



Financial regulatory framework and home ownership

Submission to the Senate Standing Committee on Economics

Discussion paper

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Introduction

Home ownership rates have been declining in Australia for most of the 21st century. At the same time the proportion of people in private rentals is increasing. Housing is becoming increasingly expensive as a larger share of the existing housing stock is purchased by households not to occupy but as an investment. The result of this is that the proportion of rental properties is rising and so the proportion of households who rent is also rising. This then explains why home ownership rates are falling.

For the last 25 years, average house prices have increased at twice the rate of income. Each year housing becomes more expensive and further out of reach of first-home buyers. Tax concessions such as the capital gains tax (CGT) discount and negative gearing are encouraging housing speculation and driving up the price of housing.

There are only two ways to make housing more affordable. Either the supply of housing is increased relative to demand, or you the demand for housing is decreased relative to supply. If a housing affordability policy does not relatively increase supply or decrease demand, then it will not make housing more affordable. The problem with the current housing policy settings is that they incentivise demand but do little to increase supply.

We recommend the following:

- Restrict negative gearing to newly built housing.
- The capital gains tax discount should be scrapped, and capital gains should be taxed like other types of income.
- Macroprudential policies should be explored to reduce households access to credit for buying residential investment property.
- The government should not pursue policies that preference one group of home buyers by allowing them access to more funding.

Home ownership rates are declining

Home ownership rates rapidly increased in the post war period – up from 56% in the 1947 census to 71% in the 1966 census.¹ The level remained around 70% until the end of the 20th century. More recently the Australian Bureau of Statistics' (ABS) Survey of Income and Housing has shown a steady decline in home ownership from this 70% level in 1999-00 to 66% in 2019-20.² Over the same period the proportion of the population renting has increased from 27% to 31%. Even more stark is that in 2021, for the first time, a majority of Australians aged in their early 30s did not own their own home³

While a 4% fall in homeownership might sound minor, it represents hundreds of thousands of households. If the rates of home ownership had stayed the same between 1999-00 and 2019-20, then an additional 430,000 households would own their own home.

¹ Australian Bureau of Statistics, *Census of Population and Housing*, various years

² Australian Bureau of Statistics (2022) *Housing Occupancy and Costs: 2019-20*,
<https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/latest-release>

³ Australian Institute of Health and Welfare (2024) "Home ownership and housing tenure"
<https://www.aihw.gov.au/reports/australias-welfare/home-ownership-and-housing-tenure>

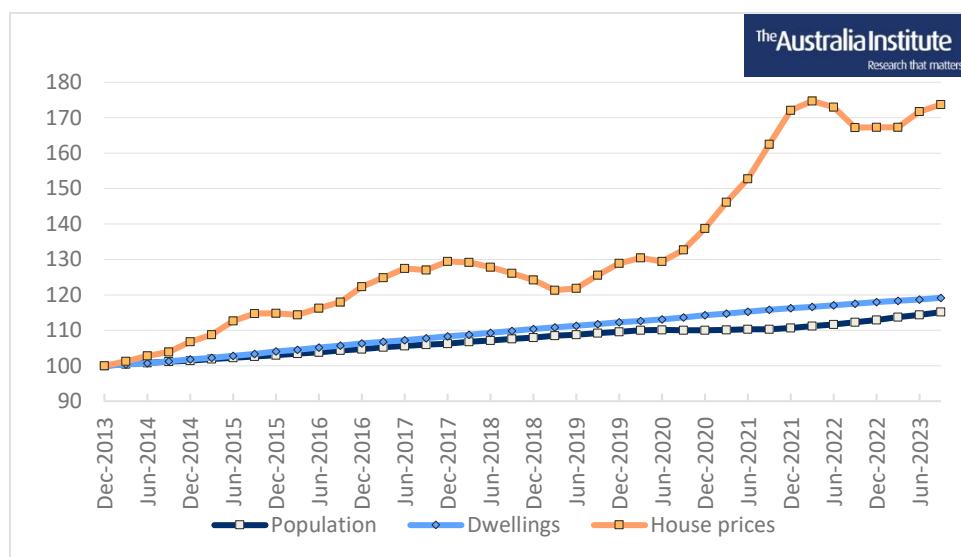
Housing supply

In the last few years, both the federal and state governments have begun to place a greater emphasis than in the past on policies designed to increase housing supply. There has been a renewed push at the state and territory level for reforms to zoning laws to increase density, particularly in the middle-ring suburbs around Australia's largest cities.

