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National Secretary
Bill Shorten

The Australian Workers' Union

Submission

Productivity Commission

Inquiry on First Home Ownership

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A. The Australian Workers' Union

The Australian Workers' Union, Australia's oldest general union, started in 1886 as the Amalgamated Shearers Union. Today, the AWU represents more than 130,000 members across Australia in a diverse range of industries. Our members build railways, work in underground mines, they mill paper and they asphalt roads. They also farm fish and grow tobacco. Some of the major industries in which our members work include: pastoral and agricultural, aluminium, aviation, oil and gas, mining, construction and steel.

The AWU is the largest union outside metropolitan Australia.

B. Social Benefits of Owner Occupied and Investment Housing

The AWU believes that enormous social benefit is derived from the ownership of housing, and in particular owner occupied housing. These social benefits include increased family and community stability, a feeling of belonging to a community (and increased community involvement) as well as other intangible benefits such as personal satisfaction and a sense of achievement. In addition, financial benefits accrue to owner occupiers – owning a home can significantly reduce costs in retirement, or alternatively homes can act as a store of household wealth.

The AWU also believes that there are social benefits derived from investment housing - in particular investment helps ensure an adequate supply of rental housing for those unable or unwilling to purchase their own homes. Property investment also accrues significant personal financial benefit.

It is the view of the AWU that, while both investment and owner occupied home ownership is beneficial to society, owner occupied housing results in greater levels of public benefit. Consequently, the AWU believes that, while investment in residential housing is important, every effort should be made to afford people the opportunity to buy their own home. Crucial to this is ensuring that homes remain affordable for first home buyers.

C. The Scope of the AWU's Submission

The AWU notes the Productivity Commission has received a number of submissions comprehensively dealing with the extent and likely causes of the significant rise in property prices in recent years. The AWU does not intend to revisit these issues in detail. Instead the AWU's submission will focus on what it perceives to be the

imbalance between investors and owner occupiers (and in particular first home buyers) competing to purchase property, and possible solutions to address these problems.

D. Brief Reasons for Growth in Residential Property Prices

In brief terms, the AWU is of the view that the factors largely responsible for increasing housing prices are:

- record high levels of investment in residential property driven by market enthusiasm, income tax benefits and favourable capital gains tax treatment;
- historically low interest rates;
- the growth in household income, and in particularly growth in household incomes driven by an increasing number of 2 income households; and
- the decision by some home buyers, particularly in Sydney, to increase the proportion of income they devote to housing consumption.

The AWU is of the view that some recent price growth has been driven by dangerous property speculation. In this respect, certain methods of property investment advocated by some property investment ‘gurus’ and the rise in the use of deposit bonds have fuelled this unsustainable speculation.

E. Imbalance Between Investors and Owner Occupiers

As noted in the Productivity Commission’s Issues Paper, government assistance to home buyers falls into two general categories – assistance designed to address accessibility issues, and assistance designed to increase housing affordability.

At present, owner occupiers face significant competitive disadvantages when competing against investors for property due to the differing nature of subsidies offered to different classes of home buyers.

Government assistance (both at a state and federal level) to owner occupiers (and in particular first home buyers) is targeted at resolving accessibility issues. The first home owners grant of \$7000 and various state government stamp duty concessions are examples of such assistance. While such assistance obviously helps first home buyers accumulate enough capital to be able to meet the initial costs of home ownership, it does not impact on the ongoing affordability of buying a home. Owner occupiers are required to fully meet the costs of purchasing and maintaining their property.

In contrast, investors receive little or no accessibility assistance from governments. There is a clear policy rationale for this - investors rarely require such assistance as they have accumulated capital that can be used to meet initial costs for investment property. However, property investors receive significant affordability subsidies from the government – particularly through negative gearing. Negative gearing gives investors a tax deduction where the income derived from a property is less than the expenses incurred in owning that property – and means that, for any given property (capable of being negatively geared) it will be relatively less expensive for an investor to own that property than an owner occupier.

It is the view of the AWU that this problem has been exacerbated by the government's decision to halve capital gains tax payable on assets held for more than one year. This has further increased the potential after-tax return that investors will receive for holding an investment property, and consequently these anticipated higher returns provide further incentive to investors to pay even higher prices for property.

