# Submission to Parliamentary Inquiry: Inquiry into Home Ownership

18 June 2015

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**Disclosure:** I own one investment property in Brisbane and rent my principle place of residence. I have worked formerly for residential property developers assessing site acquisitions and conducting development feasibility studies. I received no payment for the preparation of this submission.

**Terms of Reference**
The Committee will inquire into and report on:
- current rates of home ownership;
- demand and supply drivers in the housing market;
- the proportion of investment housing relative to owner-occupied housing;
- the impact of current tax policy at all levels; and
- opportunities for reform

The Committee will also give due regard to the aspects of the current Tax White Paper process being conducted by the Government that pertain of housing Australia.

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## Summary

1. The key message of this submission is that **any policy that successfully reduces the price of homes is a massive redistribution of wealth away from existing home and land owners** (both owner occupiers and investors) towards renters and future home owners.

   This political reality stands in the way of genuine reform in this area, despite decades of housing inquires, plans and strategies from multiple levels of government.

2. Home ownership and reducing housing costs are not necessarily related policy goals. Housing can be cheap with extremely low rates of home ownership, and expensive with high rates of ownership. **Clarity about what housing affordability means as a social policy goal is necessary before any progress can be made.**

3. The policy goal of private rental provision has **tilted advantages for housing purchase in favour of investors via CGT concessions and negative gearing against personal income**. This has made it financially more attract to own residential property for investment rather than occupation and deterred corporate and institutional investment in residential property. Current high investor levels, including first home buyer investors, are clear evidence of this.

4. **Rental affordability has stable for 20 years**. This indicates that supply is not major factor influencing prices, though rental affordability moves with the asset cycle as new construction booms and busts. Government action could still reduce rents from this point in order to improve overall welfare.

5. The affordability of home ownership has been roughly unchanged over the long term, despite it tracking the business cycle (including the current Sydney boom). **Home ownership rates are also stable over the past four decades**.

6. Many **myths hamper debate** in this policy area. These myths centre on the apparent impact of town planning regulations and other developer fees and charges on prices, even though the evidence shows these factors are unrelated to home prices.

7. I make **six reform recommendations** to the Committee
    1. Provide a clear policy statement that about the specific social goals of housing policy
    2. Shift to tax burden away from wages and onto land to stimulate construction on underused lots
    3. End the 50% CGT discount for individuals, or extend its time threshold to 10 years
    4. Reinstate quarantining of negative gearing losses to residential property incomes
    5. Implement LVR lending restrictions for investors (by not allowing equity in other properties to be leveraged for new property purchases), as well as owners
    6. Improve bargaining power of renters through maximum allowable rate of rent increases, such as recently implemented in Berlin.
    7. Governments could target rental prices as a policy priority by acting as developers and transforming under-utilised public lands into housing and leasing in the private rental market. Because this supply would not be responding to price signals it could be built a high enough rate to lower market rents.

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## 1. The goal of housing affordability

Housing costs are the largest budget item for most households, and even more so for low income households. As such, reducing the cost of housing relative to incomes has been an ongoing concern of government.

A number of inquiries and housing strategies have been conducted or implemented in the past decade in Australia, including

- The Productivity Commission's First Home Ownership Report in 2004
- The implementation of Queensland's Housing Affordability Strategy in 2007[1]
- A Good House is Hard to Find Report from the Senate Select Committee on Housing Affordability in Australia in 2008
- Western Australia's Affordable Housing Strategy 2010-2020
- The New South Wales Parliamentary Inquiry into Social, public and affordable housing which is ongoing.
- Senate Inquiry into Affordable Housing, 2014-2015.

Despite the apparent political will at multiple levels of government to reduce housing costs, absolutely none of the tough policy choices necessary for this to happen have been made.

This submission is structured around key 'big picture' economic trade-offs inherent in housing policy. I start by exploring the policy decision to supply rental housing via a private rental market, and the trade-off this creates between home ownership rates and provision of housing the rental market. I then analyse what is meant by housing affordability, before dispelling some myth that surround housing policy, before offering a number of key policy recommendations.

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## 2. The big picture

[1] Including the subsequent formation of the Urban Land Development Authority (ULDA) in September 2007 as an institutional tool to fast-track release of State government land into private development. The ULDA was dissolved in 2012.

### *2.1 The distributional question*

Any discussion about policy changes intended to reduce housing rents, and subsequently prices, must acknowledge the enormous distributional implications. At current prices Australia's total housing stock is valued at around $5 trillion. If a policy successfully reduced rent and prices by 20% it would wipe $1 trillion of value from this market. Purchasing power of around $40 billion per year would be redistributed from the almost 6 million current home owning households and 1.8 million residential property investors, to the 2.8 million renters, along with future home buyers and owners of other non-residential domestic assets.[2]

There is no win-win scenario. Housing affordability is almost completely a question about the distribution of wealth in society.