While increasing housing supply can help improve housing affordability, it is not the whole solution. Over the past ten years the population has increased by 15%.⁴ Over that same period the number of dwellings has increased by 19%.⁵ Despite the supply of new dwellings growing faster than the population, house prices increased 75% over that period.⁶

Figure 1 shows growth in population, dwellings, and house prices over the last 10 years. It shows that the growth in dwellings has been consistently ahead of population growth. At the same time house prices have increased dramatically. This suggests that a lack of supply is not the significant driver of house price increases.

Figure 1: Index of Population, Dwellings, and House Prices (December 2013 = 100)



Source: Australian Bureau of Statistics (2024) *3101.0 Nation, state and territory population December 2023, Table 1*, <https://www.abs.gov.au/statistics/people/population/national-state-and-territory-dec-2023>

⁴ Australian Bureau of Statistics (2024) *3101.0 Nation, state and territory population December 2023, Table 1*, <https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/dec-2023>

⁵ Australian Bureau of Statistics (2024) *6432.0 Total Value of Dwellings March 2024, Table 1*, <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/total-value-dwellings/mar-quarter-2024>

⁶ Australian Bureau of Statistics (2024) *6432.0 Total Value of Dwellings March 2024, Table 1*, <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/total-value-dwellings/mar-quarter-2024>

population/dec-2023 and ¹ Australian Bureau of Statistics (2024) *6432.0 Total Value of Dwellings March 2024, Table 1*, <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/total-value-dwellings/mar-quarter-2024> and Australian Bureau of Statistics (2024) *6432.0 Total Value of Dwellings March 2024, Table 1*, <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/total-value-dwellings/mar-quarter-2024>

Residential property speculation

An important driver of the declining home ownership rates and the increase in the proportion of households renting has been the impact of the tax treatment of residential property. The interaction between two tax concessions; negative gearing and the capital gains tax (CGT) discount has encouraged speculation in housing, driving up demand and the price of housing. This has made it increasingly difficult for aspiring first-home buyers to own their own home.

Negative gearing occurs when expenses associated with owning an investment property are larger than the income (rent) from than investment property. This loss can then reduce the tax paid on other sources of income like wages. This means that the public pay for some of the loss, depending on their marginal tax rate, up to 47%.

Negative gearing has been a long-term component of the tax system, but until the turn of the century did not play a significant role in encouraging speculation in the housing market. In September 1999 the Howard Coalition Government passed the CGT discount. This changed the taxation of capital gains from one in which gains were indexed to the inflation over the period in which the investment had occurred to a 50% discount on the gain. This means that only half of eligible capital gains are taxed. For example, if someone buys a house for \$500,000 and then many years later sells it for \$900,000, then they made a capital gain of \$400,000. The CGT discount means only half that gain, \$200,000 is subject to tax. The other half is tax free.

