found the property industry:

- has the largest economic footprint of any sector of the Victorian economy, directly **contributing $58.1 billion to Gross State Product** (GSP) in 2021-22 (12.1 per cent of the total contribution to GSP by all industries in the state) and is estimated to have contributed a further $83.9 billion to Victoria's GSP through flow-on demand for goods and services.

- **directly employed approximately 393,100 full time equivalent (FTE) employees** in 2021-22 (12.8 per cent of Victoria's total) and supported more than 516,300 FTE jobs through flow-on activity.

- **generates approximately 29.8 per cent of wages and salaries** paid to Victorian workers.

- **contributed approximately $23.6 billion in combined Victorian Government tax revenues and local government rates, fees and charges revenue** in 2021-22, equating to 62.4 per cent of total State taxes and local government rates, fees and charges revenues in 2021-22.

The Property Council is committed to the success of the housing statement and our members are committed to delivering thousands of new homes each year in Victoria. Our ongoing dialogue on housing supply and affordability is aimed at ensuring future policy changes are practical for developers, and the wider property industry, so the industry can be fully armed to actively address the shortage of new homes in the market.

1. Putting our apartment market back on the road to recovery with extended implementation of expanded off-the-plan concessions

Given the successive changes to property taxes over the past decade, Victoria has become an uncompetitive destination for critical new investment. The potential reactivation of sales through the expanded off-the-plan (OTP) concessions revealed in October 2024 to apply for 12 months is recognition of their importance in supporting the build-to-sell apartment pipeline.

Apartment commencements have declined from close to 20,000 a year in 2016-17 to only 3,400 in 2023-24, according to Charter Keck Cramer's bi-annual apartment market update. This corresponds directly with the initial tightening of eligibility for this concession. As Charter Keck Cramer states, "the price gap between house and units (56 per cent) remains very wide compared to its long-term pre-Covid average (35 per cent) …and is anticipated to close further as affordability pressures drive demand to the established unit market".

A longer reinstatement of the off-the-plan duty concessions, with as few restrictions as possible on the investor market, will be key to supporting a lift in commencements.

Feedback from industry has indicated an immediate lift in inquiry for off-the-plan sales since the date of announcement. However, developers initiating new projects will not be in the 12-month window in time to take advantage of the current arrangements.

To fully maximise the possibility of new projects that increase the volume of apartments, units and townhouses, we recommend the Victorian Government extend the arrangements until at least 30 June 2027, with data to be collected progressively to inform the success of the concessions.

We also recommend the government models the inclusion of non-strata townhouses for the extension of the policy. Townhouse developments on strata titles are less common developments, typically on smaller subdivisions where two to four townhouses replace a single dwelling. These projects differ from the larger-scale townhouse developments that form a key component of Melbourne's housing supply. Under the expanded stamp duty concession policy, these larger developments are disadvantaged, which could ultimately limit the availability of affordable medium-density housing options.

It's also essential to minimise the impact of distortion in the market and to support developers to invest in future projects that completed but unsold apartments, units and townhouses are included in the eligibility.

Additionally, expanding the off-the-plan concessions beyond 12 months would encourage older Australians to downsize by removing the significant financial barrier of stamp duty. Many older homeowners are deterred from selling their large family homes and moving into apartments or other more manageable housing due to the costs associated with purchasing their next property. By extending the off-the-plan concessions for a longer period, it would help unlock more family-sized homes for younger buyers while offering older Australians a smoother, more affordable transition into housing that better suits their needs. This approach would amplify the dual benefits of increased housing supply and better utilisation of existing stock.

2. Restore consumer confidence in Victoria and drive short-term demand for greenfield housing with a temporary and targeted increase to the first home owner's grant

The recently released 10-Year Greenfield Plan takes an important step towards providing clarity about future supply for the residential development industry, albeit with a lot of work still to take place on ensuring effective implementation and removing persistent barriers to development.

At the same time, national residential developers operating across all state markets are consistently reporting much lower consumer confidence in Victoria and therefore significantly lower conversion rates.

Following the Homebuilder-fueled surge of demand, conditions have moderated, and the industry is able to deliver more new housing now in growth areas, but demand needs to be supported in the short term.

The First Home Owner's Grant (FHOG) has proven to be a successful measure in stimulating demand. While the focus of overall measures is right to be on supply, the industry requires a steady level of demand to deliver the volume of homes required. Therefore, we recommend a temporary lift in the FHOG from $10,000 to $30,000 for 12 months to deliver the demand needed to get the supply of new greenfield homes moving upward.