To understand the magnitude of potential redistribution from successful policy to improve housing affordability, a reduction in housing rents by even as little as 10%, would lead to possibly the largest redistribution of wealth from the richest to the poorest Australians in recent memory.

### *2.2 Confusing goals*

Concerns about housing affordability are typically associated with the change in the purchase price of housing assets. The fear that home prices had increased beyond the reach of first home buyers triggered a number of policies aiming to subsidise the purchase of a first home, including repeated variations of the First Home Owners Grant theme at both national and State levels.

However it is somewhat absurd to think of home ownership as a social goal in the context of an otherwise market economy. The is no social policy encouraging households to own the means of production for other goods they consume. It would be most curious to provide government grants to subsidise the purchase of BHP shares because of fears about the escalating share price. Why it is desirable for a household to own the means of production of their housing services is a policy question that needs to be addressed in order to make any reasonable recommendation about the direction of future housing policy.

If home ownership is a social objective, then the government will have to play an active role in setting conditions in the housing market to achieve this. A high proportion of households owning BHP shares does not arise naturally in the market, nor do high rates of home ownership.

Moreover, reducing rental prices will reduce home prices, but reducing home prices doesn't imply a reduction in rental prices, since this can be achieved with changes to tax conditions, interest rates, and other factors affecting the way rent are capitalised into prices.

### *2.3 The investor as market maker*

Australian housing policy appears to have evolved to preference private investor ownership in order to encourage private provision of rental housing. This goal is at odds with making owner occupation more affordable. The tax benefits in the form of negative gearing and Capital Gains Tax (CGT) discounts accruing to private investors shift net returns to housing in their favour in comparison with owner occupiers. Thus in Australian housing markets investors are the price-setting marginal buyers. In the absence of any intrinsic value from home ownership rather than renting[3] there should be no willing home owners in Australia.

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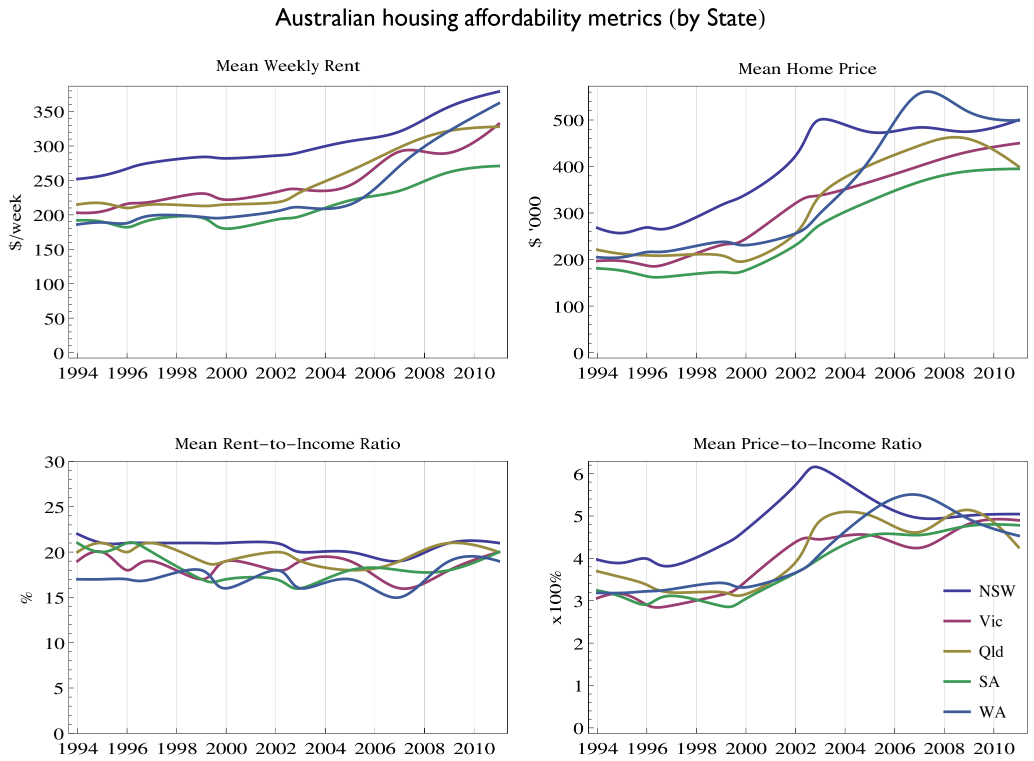
[2] Data on home ownership numbers from 4130.0 - Housing Occupancy and Costs, 2011-12