F. A Special Disadvantage Facing First Home Buyers

In addition to the general competitive disadvantage facing owner occupiers outlined above, many first home buyers face additional disadvantage. In particular, many first home buyers, or potential first home buyers, are young and many have accrued large financial debts, in the form of HECS debts or bank loans as a result of a period of study. Given the rapidly increasing size of HECS debts, many university graduates will be burdened with repayments for a significant proportion of their lives. This in turn impacts of these people's ability to save to pay the entry costs of home ownership. In addition, the ongoing costs associated with servicing a HECS debt decreases their ability to service home loan repayments and other costs of home ownership.

G. Special Disadvantages Facing Persons in Non-traditional Employment

Increasing levels of casual and non-traditional employment have also adversely impact on the ability of people to enter the housing market. The ACTU estimates that over 25% of employees are now employed on a casual basis.

This casualisation of the work force has impacted on first home buyers in two major ways:

- Casual employees are disadvantaged when seeking a bank loan to buy a home as most lending institutions require a person to be in stable, and preferably permanent full-time, employment in order qualify for a home loan; and
- casual employees, particularly those who are underemployed, often do not earn enough to either save for the initial costs associated with home ownership, or to meet the ongoing costs of home ownership.

In this respect, the AWU advocates measures designed to decrease the casualisation of the workforce, and in particular advocates the right of long-term casuals to convert their employment into permanent full-time or part-time work after certain periods of regular casual employment.

H. Mechanisms To Assist First Home Buyers

As noted above, government assistance for home buyers fall into two categories – assistance designed to address affordability, and assistance designed to address accessibility issues. It is the AWU's view that, while assistance to first home buyers that helps to address accessibility issues is important to assist home buyers, assistance aimed at improving home affordability, is, in the long run, far more valuable.

1. Affordability Measures

The preferable solution to the current difficulties facing purchasers of owner occupied housing, and in particular first home buyers, would be to give them access to the same, or similar, affordability assistance that is currently available to investment property owners.

1.1 Tax Deductibility of Interest Paid by First Home Buyers

As noted above, major concessions are given to investment property buyers in the form of tax deductibility of interest payments and other property costs. Allowing owner occupiers to claim a tax deduction for all or part of their interest payments with respect to an owner occupied dwelling would help remove the competitive advantage currently enjoyed by property investors. However, the AWU notes that allowing all owner occupiers to deduct the entire interest cost of their home would be extremely costly, and could not be met from current revenues.

A less costly alternative would be to allow deductibility of a proportion of the interest costs associated with repaying the loan on an owner occupied property. For social equity reasons it would be prudent to impose a cap on the maximum deduction that could be claimed under such a scheme. A reasonable cap would probably be in the region of \$10,000 per year, although could also be set with reference to prevailing interest rates and median house prices. However, such a broad based scheme, even if only allowing a limited tax deduction, would still be extremely costly.

A more realistic alternative to a blanket scheme of home interest deductibility would be to limit deductibility of interest to first home buyers, and limit the duration of the tax deductibility of interest to a period of 5 years. A similar scheme has commenced in operation in Hong Kong. There individuals can claim a tax deduction of up to HK\$150,000 per year (approximately AUD\$27,500) for up to 5 years with respect to an owner occupied dwelling.¹

The cost of such a proposal would be far less significant than any broad based scheme. If limited to first home buyers with a maximum potential deduction of \$10,000 per year for a maximum of 5 years, the likely cost next financial year would be approximately \$300 million.² This cost would rise to a cost of approximately \$1.5 billion per year in 5 years (as more first home buyers became eligible for the assistance), before costs stabilised.

The major benefit of such a scheme is clear - unlike the FHOG, it would actually address home affordability issues in the first, and highest cost, years of home ownership.

¹ The Hong Kong scheme differs slightly in that a person may claim the tax deduction once in their lifetime, rather than specifically with respect to their first home. Further, with its low rate of personal income tax (with a maximum marginal rate of 17%), the maximum subsidy for owner occupiers in Hong Kong is approximately AUD\$4675 per year (which is approximately the same maximum subsidy that would be achieved in Australia by allowing a \$10,000 deduction).

² Based on Budget estimates of the number of people likely to be eligible to receive the FHOG in 2003/04, a maximum deduction of \$10,000 per year and the assumption that, on average, recipients have a marginal tax rate of 30 cents per dollar.