3. Remove surcharges on foreign investment, and implement measures that drive growth of new housing including student accommodation, retirement and seniors' communities, and build-to-rent

Foreign investors in the housing market in Victoria have been hit with a range of regressive additional taxes and surcharges over the last decade. In a housing crisis, Victoria needs to welcome foreign investment to develop supply, of which a significant percentage is made available to the local market for purchase or rent.

Residential developers with foreign ownership interests are penalised for their efforts to build more homes for Victorians through the introduction and increase of the Absentee Owner Surcharge (AOS), which adds cost and complexity to transactions and development processes. By placing such a surcharge through FPAD and AOS, the Victorian Government has decreased the attractiveness of Victoria's residential property to foreign investors who have been responsible for delivering a significant slice of new housing supply. While there remains undersupply of new housing in Victoria, we strongly recommend the government pauses the FPAD and AOS for at least three years.

An alternative is to at least carve out key housing sectors that rely on higher than usual sources of foreign capital for their growth.

Three sectors that rely heavily on foreign capital to provide much needed new housing for Victorians are the purpose-built student accommodation, retirement and seniors' living, and build-to-rent sectors. All three are on strong growth trajectories but face significant risks without coordinated government action.

Purpose-built student accommodation (PBSA), which provides a customised and fit-for-purpose accommodation option for domestic and international students studying in Australian cities, benefits from a strong pipeline, with over 26,100 beds for students in Melbourne – the largest PBSA sector in the nation.

Historically, Melbourne has enjoyed a strong supply of PBSA developments due to its strong university sector and attractive investment settings. However, the recent doubling of the AOS has had a disproportionate impact on a sector which reduces pressure on the private rental market by providing custom living options for students.

PBSA is an asset type underpinned nearly entirely by foreign capital. This is because of the relatively young age of the sector in Australia (12 years), with local investors and super funds preferring to put their capital in asset classes with long track records, like office and industrial. International investors have much more experience and exposure with PBSA overseas, and thus understand its value proposition.

While this foreign capital is desperately needed to grow the supply of beds in a constrained rental market, it also means they are captured by the AOS. Since the increase, owners of PBSA in Victoria have seen an increase of around 170 per cent in their land tax bills. This equates to an **annual cost per bed** of around $2,500 in land tax alone. In comparison, the cost per bed in NSW and QLD respectively is $915 and $145. We are already aware of developments which have been granted approval, but which have been paused while investors weigh up the viability of continuing with new projects in Melbourne.

We strongly recommend that the Government exempts all PBSA developments from the AOS – a levy which was originally intended to free up residential stock is having the opposite effect when applied to PBSA – instead dampening the future supply pipeline and leaving more students searching for homes in the private market.

The same applies to retirement and seniors' living communities.

It is worth noting some important demographic and healthcare considerations.

- Victoria's population continues to age;
- Victoria, like the rest of the country, is navigating a housing supply and affordability crisis;
- The cost of healthcare and demand for services is increasing; and
- The World Health Organisation has declared loneliness as a global public health concern.

With an ageing population and housing crisis, it has never been more critical to develop age-appropriate and age-friendly housing that can address these issues in meaningful ways.

Given the number of Victorians over the age of 75 is forecast to increase from 520,555 people today to 951,072 in 2040, more needs to be done to accommodate for this growing cohort of older Australians.

Foreign owned retirement and seniors' living operators are subject to residential surcharge stamp duty and land tax rates which are significantly hindering the supply of retirement living accommodation. These operators are in a unique position to continue to make a substantial contribution to new supply of retirement living accommodation which in turn frees up existing housing for the general population. However, these surcharges are hindering foreign owned capital from participating, meaning empty nesters stay in their homes for longer.

For build-to-rent, we recommend the government extend its existing foreign purchaser additional duty (FPAD) exemption to the operational phase of build-to-rent projects, to align the exemption with other jurisdictions and support the sector's continued growth in Victoria. This would build on the positive changes implemented by the government in its 2020-21 Budget when a 50 per cent land tax concession and absentee owner surcharge exemption was granted for operational projects.

Victoria has 15,000 units in the build-to-rent pipeline, but capacity exists for this to be increased with further positive taxation changes, that are designed to increase capital investment into new and existing assets.

Major international build-to-rent (or multi-family) developers and owners have entered the Melbourne market to provide much-needed rental housing supply, and it's essential that the government continues to work to preserve the advantage it helped to create through its 2020 incentive package.

4. Providing relief for developers building housing at scale with carve outs from the windfall gains tax and vacant residential land tax

Since the Windfall Gains Tax's introduction on 1 July 2023, we have heard clear evidence that the tax is already delaying and, in some cases, preventing transactions that would otherwise lead to the development of housing supply. Explaining the WGT to overseas investors is proving incredibly challenging and a deterrent to investment given no other regime like WGT exists in other states. We outline a couple of recent industry case studies in this paper.