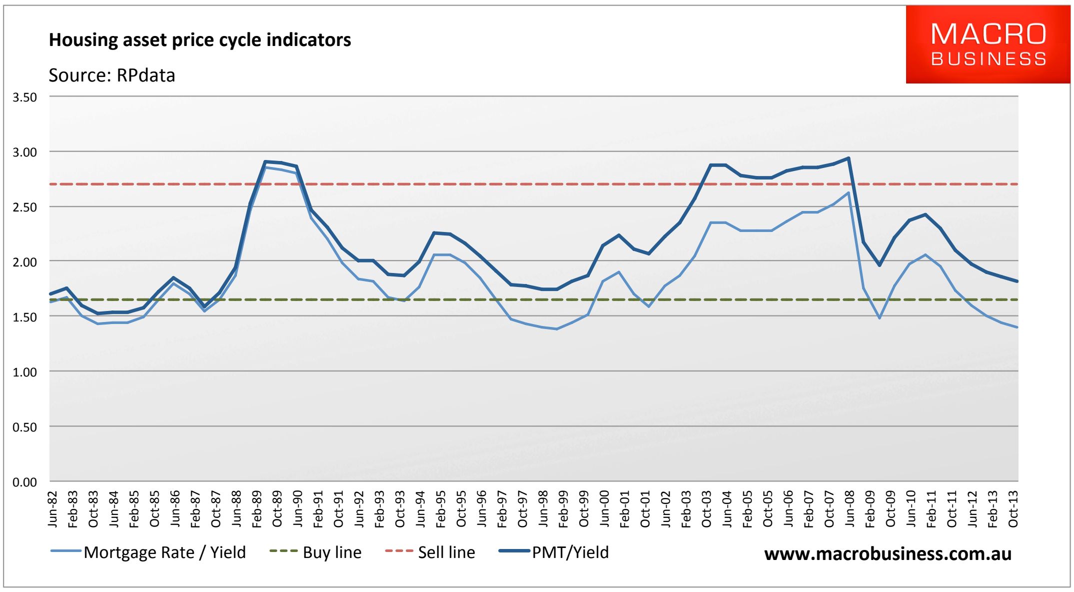
[3] Security of tenure is one value to owner occupation above that of renting




Source: ABS 4130.0 Housing Occupancy and Costs, 2011–12

The economically rational person would instead buy a home as an investment and rent their residence elsewhere.

In the past I have explored this issue in detail, and in Appendix A I provide this past modelling exercise on the relative economic advantageous of housing investment, and the contribution of CGT exemptions and negative gearing to these advantages.




It seems an unfounded fear that investors will not enter the housing market without sufficient tax incentives, and policy responding to this fear has increased prices to such a degree that home ownership has become financially less attractive than home rental.

Indeed, negative gearing incentivises private rental housing provision by wage earners with high marginal tax rates, to the exclusion of institutional investors who successfully provide large shares of rental housing stock in much of Central Europe.

### *2.4 Which affordability?*

So far I have explained that high rates of home owner-occupation are not necessary for affordable housing, and that there is an investor bias in housing policy which makes home ownership more difficult. The next major consideration of housing policy is to define what we mean by affordability. The charts below summarise some of the basic housing statistics for each State since from 1994-2012.
Crucially the metric widely considered the most general definition of housing affordability, the rent-to-income ratio, has been steady for the past two decades at around 20% of household income.

In analysis undertaken in May 2013[4] I showed that home ownership is comparatively affordable by historical standards, due to the reduction of interest rates, stagnant home prices, and wages growth since the financial crisis of 2008 (my metric of relative affordability of ownership compared to renting in the below chart).

This recent 'relative' affordability of homes is one factor behind the current surge in Sydney home prices, which can in fact be seen as a return to normal asset cycles.

In light of this data, the housing affordability situation in Australia could be described, with reference to recent historic norms, as relatively affordable. This is not to say however, that policy changes cannot be made to improve on the contemporary Australian housing situation if there is a genuine political desire to reduce housing costs.

### *2.5 The planning constraint myth*

A prominent myth surrounding house price patterns is that constraints on development type and scale through local government planning regulations are reducing the rate of new housing supply than would otherwise be the case, and thus are a direct cause of increasing prices.

While this argument has a common sense appeal, the evidence is overwhelmingly against it. Two pieces of evidence would be required to confirm the planning constraint argument:

1. An increase in rents commensurate with home prices, and
2. A reduction in the stock of approved but undeveloped housing sites.

The charts in Section 2.4 make clear that in fact there has been a divergence between prices and rents since 2000 in all States. While the rent-to-income ratio has been flat, the price-to-income ratio has ballooned by up to 60% in some States.

In earlier work[5] I have described in detail the housing development process and tracked the stock of approved but undeveloped residential dwellings in Queensland. I used data from Queensland's Office of Economic and Statistical Research[6] which is reproduced below. This

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[4] Published on MacroBusiness and available at http://www.macrobusiness.com.au/2013/05/melting-towards-the-bottom-of-the-housing-cycle/

[5] This analysis can be found at MacroBusiness http://www.macrobusiness.com.au/2011/09/the-housing-production-line/

[6] Available at http://www.oesr.qld.gov.au/products/profiles/res-land-dwelling-activity-reg-plan/res-land-dwelling-activity-seq.pdf

data clearly shows that the various local Councils in SE Queensland have approved far more dwellings than can absorbed into the market.

