High real estate prices are caused by federal government policies

by Tony Graddon

I love being an Australian and I love living in Australia.

I am really concerned that our Australian way of life is being destroyed by excessive real estate prices.

Bad for the Economy – So much of our wealth is being consumed by the cost of real estate that our economy is sluggish. Households and businesses are spending so much on real estate that spending on goods and services has been constrained. Jobs and growth will always be elusive in this context.

Bad for our Society – Poverty and homelessness are increasing. When house prices grow so much faster than income, people with low incomes experience hardship. Pensioners with fixed incomes are in deep trouble unless they own their house, and so are people who depend on other government benefits. The younger generations are facing a lifetime of paying rent or decades of mortgage stress.[1]

All this has happened in the last 20 years while inflation and interest rates have been low and employment has been robust. Australia should be booming, but instead we are seeing the rise of inequality and hardship and bullying.

This price hike started in year 2000 caused by tax policy

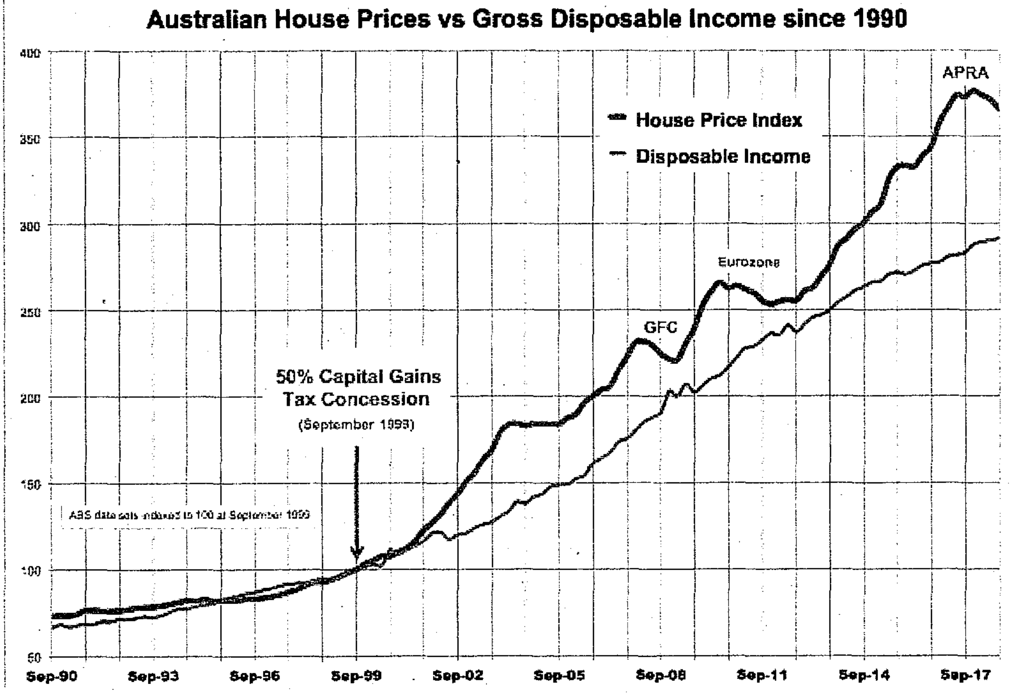
The federal government introduced 50% Capital Gains Tax Concession in September 1999.

They said that this would simplify the arithmetic and encourage investment in small innovative businesses.

A recent report by Anglicare indicates that the

1 www.abc.net.au/news/2017-11-29/poorer-australians-bear-brunt-of-rising-housing-costs-charts/9202804

Australian House Prices vs Gross Disposable Income since 1990



50% Capital Gains Tax Concession now costs the federal government about $10 billion per year in revenue foregone, which is equivalent to 0.8% of Australia's GDP.[2]

Said another way, the federal government is subsidizing the trading of real estate by $10 billion per year.[3]

This is equivalent to 10% of all revenue collected from the Goods and Services Tax, **or 4% of all income taxes.**[4]

The chart reveals what has happened and shows the trigger that caused our real estate crisis.

Real estate prices and disposable income were closely aligned for many years before 2000. Housing was affordable. House prices began their extraordinary ascent when the benefits of the new tax concession started to flow into the real estate market – 12 months after the 50% Capital Gains Tax Concession commenced.

Since 2000, the ascent of house prices has been relentless whenever debt has been available. The chart shows that the rapid ascent of house prices was halted briefly only by debt limitations – first by the Global Financial Crisis in 2008 and then again by the Eurozone crisis in 2012-2014 and then again from 2017 by APRA's restrictions on bank lending.

If the 50% CGT concession remains in place, then house prices will rise strongly again when debt is available.