An exemptions framework was created that carves out some important rezonings such as rezonings within the growth areas infrastructure contribution areas, as well as other select rezonings. But large volumes of rezonings on vacant land, that would otherwise deliver significant volumes of new homes, will continue to incur the WGT.

The current WGT legislation contains no discretionary powers for the Commissioner of State Revenue to grant exemptions for housing projects of scale, including affordable housing delivery. The current framework enables exemptions only to be considered for a few specific circumstances.

Given the extent of the housing undersupply Victoria faces, we propose that exemption criteria be widened to provide discretionary powers to enable exemptions for large-scale residential rezonings, which will produce 50 or more new homes of any type. Alternatively, we propose WGT notices issued against the land, which would normally be deferred until subsequent transactions in any case, be expired upon construction of the homes.

Additionally, exemptions should be given to local governments outside the seven major growth area councils, where WGT is not applicable, which are looking to rezone their own land to other uses that could create additional housing supply.

Vacant Residential Land Tax (VRLT) liabilities should also not apply in any form to new housing projects. Recently completed projects, which have encountered significantly changed market conditions between project commencement and completion, are potentially facing VRLT liabilities for unsold units, which risk returns that can be invested into future housing projects. An example is outlined below.

5. Maximising the benefits of upcoming planning initiatives by implementing special economic zones in defined activity centres and precincts

To support the government's ambition of delivering to the 'Plan for Victoria' and 70-30 urban growth aspirations which necessitates greater density, we recommend the creation of 'Special Economic

Zones' in established urban locations, starting with a rollout across the government's 10 pilot activity centres and the six soon to be defined Suburban Rail Loop East station precincts.

Given the government has declared it is looking to increase development volumes in these established areas and will soon be rolling out a range of positive planning initiatives, we believe their potential will begin to be realised with a suite of taxation incentives to be made available to developers, purchasers and owners, such as land tax discounts, foreign investment surcharge exemptions and stamp duty relief for purchasers.

Enabling geographically defined areas for targeted implementation would facilitate rapid growth and support decentralisation to the regions. Including sunset clauses of 30 years within the enabling legislation would also ensure that the circumstances of these areas could be reassessed, and the policy implementation recalibrated.

6. Supporting the economic growth of our state by reducing the tax burden for commercial property owners

The increase in the Absentee Owner Surcharge (AOS) in the 2023-24 Victorian Budget, on top of the introduction of the COVID debt levy land tax surcharge, has had a disproportionate impact on the commercial and industrial property sector, especially in comparison to Western Australia where no foreign owner land tax surcharge is imposed and New South Wales where the foreign owner surcharge only applies to residential land and there is an exemption from the surcharge for commercial residential premises. This is a direct disincentive to further investment in Victoria.

The AOS acts as an additional land tax and, depending on the sector and related requirements, either gets passed through to tenants via higher rents (or outgoings), or gets absorbed into the capital value of the asset. This further deters investment into existing assets, which in many cases require investment to support necessary upgrades in amenity and energy efficiency.

There is limited recognition within the AOS framework for companies making a substantial contribution to the Victorian economy, either through employment, procurement of local materials and services, or corporate behaviour – this is true in commercial development as well as residential. The only pathway is through the consideration of Treasurer guidelines, but member experience confirms these exemptions are extremely hard to obtain.

Providing foreign owned companies with a clear option – through legislation – to clearly obtain exemptions that recognise the scale of commitment they make to the Victorian economy should be a priority of future policy development, with the 4 per cent absentee owner surcharge making a material difference to companies' decisions whether to invest in Victoria or not. If the government is not in a position to pause all foreign surcharges, we ask the government to:

- Provide AOS exemptions to owners of 'active' commercial and industrial assets where owners can demonstrate either:
    - a recent history of ongoing investment into their asset, or
    - current attempts to lease vacant tenancies within the asset, or
    - are significant employers of Victorians.
- Exempt asset owners from the COVID debt levy component of their land tax if they have suffered a valuation decrease in the last 12 months, recognising their decreased capacity to absorb the higher rate.

7. Bridging the Feasibility Gap – tax relief for active development projects

As the government understands, market conditions are restricting development due to projects not being commercially viable. Construction cost escalation, increased taxes, and the higher cost of finance cannot be offset by higher rents or selling rates due to affordability pressures.

A leading advisory firm in the industry estimates that of more than 150 projects reviewed in the last two years, only 10 to 15 per cent are ultimately viable, and are largely at the premium end of the market.

While financing costs may be reduced in coming months with broader interest rates relief, construction costs are baked in and government needs to seriously consider measures that bridge the feasibility gap and improve overall cash flow to support intended development outcomes, particularly for infill residential development which is the most challenged by higher construction costs.