*Table 2: Uncompleted residential lots[1], South East Queensland (SEQ)*

| Year to June | Opening stock (a) | Lots approved (b) | Operational works approvals | Lots certified (c) | Lots lapsed (d) | Closing stock (a+b-c-d) |
|---|---|---|---|---|---|---|
| 2005 | 37,650 | 28,145 | na | 16,927 | 1,815 | 47,053 |
| 2006 | 47,053 | 20,019 | na | 15,164 | 1,810 | 50,098 |
| 2007 | 50,098 | 18,006 | na | 16,695 | 681 | 50,728 |
| 2008 | 50,728 | 18,821 | 15,840 | 14,525 | 1,452 | 53,572 |
| 2009 | 53,572 | 15,167 | 10,656 | 12,348 | 2,980 | 53,411 |
| 2010 | 53,411 | 14,166 | 10,789 | 11,313 | 2,876 | 53,388 |
| 2011 | 53,388 | 14,909 | 11,928 | 9,710 | 1,828 | 56,759 |
| 2012 | 56,759 | 12,716 | 8,823 | 8,038 | 1,955 | 59,482 |
| 2013 | 59,482 | 10,884 | 9,052 | 7,075 | 1,601 | 61,690 |
| Sep qtr 2012 | 59,482 | 2,361 | 1,649 | 1,280 | 651 | 59,912 |
| Dec qtr 2012 | 59,912 | 3,871 | 2,567 | 1,983 | 510 | 61,290 |
| Mar qtr 2013 | 61,290 | 2,391 | 2,721 | 1,162 | 332 | 62,187 |
| Jun qtr 2013 | 62,187 | 2,261 | 2,115 | 2,650 | 108 | 61,690 |

*na = not available; operational works data collected since September quarter 2007.*

*1) Uncompleted lots are lots with a RaL development permit approval but have not proceeded to survey plan certification.*

The evidence is clearly in favour of the argument that planning regulations are not a fundamental factor determining current housing prices.  And indeed, one can make a further argument that if town planning regulations significantly increase home prices, historical periods prior to the advent of town planning would have had much cheaper housing relative to incomes. This is not the case.

Associated with the planning constraint myth is that the costs of regulatory compliance are added to new home prices. Typically stamp duties and government fees such as infrastructure charges are targeted in this myth. However the logic here is completely unsound. If developers we able to charge higher prices when their costs increase, they would charge higher prices **at any time** even if their costs didn't increase. The sound logic is borne out in more thorough analysis, with the weight of academic analysis showing that any increasing stamp duty decreases home prices by at least that amount, and sometimes more.[7] Furthermore, if stamp duty decreases housing turnover it may have the advantageous effect of constraining speculative price bubbles in the manner of a Tobin tax.

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## 3. Recommendations

With the big picture of housing policy in mind I make six simple policy recommendations to the Committee.

1. *Provide a clear policy statement that about the specific social goals of housing policy*

This policy statement should include specific details about targets for all aspects of the policy, including such items as

- rental prices in relation to household incomes
- relative costs of buying versus renting

[7] For example, this recent Australian study http://onlinelibrary.wiley.com/doi/10.1111/1475-4932.12056/abstract

- relative importance of individual investors in the private rental market, and
- minimum standards of housing, particularly for the most disadvantaged.

As earlier discussed there is a great deal of confusion about the actual goals of housing policy. High rates of home ownership do not imply housing affordability in any meaningful sense. Any metric must compare housing costs to incomes with some consideration of quality. Moreover, the current mechanisms encouraging private provision of affordable rental housing must be considered as just one of many possible ways to achieve a functioning private rental market, and as such this investor market must be willing to accept significant changes in order to improve housing affordability. Implementing my recommendations 3. and 4. will definitely disrupt this market and potentially make it attractive to institutional rather than individual investors.

*2. Shift to tax burden away from wages and onto land*

Increasing taxes on land in proportion to its value at its highest and best use provides enormous incentives to construct new housing even if it reduces rents and prices. Implementing changes to land taxes will require cooperation of the States as well as adjustments to other taxes.

Introducing or increasing the rate of land value tax (LVT) is one of few policy measures that provide incentives to develop new housing at a rate that will reduce rents and prices. It also provides opportunities to reduce distortionary taxes elsewhere in the economy. It therefore has three complementary beneficial effects - first, increase housing supply to depress rents, second, by doing so increase investment and economic growth, and third, at the same time reduce distortions elsewhere in the economy.

*3. End the 50% CGT discount for individuals, or extend its time threshold to 10 years*

For assets, including residential investment property, held for more than 12 months there is a 50% CGT discount available to individuals. Residential property should either be removed from eligibility for this discount, or the time period for asset ownership to qualify for the discount be extended to 10 years.