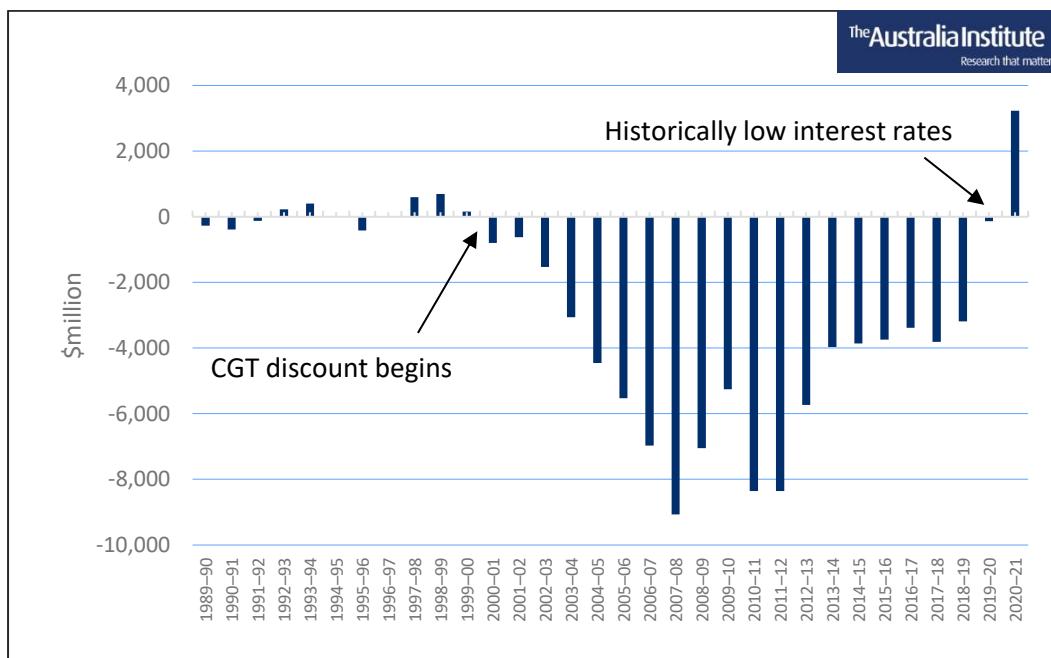
Negative gearing is not a successful long-term strategy because even though some of the loss is paid by the public, the speculator must still pay for most of it. This only works if they sell the investment property for an amount that ensures the income made from the capital gain is greater than the losses made from negative gearing.

The CGT discount means that someone with an investment property makes more from the capital gain and so can sustain a larger loss on the property, and hence buy it for a higher price. After the CGT discount was introduced negative gearing rapidly increased.

One method to track in the impact the CGT discount has had distorting the housing market is the net rental value contained in the annual taxation s data from the ATO. The net rent position in any given year is the sum of all the income (rent) from rental properties less all the expenses, including interest expenses of investment mortgages. A positive number means that in aggregate rental properties made more in total income than they paid in total expenses. A negative number means the reverse, that is in aggregate, rental properties were negatively geared.

Figure 2 shows that before the introduction of the CGT discount the net rent position each year was sometimes positive and sometimes negative. In essence, prior to the CGT discount, there was no bias toward positively or negatively gearing properties. After the introduction of the CGT discount, however, the net rental position deteriorated dramatically. In 1998-99 50.4% of all rental properties recorded a loss; by 2007-08 this had risen to 70%. More recently the net rental position has swung back to a positive position. This however is not due to a change in the incentives to negative gear or the benefits of doing so in combination with the CGT but because the Reserve Bank of Australia (RBA) reduced interest rates to historically low levels during the COVID pandemic. When rates are so low it becomes harder for investors to record a loss given the loan repayments also fall. The official cash rate has since increased, and it is likely that the net rental position will again turn negative.