For projects maximising land use, and increasing density from current use, we propose a land tax exemption be granted when a development application is lodged for a new commercial, residential, industrial or mixed-use development. If a project is not completed or does not commence, the liability for land tax would be reinstated and payable at the lapse of the planning permit.

We also suggest stamp duty exemption to be granted when an eligible development requires the land to be transferred into a suitable ownership structure to carry out the development (for example, where the land is transferred into a joint venture entity so that the development can be commenced by the joint venture partners). A similar claw back provision could operate for when development does not commence or is not completed.

While not within the Victorian Government's control, we ask it directly advocates to the Commonwealth Government to allow developers to reclaim input tax credits on expenses for purpose-built student accommodation, retirement communities and build-to-rent, to remove another hurdle for both financiers and developers' inability to claim credits for genuine costs to development.

Case Study 1: Impact of cumulative taxes on apartment development

A major apartment builder developer has tracked Victorian apartment sales since the 2015 introduction of foreign purchaser additional duty, and the 2017 change of eligibility which restricted the off-the-plan duty concessions to owner-occupiers and prohibited investors from accessing the concession.

Sales that were tracking at 156 per month in the first half of 2015 have gradually reduced to just five per month. Once the developer funded stamp duty as a purchase incentive, sales moved to 17 per month.

While there is a clear acknowledgment of other market factors that have also negatively influenced sales over the period, the trend of sales clearly links buyer behaviour to the impact of increased taxes being introduced in the table below.

	May 2014 to June 2015	July 2015 to June 2016	July 2016 to June 2017	July 2017 to June 2019	July 2019 to June 2022	July 2022 to April 2023
Period Duration	14 months	12 months	12 months	24 months	36 months	6 months
Average Sales per Month	156 per month	50 per month	18 per month	11 per month	5 per month	17 per month
Investor off-the-plan Stamp Duty Concession to All Purchasers	Yes	Yes	Yes	No	No	No
Additional Stamp Duty to Foreign Purchasers	0%	3%	7%	7%	8%	8%
Stamp duty paid as sales incentive	No	No	No	No	No	Yes

These reduced sales clearly impact the developer's capacity to invest in future housing projects in Victoria and negatively influence the volume of future apartment supply. The changes to the off-the-plan exemption have immediately translated to a lift in inquiry for a selection of projects and demonstrates further positive changes will support consumer confidence and project feasibility.

Case Study 2: Windfall Gains Tax impact

During 2023, a foreign-owned retirement village operator entered into six contracts to acquire Victorian property. The properties required rezoning to undertake the project (retirement village and aged care accommodation). The vendors and the purchaser could not agree on the allocation of windfall gains tax as part of the transaction. All six contracts did not complete, and the operator instead looked for opportunities to undertake the project in Queensland.

Case Study 3: Windfall Gains Tax impact

A major Melbourne apartment project of several hundred units including 80 affordable housing units that began development before the pandemic, required a rezoning for part of the site, which has incurred a $6 million windfall gains tax liability. The developer had no way of anticipating the size of the liability given no information is provided on valuation methodology in advance of the windfall gains tax notice being received.

There are already very significant challenges in the feasibility of apartment projects including financing challenges and increased construction costs. The $6 million liability is now jeopardising the future of the entire project and will likely need to be passed through to consumers to ensure the project goes ahead at all. It will also scupper any plans the developer has of offering an increased number of affordable housing units beyond those already slated for inclusion.

Case Study 4: Windfall Gains Tax impact

A 30-hectare inner urban vacant site is being investigated for suitable residential development. Currently a Special Use Zone site, the activation of the site would require a rezoning, and valuation estimates done for the landowner project a $150 million windfall gains tax liability would incur if a rezoning proceeded. It is likely that the landowner won't proceed with the project under the current legislation.

Case Study 5: Vacant Residential Land Tax impact

An apartment project initially approved in 2015 was completed in 2021 through the complexity of the pandemic. During the period from approval to completion, several adverse taxation and policy changes occurred to make apartments less attractive for purchasers, including foreign purchaser additional duty, restricted off-the-plan duty concessions and vacant residential land tax.

Because of the pandemic, completed apartments could not be marketed for sale until after lockdowns had concluded, but a softening market means that some apartments remain unsold. The developer's priority is solely to recover the equity invested in the project to reinvest in future projects, but remaining unsold units are now likely to incur vacant residential land tax. This effectively penalises the developer for overcoming adverse circumstances to deliver new housing and makes it less likely to support their efforts to develop a new project, which will likely be 40 per cent per cent more expensive to deliver due to the escalation of construction costs.