The CGT discount encourages speculative investment in residential property and merely amplifies the housing cycle. A much longer qualifying period, or the removing of the CGT discount from residential property would reduce investors' willingness to pay for housing, and therefore make owner occupation a more attractive choice.

*4. Reinstate quarantining of negative gearing losses to only residential property investment*

This would mean that any expenses in excess of rental income for a residential investment property could not be deducted against other personal income of the property owner.

The ability to deduct losses from residential property investment against wages and other income sources means that high income earners have a given a massive financial advantage in the housing market. Removing this deductibility would even the playing field for all potential investors, including corporate investors, and like the recommended changes to the CGT exemption, reduce prices for owner occupiers.

In combination, these two recommended policies will reduce the purchase price of housing, making home ownership more attractive, and therefore providing renters with a less costly ownership alternative, which subsequently improves their bargaining position.

*5. Implement a maximum Loan-to-Value ratio (LVR) limit on new lending of 80%*

This limit can be implemented in a similar manner to those introduced in New Zealand on 1 october 2013. The New Zealand scheme[8] limits the ability of banks to issue new mortgages with LVRs above 80%, with the 'speed limit' set so that no more than 10% of new bank mortgages exceed this LVR.

The effect of this policy recommendation is to reduce exclude high risk investors from the mortgage market and dampen their impact on price cycles.

*6. Improve bargaining power of renters through maximum allowable rate of rent increases*

This limit could be set at maximum once per year increases at a maximum of CPI, and could be coupled with other default contract conditions that favour long term tenants. This is one method to improve housing affordability to renters, as their rental costs will likely fall in proportion to their income over time if incomes grow above the rate of CPI.

*7. Target rents through the provision of additional publicly supplied housing in urban markets*

State or Federal governments could act as a non-market supplier of housing into the private rental market. By transforming under-utilised public lands into housing at a rate that is not sensitive to prices, pre-sales and other asset market considerations, supply can be radically increased beyond what the private sector would supply, and rents would subsequently decrease.

Again I reiterate that while all these policies are technically possible, any policy that is effective in reducing housing prices via rents, taxes or other mechanisms, will entail a massive transfer of wealth away from home owners and the wealthy (who are disproportionately large land owners).

[8] Details of the scheme are at the RBNZ website http://www.rbnz.govt.nz/financial_stability/macro-prudential_policy/5393159.html

## Appendix

### *MacroBusiness Subscriber Analysis, 6 December 2011*[9]

There is widespread acknowledgement that Australian tax rules, particularly negative gearing and capital gains tax (CGT) discounts for assets owned for more than a year, lead to higher home prices (and reduced tax revenue for government – in the order of $2.5billion pa). Together, these tax rules tilt returns in favour of owning residential property for investment rather than occupation. Even the tax-free capital gains on the family home are insufficient to make owner occupying a more attractive financial position.

Even the financial illiterate will know these rules increase prices simply by looking at the vested interest group most vocal in support of them – the property industry.

So how big is the price impact? The short answer is 'it depends'. But it is always positive.

Below are a series of models demonstrating the scale of price impacts under various scenarios. What we learn from this investigation is that not only do these two tax rules work in tandem to increase prices, while the scale of price impacts is dependent on investor expectations of capital growth – the higher the expected capital growth, the greater the price impact. In this way, the asset price cycle is amplified by these rules.

We also come to realise that the rules are a political construct, and actually do serve the purpose of allowing markets to deliver private provision of rental accommodation by making the investment market the price setter, rather than the owner-occupied market.

The models
All models are discounted cashflows, calculating the purchase price based on investor expectations of after tax return on equity (ROE), along with the following assumptions and specifications:

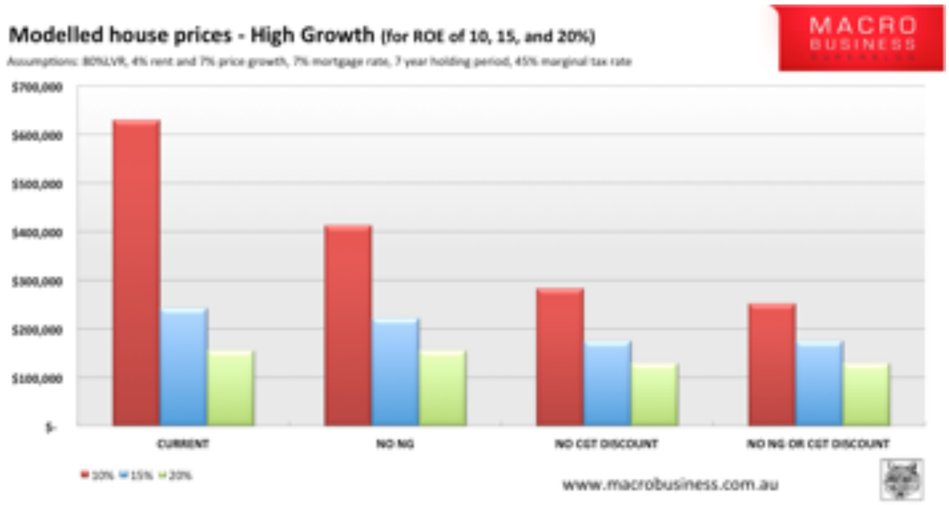
- 7 year holding period
- 80% LVR
- 7% mortgage interest rate
- 45% marginal tax rate (the current to income tax rate)
- Weekly rent of $250
- Operating costs of 2% of value (each period)
- Other transaction costs ignored (stamp duty, commission, legal fees and searches)
- In the baseline case, of no negative gearing or CGT discount, losses carry over to the sale period and subtracted from capital gains to calculate CGT liability.