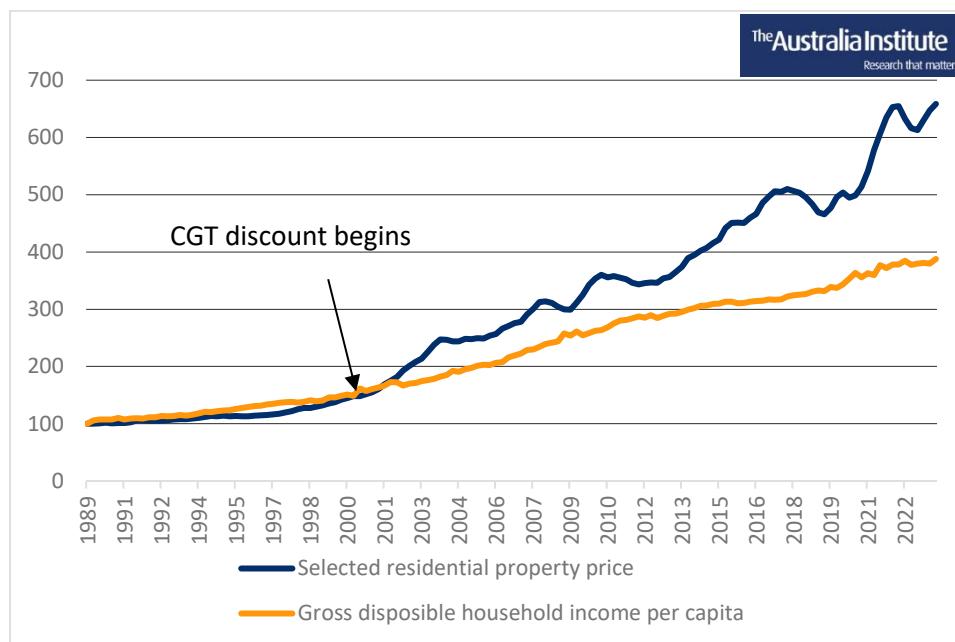
Figure 2: Net rent 1989-90 to 2020-21



Source: Australian Tax Office (2023) *Taxation statistics 2020-21, Individuals, Table 1*,
https://data.gov.au/data/dataset/taxation-statistics-2020-21/resource/cf170ab8-5510-481a-8026-fb4a08f97f4e?inner_span=True

After the introduction of the CGT discount, house prices also started increasing more rapidly than in the previous decade. In the ten years leading up to the introduction of the CGT discount, on average house prices increased at the same rate as income. In the 23 years since the introduction of the CGT discount, house prices have increased at more than twice the rate of incomes. This is shown in Figure 3.

Figure 3: Index of Property prices and Incomes 1989 to 2023



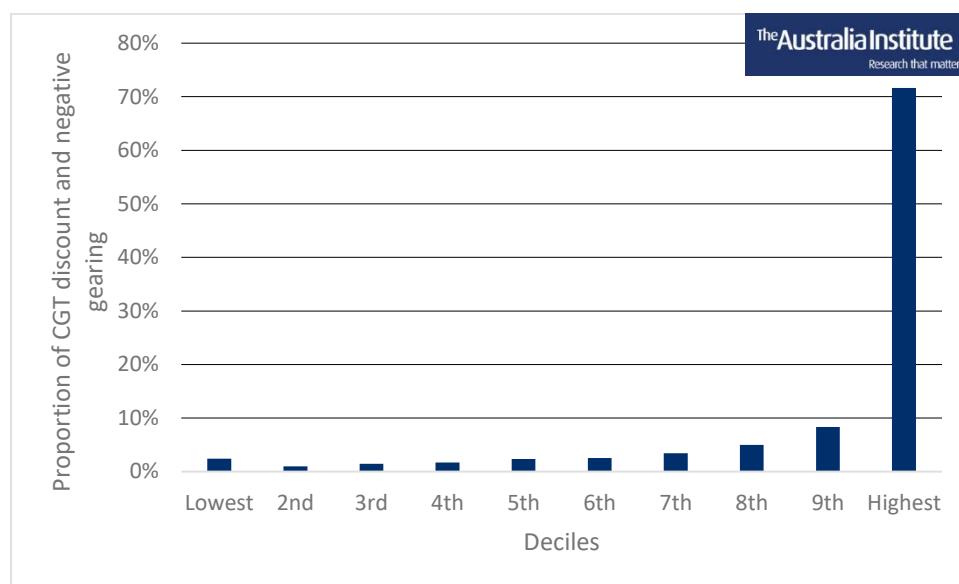
Source: Bank of International Settlement (n.d.) *Selected residential property: Australia*, <https://data.bis.org/topics/RPP/data> and Australian Bureau of Statistics (2024) *Australian National Accounts: December 2023*, <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/dec-2023>

Negative gearing and the CGT discount cost the budget around \$20 billion per year. This is equivalent to the annual cost of the Pharmaceutical Benefits Scheme each year. It is also more than twice the \$8.4 billion state and territory governments spent on public and community housing in 2022-23.⁷

These tax concessions overwhelmingly go to high income earners. 70% go to the top 10% of income earners, while the bottom half get only 8%. The distribution of negative gearing on the CGT discount by decile is shown in Figure 4.