Impacts on our economy and society since 2000

- Housing costs consumed 20% of household spending in 2015 (even higher now), up from 13% before 2000.[5]
- Sydney, Melbourne and Brisbane are now in the top 12 most unaffordable cities for real estate worldwide.[6]
- Rental accommodation for students and pensioners has become "Extremely Unaffordable" in these cities.[7]
- Commercial property rents are also higher, affecting business profitability.[8]
- Real estate is the preferred asset for accumulation of wealth. This does not benefit our economy or our society.
- Dollars consumed by rents and mortgages have reduced the ability for consumers to spend in other sectors.
- It has become normal for Australians to be landlords – owning another house and earning income from rents.
- We are seeing the separation of our society into landlords and renters. [9]
- Homelessness is in the news headlines.

Tax subsidies for real estate speculation

Before 1999 the rate of Capital Gains Tax Concession was linked to the Consumer Price Index (CPI). Since 1999 the 50% CGT concession has provided a tax subsidy almost 40% higher than the CPI-based tax concession would have provided over the same period.

The attractiveness of any investment depends on the level of risk. Changing to a flat 50% tax discount reduced the risk of investing by removing the link to the rest of the economy, making investment in real estate much more attractive.

Yes, other types of assets are eligible for the 50% CGT discount, but the house price boom has

2 www.anglicare.asn.au/news-and-media/latest-news/2018/03/25/landmark-report-on-the-cost-of-privilege-shows-our-tax-system-is-unfair

3 www.anglicare.asn.au/news-and-media/latest-news/2018/03/25/landmark-report-on-the-cost-of-privilege-shows-our-tax-system-is-unfair

4 www.abc.net.au/news/2018-05-08/chart-of-the-day-budget-tax-expenditures/9737378

5 Australian Bureau of Statistics Household Expenditure Surveys 2015-16 versus 1998-99

6 14th Annual Demographia International Housing Affordability Survey: 2018 page 11, Figure 4, demographia.com/dhi.pdf

7 SGS Rental Affordability Index May 2018 pages 22-30, www.sgsep.com.au/application/files/2215/2661/5595/RAI_May_2018_-_Press_Quality.pdf

8 www.news.com.au/finance/economy/australian-economy/commercial-real-estate-is-australias-other-big-property-risk/news-story/94e9bcbcb647d9f040a438ec8f5a2fdf

9 http://www.abc.net.au/news/2017-11-29/poorer-australians-bear-brunt-of-rising-housing-costs-charts/9202804

been fueled by debt and banks will always give priority for loans that are secured by mortgages on urban real estate.

The real estate sector benefits from interest rates that are lower than loans for other assets or for business investment. Real estate investment has an advantage in both the cost of debt, the availability of debt, and big tax concessions.

In the periods when house prices have fallen slightly due to restrictions on bank lending, the real estate investors still benefit from negative gearing as an additional type of tax subsidy.

How much money is involved?

In the last 4 years the total value of dwellings in Australia has increased from $5.2 trillion to $6.8 trillion – about $400 billion per year. That is the equivalent of 22% of Australia's GDP going into real estate prices for dwellings.

Since September 1999, if house prices had grown only at the same rate as gross disposable income, the chart shows that the total value of dwellings would be about $5.1 trillion. The excess is $1.7 trillion dollars – or $100 billion per year on average. If we include commercial and industrial real estate the numbers are even higher.

In summary, the federal government is providing a real estate tax subsidy that has grown to $10 billion per year. This has driven the total value of residential real estate to increase by $100 billion per year in excess of disposable income.

What if we could channel this wealth into education, hospitals, social services, small business and infrastructure instead of into real estate prices? $100 billion per year is enough to make a big difference.

Stop the real estate tax subsidies before more damage is done

This real estate price boom must stop and there is no doubt that our federal government can make it stop.

They pretend it is out of their control, but federal government tax policies are actually causing the real estate boom.

Prices appear to be out of control because the real estate sector is receiving an indirect tax subsidy of $10 billion per year. The federal government has direct control of this economic lever.

The government considered cutting the CGT Concession in the 2017 budget, but failed to go ahead.[10]

The 50% Capital Gains Tax Concession was touted as a mechanism to encourage investment in small innovative companies, but someone forgot to exclude real estate. Maybe that was an accident? It has certainly been a disaster.

What does our society and economy need?

Australia desperately needs many years of static house prices to allow our economy to find a productive balance.

We are only half way through the current 18-year real estate cycle. If the 50% CGT Concession remains in place, then real estate prices will double again in the next seven years. If our government allows this to happen there is a grave risk of severe recession when the next real estate crash arrives towards the end of the 2020s.[11]

If we truly want jobs and growth and we truly want our economy and our society to prosper then the tax subsidy for trading of real estate investments must be ZERO. We have 18 years of evidence to prove this is true.

We must stop the tax subsidies for real estate right now – before the next wave of easy debt revives the boom.

Instead, let us have policies that encourage productive innovation as promised by our government back in 1999.

End tax subsidies for the trading of real estate

10 www.afr.com/news/policy/plan-to-cut-capital-gains-tax-discount-for-property-investors-20170215-gudwdc Australian Financial Review February 2017

11 Phillip J Anderson: "The Secret Life of Real Estate and Banking". Book published in 2008 and various online publications.