All numbers are arbitrary and are simply used to demonstrate the relationships between price and other factors. However it is important to note that while there are huge price variations, housing will be equally affordable in all cases since the rent does not change. Take this as a warning when drawing conclusions form comparisons of prices to household income. Prices are very sensitive to tax rules, growth expectations, and interest rates, all of which need consideration. Also, in Australia, the investment market usually sets the price of housing.

### *Scenario 1 – High growth high return*

[9] http://www.macrobusiness.com.au/2011/12/negative-gearing-price-impacts-modelled/

This high growth model is based on an assumption of 7%pa capital gains (which the property industry assures us is typical), and 4% rental price growth:

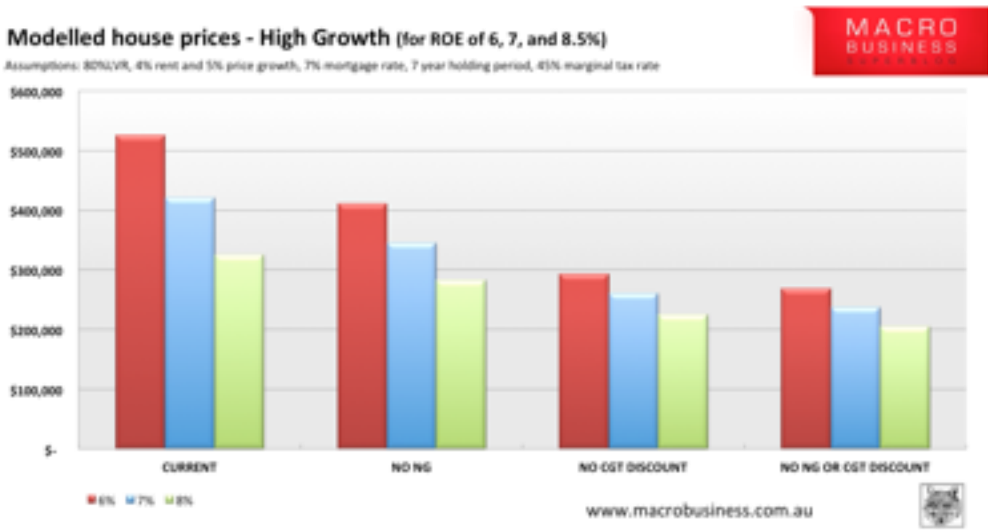



In this model, the price setting investor is seeking an after tax ROE of 10,15 or 20%. The removal of negative gearing alone (while keeping the CGT discount), would reduce the price by between zero and 35%, depending on whether expectations of ROE are 20% or 10%. I would imagine that the reality of the last decade in Australia is in this, albeit large, ballpark.

Removal of both tax rules (noting that removing these rules treat residential property inconsistently compared to other asset classes) reduces prices between 20 and 50%.

The CGT discount is also shown to have a larger price effect than negative gearing (since negative gearing brings forward tax benefits, while the CGT removes a tax obligation). This CGT price effect is sensitive to the holding period, where the longer the expected holding period, the lower the price impact.

