

About the author

I am a first home buyer who is currently looking for a home in the outer suburbs of Melbourne. Housing costs such as saving for a deposit and paying rent consumes about 70% of my income.

Summary

Investors are pushing first home buyers aside as they buy up the cheap housing stock that is usually purchased by first home buyers. The capping of negative gearing on residential property is proposed as a possible solution. ATO audits that target property investors are also suggested. The cost of state government taxes is refuted as a cause of the housing affordability crisis. The possible problems of making more land available for housing are discussed. Encouraging regional development is also advanced as a possible solution.

The problem of housing affordability

I am writing to discuss the possible causes and solutions to the current housing affordability crisis. Some might want to downplay the situation by avoiding the word “crisis” to describe the current situation. Let us not be picky about words here: it is a crisis because there are an increasing number of people performing valuable services in the community such as teachers, nurses and firefighters who can no longer afford to own a home in the community in which they live.

Are investors the cause?

Lending for housing is increasing, but the number of first home buyers is decreasing.

Naturally, we should ask the question: if first home buyers aren't buying homes, but more homes are being bought, then who are buying the homes? Examination of a sample of real estate advertisements at the low end of the market – the market that is the usual domain of first home buyers – reveals the probable buyers. Words like “investment opportunity”, “investors” and the like on about half of all advertisements for cheap housing suggest that investors are the cause of the current crisis. Real estate agents are smart people. They would not be using the word “invest” and its various grammatical derivatives in such abundance if there were few investors in the marketplace.

I feel that there are many investors compared to first home buyers in the current residential property because the share market has recently lost value, and investors have been seeking property as a sanctuary to reduce their losses. Investing in residential property has tax concessions for investors such as negative gearing, making it an attractive investment. This would attract investors in large numbers, and as the supply of cheap houses dries up, the prices must rise. Rising house prices have encouraged more investors to enter the marketplace, as the rise in home equity has tempted some people to borrow money against their home equity to purchase additional homes.

Many investors investing in residential real estate at the same time has caused an artificial scarcity in the residential real estate market and has driven up the prices of homes. This draws in more investors and drives up the prices further, causing the price of houses to spiral higher and higher. This mechanism has an alarming similarity to the rising of large masses of warm, moist air in tropical regions, which draws in more warm moist air and grows into a cyclone. Without some strong decisions being made at all levels of government, the spiralling housing market could cause damage to the Australian community as great as that caused by a cyclone.

Therefore, we should encourage the property investors to invest elsewhere.

Possible solutions that may cause problems

Some solutions have been advocated to help alleviate the housing affordability crisis, but some do little to fix the problem.

Reducing taxes

One solution that has been proposed is for the several state governments to lower stamp duty, mortgage duty and other similar taxes. This would provide some relief for all home buyers and would be welcomed by the community. However, it must be remembered that the rising taxes is the *effect* of rising house prices and not the cause, and thus cutting taxes would do little to make homes more affordable for first home buyers. Even if first home buyers received a 100% reduction in all state taxes when purchasing their first home, all these gains would be wiped out in just a few months as the prices rise further. Therefore, cutting taxes here will not have a great impact on house prices, but should be considered.

More land for housing

Another solution that has been proposed is for more land to be made available in the outer fringes for more homes to be built. This could be a bad idea if not done properly, because the price of this land would be inflated by the current high prices of real estate. If the residential real estate market crashes, we are likely to have many people in the uncomfortable position of having a negative equity in the home they live in – which means they owe more money to the banks than their home is worth. We must remember that property investors are creating a scarcity in the marketplace. Placing too much land on the market at the same time can increase the chances of a crash in the property market. More land does need to be made available, but care must be taken not to put too much on the market at once.

Possible solutions that may work

Capping negative gearing

The biggest cause of the problem with housing affordability is the attractiveness of the residential housing market to the investor. The negative gearing on residential property permits the investor to use the losses incurred to reduce their tax liability. Uncapped negative gearing on residential property can allow an investor to purchase and own many homes at once and claim large tax deductions.

Negative gearing also gives the investor an advantage over the owner-occupier because investment properties can be negatively geared but owner occupied properties cannot. It costs an investor much less to pay off an investment property than an owner-occupier would spend, both through the tax deductions and the rents that they earn. This is one of the causes of the growing wealth divide in the Australian community, with negative gearing providing a form of welfare for the rich.

Some have advocated the complete abolition of negative gearing on residential property as a solution to the housing affordability crisis. Experience shows that this is undesirable. When negative gearing was abolished some years ago, this caused rents to rise, and brought on a different housing affordability crisis. Negative gearing had to be reinstated.

I advocate a different solution to the problem posed by negative gearing. If negative gearing on residential properties was capped, then investors who own an excessive number of investment homes will be compelled to sell their excess properties. (The smart property investor will already be diversifying out of residential property, because interest rates are almost certain to rise soon, and the share market is no longer in decline.) A negative gearing cap on residential property of \$5,000 to \$10,000 per annum will allow investors to own one or two investment properties, but discourage them from owning too many. The cap should not be set at this level immediately, because this will hurt some investors. Imposing an initial higher cap and then progressively reducing it will give the investors with many properties ample time to sell the excess properties.

ATO audits

Another simple solution to the housing affordability crisis is to make residential property investors the target of taxation audits over two or three years. It is likely that many property investors are using negative gearing to minimise tax, and anyone that feels the need to minimise tax in this manner is someone that the Australian Taxation Office may need to scrutinise closely in an audit. This solution may not have a large effect on housing

affordability, but the fear of taxation audits may encourage some investors to look elsewhere when minimising tax.

Regional development

The housing affordability crisis is mostly a phenomenon seen in the capital cities. About half of Australia's population resides within 50 km of a capital city. Regional areas that are not close to a capital city often have very affordable housing. The reason why these are not seen as desirable is the perceived lack of employment opportunities in regional areas, and the difficulty of relocating there. If people could move to regional areas, and be assured of finding suitable employment upon their arrival there, then this will be an attractive option for many, and there will be less pressure on house prices in capital cities.

If regional development is to be encouraged, it cannot be done through Federal tax concessions on companies relocating to regional areas. Section 51(ii) of the Australian Constitution specifically forbids taxation that discriminates between states or parts of states. Therefore, any Federal initiative that is designed to encourage companies to move to regional areas must use other means to do so. A Referendum can also change Section 51(ii) of the Constitution. Such a Referendum is unlikely to be passed by the voters because Australian referenda historically have a low pass rate.

Conclusion

The solutions presented here are not the only solutions to the housing affordability crisis. They are also not necessarily the best ones. Other solutions may ultimately prove to be the best way of making housing affordable. However, any proposed solution to the current crisis that does not examine the effect of large numbers of property investors entering the market at the same time must be at best an incomplete solution. It is important to pay attention to the property investors. The property investors are responsible for driving the prices higher, more so in some places than others. We can cool the housing market down by making housing less attractive as an investment, but we must be careful lest we cause the housing market to crash.