⁷ Productivity Commission (2024) *Report on Government Services 2024: Housing*, <https://www.pc.gov.au/ongoing/report-on-government-services/2024/housing-and-homelessness/housing>

Figure 4: Distribution of CGT discount and negative gearing in 2020-21 by income decile



Source: Australian Government Treasury (2024) *2023-24 Tax Expenditure and Insights Statement*, <https://treasury.gov.au/publication/p2024-489823> and authors calculations

As investment properties became a larger proportion of total residential properties, then assuming those investment properties were being rented out, the proportion of people renting must also increase. This then leads to a fall in home ownership rates. While the government continues to encourage households to buy investment properties by making them such a tax effective investment, they will continue to encourage home ownership rates to fall.

Ownership of investment properties is concentrated in the hands of a small number of taxpayers. While about a fifth of taxpayers own at least one investment property, there are a very small proportion of taxpayers who own a much larger number of properties.⁸ A quarter of investment properties are owned by just 1% of taxpayers.

⁸ Australian Tax Office (2023) *Taxation Statistics 2020-21: Table 27A*, https://data.gov.au/data/dataset/taxation-statistics-2020-21/resource/7f5d4873-e8b2-4a3e-b586-d16623c41731?inner_span=True

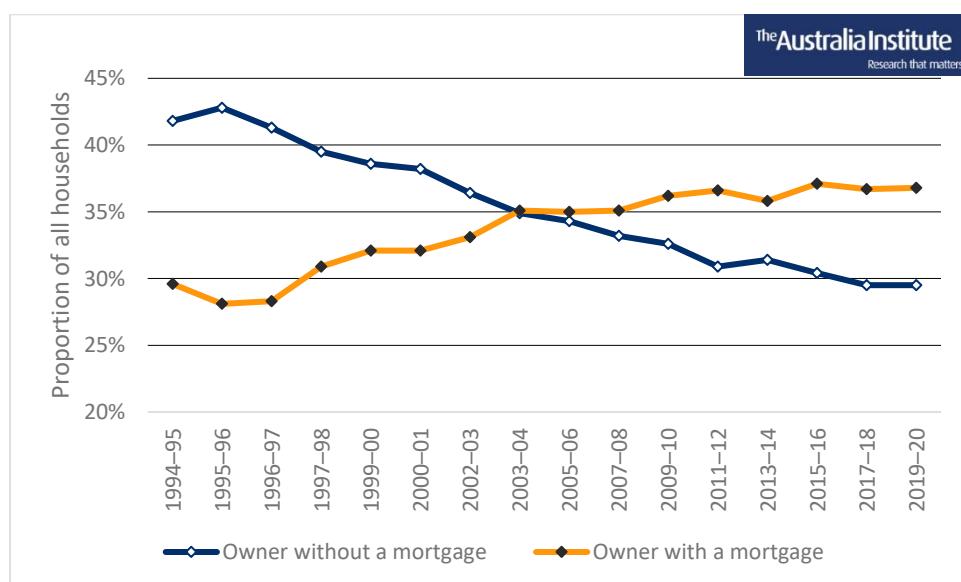
Reducing speculation in residential housing

Reforms to negative gearing and the CGT discount are not about punishing people who have invested in housing. Changes can be made with sufficient warning to allow people who have invested in housing to switch to other investment types.

There are many different ways that households can invest. The problem with over-investment in housing is that it pushes up house prices and has large spillover effects making this essential good more expensive which then has large negative impacts on people's lives. If there was over-speculation in the share market causing shares to increase in price, this would not increase the financial stress of a large proportion of households.

The increase in house prices relative to income has had negative consequences beyond making it more difficult for aspiring households to buy their own home. As mortgage sizes have increased, households are taking longer to pay them back. This is shown in the proportion of households that have a mortgage. As figure 5 shows, households with a mortgage have increased from 30% of all households in 1994-95 to 37% in 2019-20. While households who own their home without a mortgage have decreased from 42% in 1994-95 to 30% in 2019-20.