### *Scenario 2 – High growth, low returns*

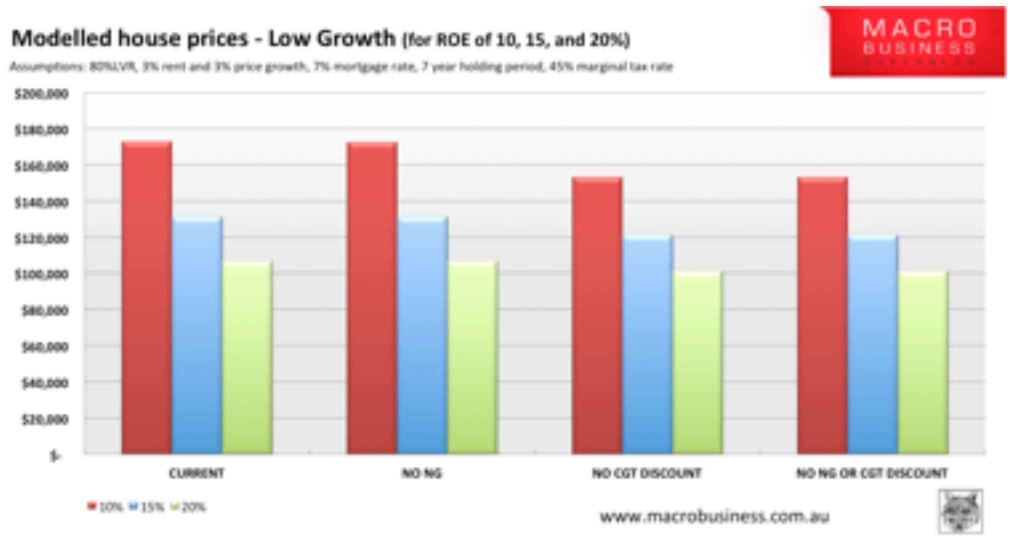



More moderate capital growth expectations of 5%, plus rental growth expectations of 4% are used. Also, much lower after tax ROEs are used in this demonstration:

We again see the consistent pattern of price reductions from removal of the two tax rules, and the more substantial price impacts from the CGT exemption. Negative gearing prices effects alone are between 20 and 25% in this model.

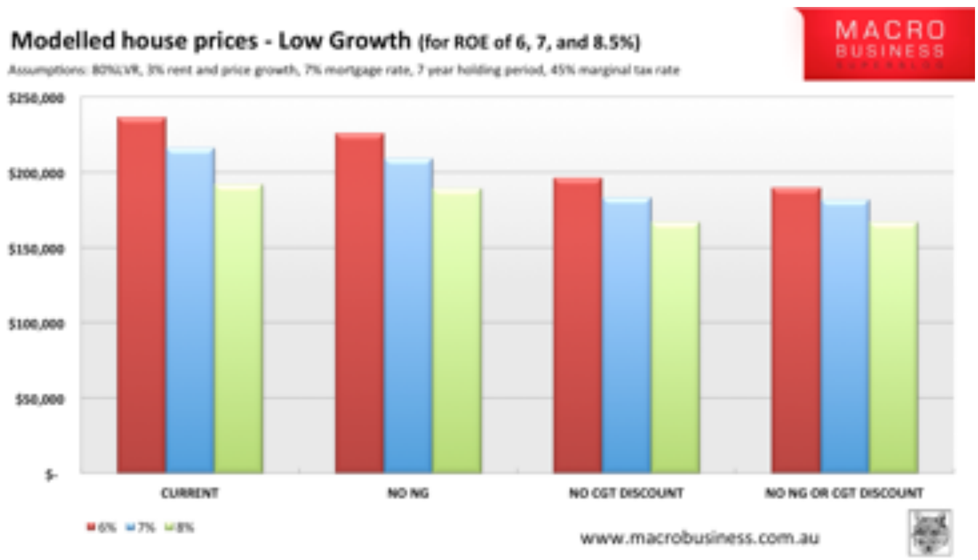
### *Scenario 3 – Low growth, high returns*

Rental growth and capital growth expectations are both 3%:
We see a new pattern emerge in the low growth scenarios. Since capital growth is low, there is little justification for incurring costs each year in anticipation of cash flow from capital gains in a later period (especially with the high after tax ROE).




Negative gearing is this scenario has no price impact, while removing the CGT discount would decrease price by 11%. The political implication of the investor price requiring positive cash flows is discussed later in the post.

### *Scenario 4 – Low growth, low return*




In this scenario rent and capital gain expectations are 3%, and investor after tax ROE expectations are all below 10%:

In these models negative cash flows are justified in all but the baseline case of no negative gearing or CGT discount (although the first two years cash flows are negative). Negative gearing has a very minor impact – just 1-5% on price.

In this scenario, removing the two tax rules would decrease prices between 15 and 20%.

What does it mean? From these simple models we can observe a number of relationships:

1. The lower the after tax ROE expectation, the greater the price impact from negative gearing and CGT discount
2. The CGT discount has a higher price effect than negative gearing at a holding period of 7 years
3. The higher the growth expectation, the greater the price impact of negative gearing and the CGT discount
4. When capital growth is expected to be low, but ROE is expected to be high, the investor's rational price will be below the cost of renting.
5. We also know from the model construction that the longer the holding period, the lower the price impact from the CGT discount.

These relationships interact dynamically, leading to an exacerbated price cycle.

Political economy of housing

These two rules do not impact housing affordability – they impact home OWNERSHIP affordability by nudging the benefits in favour of home investment, rather than home ownership. After all, it still costs $250/wk to rent this home under all scenarios.

Is this a desirable social outcome? In a way, yes.

Governments, present and past, have taken the view that private markets should supply rental housing. If housing investment is not made more attractive to investors rather than owner-occupiers, there is a possibility that no private market for rental housing will emerge. Yet we know that some people will be incapable of saving or borrowing sufficiently to own their own homes, even if it is cheaper than renting, so that some form of rental market will be required.