Figure 5: Proportion of owner households with and without a mortgage 1994-95 to 2019-20



Source: Australian Bureau of Statistics (2022) *Housing Occupancy and Costs: 2019-20*, <https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/latest-release>

The result of this is that even households that manage to buy into the housing market are spending more of their incomes for longer periods of time paying off their mortgages. This reduces the amount they can spend on other things and increases the chances that they will be in financial stress. This is particularly concerning given it will inevitably mean a higher percentage of people each year will retire while still needing to repay a mortgage.

Macroprudential policies

Restricting negative gearing to newly built homes and scrapping the CGT discount will go a long way to reducing the distortions in housing market that have significantly reduced housing affordability, but the government has other levers that it can employ. It could use macroprudential policies to restrict finance for investment properties. This has been used in the past and has reduced investor demand for housing which then slowed house price growth.

In December 2014 the Australian Prudential Regulation Authority (APRA) announced a limit on the growth in investor lending of 10% annually. Demand for investor loans was seen as high by historic standards. APRA thought that high levels of investor lending was increasing risk and was concerned about the stability of the financial system. Other macroprudential measures related to improving the resilience of the financial market were also introduced.

The impact of these policies was initially limited. In April 2017, APRA went further introducing a limit on the share of interest only loans at 30% of new lending.

The limit was introduced in an environment of high housing prices, high and rising household indebtedness, subdued household income growth, historically low interest rates, and strong competitive pressures. APRA took the view that in this environment, the shares of interest-only lending were too high: they were elevated by both historical and international standards.⁹

The response from lenders was to increase the interest rates charged on investor loans, for both interest only (IO) and principal and interest (P&I). They also increased interest rates on owner-occupier IO loans. This meant an extra 50 basis points above owner-occupier P&I loans was charged on owner-occupier IO loans and investor P&I loans. An extra 100 basis points was charged on investor IO loans.

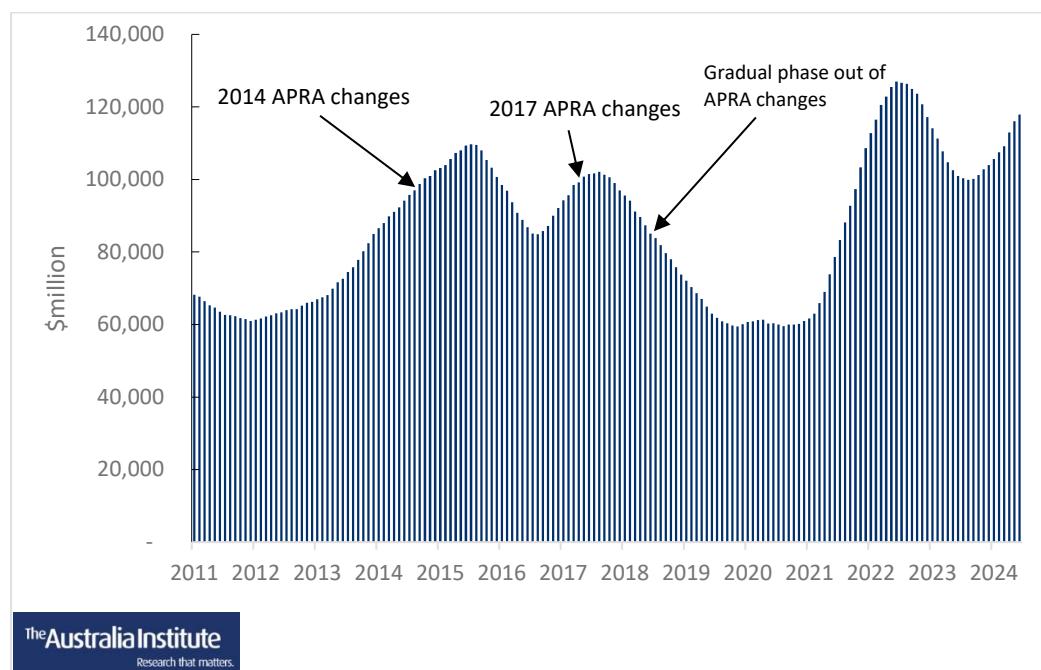
This was effective at limiting investor loans. It also slowed house price growth to the point where over the next two years house prices decreased. From June 2017 to June 2019 house prices fell 4.3%. This was one of the weakest two-year periods for house price growth for over 30 years.

As figure 6 shows APRA's initial December 2014 changes had some limited effect on investor lending, but by the middle of 2015 the amount of investor loans was rebounding. The stronger lenders response to the 2017 changes, which saw them increase interest rates on investor loans, was followed by a sustained fall in investor lending. This fall continued as the

⁹ Bank of International Settlement (2023) *Macroprudential policies to mitigate housing market risks: Country case study Australia*, CGFS Paper, no. 69, https://www.bis.org/publ/cgfs69_au.pdf

APRA changes were phased out on a case-by-case basis which began in April 2018. Investor loans did not start increasing until the beginning of 2021, after house prices started to rapidly increase in the second half of 2020.

Figure 6: Household investor loans for housing excluding refinancing, annualized (sum previous 12 months)



Source: Australian Bureau of Statistics (2024) *Lending indicators: July 2024, Table 13*, <https://www.abs.gov.au/statistics/economy/finance/lending-indicators/latest-release>

Macroprudential policies that increased the interest rate paid on investment loans can restrict investors, reducing demand for housing and the price of housing, but it is not as effective as reforms to negative gearing and the CGT discount. Investors are more likely to have significant resources and so will be better able to bypass bank investor lending restrictions, particularly in the longer run. Reforms to negative gearing and the CGT discount will be more effective at reducing investor demand for housing as they will make the returns from those investments less tax effective.

Ineffective housing affordability policies that increase demand

Policymakers have been discussing ways to make housing more affordable, particularly for first home buyers, for over 20 years. Over this period, housing, however, has become less affordable and housing affordability policies have been either ineffective or have made housing more expensive.

First-home buyer's grants have been some of the worst policies for making housing more affordable. Studies have shown that they have just increased house prices making housing less affordable for many people.¹⁰ The RBA has also noted that the Morrison Government's HomeBuilder program, which was part of the response to the pandemic, has also pushed up house prices in a very similar way to first home buyer's grants.¹¹ This is because these policies have increased demand for housing by increasing the amount that people can pay.

The Coalition has proposed a 'Super Home Buyers Scheme' in which people would be allowed to withdraw up to 40% of their superannuation savings up to a maximum of \$50,000 in order to buy a home. This policy would act in a similar way to the first home buyer's grants. First home buyer's grants were initially \$7,000 and were later doubled to \$14,000 and also tripled to \$21,000 for new homes.

HomeBuilder was even larger, giving up to \$25,000 for new builds or substantial renovations. The Super Home Buyers Scheme is much larger than even HomeBuilder, up to \$50,000. This means that the scheme is likely to have an even bigger impact on increasing house prices. The result will be that first-home buyers will have substantially reduced their superannuation accounts to buy houses that are even more expensive.

¹⁰ Blight et al (2012) *The first home buyers grant and house prices in Australia*, Deakin Papers on International Business Economics, <https://ojs.deakin.edu.au/index.php/dpibe/article/download/52/59/114#:~:text=Due%20to%20the%20combination%20of,in%20Australian%20by%20approximately%20%2457%2C321>

¹¹ Khadem (2022) *HomeBuilder and first home buyer grants made housing less affordable says Reserve Bank*, ABC News, 25 May, <https://www.abc.net.au/news/2022-05-25/homebuilder-first-home-buyer-grants-housing-affordability-rba/101097376>

Conclusion

A major cause of housing becoming more expensive has been the increase in demand from investors. This has been driven by the interaction between negative gearing and the CGT discount. These two tax concessions have made investment by households in housing very tax effective. Reducing this investor demand will make housing less expensive, making it easier for first home buyers to enter the market. This in turn will lift home ownership rates.

Policies that preference one group of home buyers by allowing them access to more funding will only increase the demand for housing and ultimately make housing more expensive. This will make the current housing crisis worse.

RECOMMENDATIONS

- Restrict negative gearing to newly built housing.
- The capital gains tax discount should be scrapped, and capital gains should be taxed like other types of income.
- Macroprudential policies should be explored to reduce households access to credit for buying residential investment property.
- The government should not pursue policies that preference one group of home buyers by allowing them access to more funding.