Such a breakdown of the private rental market would occur because home buyers, given they typically value ownership more highly than renting, could bid up prices to, or above, that which reflects the cost of renting.

If that occurs, no investor will enter the housing market because returns would be so poor. Home ownership would simply become a consumption good that not everyone could afford.

To ensure a private rental market, tax rules appear to have evolved to ensure that owner occupying is more costly, and that investor demand sets the market price, allowing for a functioning private rental market. This is why over the past thirty years, owning has never been more financially attractive than renting (except for rapid capital gains).

How likely is a situation of private rental market breakdown if these tax rules where changed? I am not sure. But it is possible under a specific set of circumstances, and a genuine political concern. These circumstances are not that unrealistic – investors requiring a ROE around 10% with rent and capital growth at around 3%.

In any case, the creation of a functioning private market is one reason you will hear that negative gearing improves housing supply – it actually allows a private market to supply rental housing if it makes investing more financially attractive than owner occupying. Once the private market is functioning, no further tax incentives will increase housing supply. Negative gearing may simply be a case of political 'insurance', guaranteeing the investor housing market exists.

Global housing markets

The RBA's Luci Ellis compared international housing market rules in her 2006 paper. The countries listed below, from Switzerland, to Netherlands, to Sweden, Canada and Australia, all have very different tax rules that reflect the quite different historical and institutional development of housing markets:

**Table 3: Features of Taxation Systems Relevant to Housing Markets**

| Country | Mortgage deductibility | | CGT | | Land/ property tax | | Negative gearing | Depre-ciation |
|---|---|---|---|---|---|---|---|---|
| | Owner | Investor | Owner | Investor | Owner | Investor | Investor | Investor |
| Australia | No | Yes | No | ½ rate[c] | Limited | Yes | Yes | Yes[d] |
| Canada | No | Yes | No | ½ rate[c] | Yes | Yes | Yes[e] | Yes |
| France | No | Yes | No | No[f] | Limited | Limited | Limited[g] | Yes |
| Germany | No | No | No[f] | No[f] | Limited | Limited | Yes | Yes |
| Netherlands[a] | Yes | na | na | na | Yes | Yes | na | No |
| NZ | No | Yes | No | No | Limited | Limited | Yes | Yes |
| Sweden | Yes | Yes | Limited | Limited | Yes | Yes | Yes | No |
| Switzerland[b] | Yes | Yes | Yes | Yes | Yes | Yes | No | Outlays |
| US | Yes | Yes | Limited | Yes | Yes | Yes | Limited[h] | Yes |
| UK | No | Yes | No | Yes | Limited | Yes | No | No |

Notes: Under CGT, 'limited' means homeowners may defer payment provided the proceeds of sale are reinvested in housing. Under land/property tax, 'limited' refers to property owner charges along the lines of council rates, which are linked to local services and need not move proportionately with property values.
(a) The Netherlands levies a tax on net wealth using an assumed rate of return, so negative gearing is not possible.
(b) Swiss homeowners pay tax on imputed rental income, net of interest and renovation costs.
(c) CGT is levied in Australia and Canada at half the taxpayer's marginal rate if the holding period exceeds one year, but in Canada gains resulting from changes in the cost base due to depreciation are levied at the full rate.
(d) For buildings constructed after 1985.
(e) Only cash expenses, not depreciation, can be negatively geared in Canada.
(f) Provided property owned for at least 15 years (France) or 10 years (Germany).
(g) Negative gearing allowed up to a set limit and interest costs may not exceed gross rent.
(h) Rental property expenses cannot be deducted against unrelated labour income in the US, which effectively limits negative gearing to professional investors and developers.

Sources: adapted from BIS (2006); Ellis and Andrews (2001); RBA (2003b); Scanlon and Whitehead (2004) with some updating from national sources.

We need to be careful about simply plucking a set of rules from another country that seem to work well, say Germany, and applying them here. German home ownership rate is just 42%. In Netherlands it's 49%. In Bulgaria, 97%. A history of war and housing shortage, and greatly differing rental rules also make comparisons difficult. For example, Germany and France have CGT discounts for residential property investment; but only after 10 and 15 years ownership, respectively.

Market rules need to be structured in a way to create the incentives to provide the desired social outcomes. At the broadest level, Australian housing policy appears to be a juggling act between encouraging homeownership on the one hand, and creating rules that allow a functioning private rental market on the other. We know there are also strong social benefits from home ownership, especially given our relatively landlord focused tenancy laws.

Indeed, if rental controls were to be implemented, current home owners and investors would lose out to the advantage of both renters and future home owners – but the system of private supply of rental housing would stay intact, even if the political risk makes it a less attractive investment. This would have the same effect as if all renters could coordinate a group decision to pay lower rents.

Australia has chosen to establish a set of rules that allows markets to provide private rental housing. The models show, however, that removing either of these two tax rules would be sufficient to reduce the ownership premium while maintaining the social aims of the 'investor price maker