2. Accessibility Measures

An alternative to implementing new affordability measures would be to provide additional accessibility assistance to owner occupiers, and first home buyers in particular. While the AWU believes that preference should be given to improving affordability assistance available to first home buyers, increased accessibility assistance could also counterbalance the affordability subsidies given to investors.

2.1 Tax Free Savings Vehicles

A method of facilitating saving for home investment could be to implement tax-free medium term savings vehicles. A model for such savings vehicles can be found in the Individual Savings Accounts (ISAs) operating in the United Kingdom. Essentially, ISAs are investment wrap accounts allowing people to invest in cash, shares and certain insurance related investments, up to a maximum of 7000 pounds per year. All earnings and capital gains earned in these accounts are tax free. In the UK, ISAs are not used to save to specific purposes, and therefore could be adopted in Australia as a general purpose savings vehicle (where the savings can be used for any purpose). Alternatively, such a model could be used to develop a specific purpose savings vehicle and penalties could apply unless the savings are used for a specific purpose, such as meeting the initial costs associated with purchasing an owner occupied home.

Such a savings vehicle could be implemented in Australia to facilitate first home buyers in saving for the initial costs of buying a home. In the Australian context, allowing an annual maximum investment of \$15,000 - \$20,000 per year in such a tax free environment could greatly assist first home buyers in achieving the goal of home ownership.

An example of the benefits that could be achieved using ISAs is as follows:

	Person 1	Person 2
Annual Income	\$50000	\$80000
Annual Contribution	\$10000	
Savings period	5 years	
Annual Return	7% pa	
Total savings in ISA after 5 years	\$61,532	
Estimated total savings after 5 years if saved outside ISA	\$57,848	\$55,848
Net benefit	\$3684	\$5684

The financial benefits accruing from such a scheme would obviously increase if a longer savings period was used, or if contributions or the annual return were higher. Another intangible benefit of ISAs, if specifically targeted at first home buyers, is that their tax free status may encourage buyers to save higher initial deposits, thereby reducing the leverage of these households (and consequently reducing the level of financial stress faced by first home buyers).

2.2 Altering the FHOG to Operate More Equitably

Another alternative could be to distribute the current first home owners grant on a more equitable basis. At present, people with high incomes are eligible for the FHOG, as are those purchasing very expensive property – and in some cases the FHOG is used to acquire properties worth in excess of \$1 million. A government subsidy of \$7000 to such purchasers is clearly poorly targeted.

Instead it would be preferable to restrict the FHOG to first home buyers buying a property less than a certain value (for example \$500,000) and simultaneously increase the amount of the grant paid to lower income earners. For low income earners, it may be appropriate to provide a much larger grant (say \$15,000). Those with higher incomes should be eligible for a smaller grant (say \$5,000), provided they acquire a property worth less than \$500,000. It would be possible to alter the distribution of the FHOG so that any change does not impose additional costs to government.

Such changes to the FHOG would ensure that assistance is appropriately targeted, and is distributed on a more socially equitable basis.

3. Negative Gearing

A final alternative would be to alter the current system of negative gearing to reduce the level of competitive advantage given to investors in relation to property acquisition. It must be noted that the AWU does not advocate the abolition of negative gearing, in particular because of the role it plays in ensuring an adequate supply of rental property. However, alterations could be made to the current system that would ensure that its social goals are achieved, while also reducing the cost to taxpayers.

3.1 Quarantining Property Losses

One possible method of decreasing the competitive advantage of investors in the property market would be to quarantine losses associated with property ownership and only allowing those losses to be offset against other (or future) property income or capital gains.

At present, investment in property is largely driven by taxation benefits rather than because of the soundness of the underlying investment. Removing short-term tax advantages would encourage more rational investment. In addition, it would require investors to consider more carefully investments they make in property at prices that, but for the tax benefits, are marginal investments.

3.2 Limiting Tax Rebate to 24.25% of Losses

Capital gains on investment property are (for property owned longer than one year) taxed at a maximum of 24.25 cents per dollar of gain. In contrast, by using negative gearing, top income earners are able to receive a tax benefit of 48.5 cents in the dollar for on-going losses.

From a policy perspective it is difficult to understand why taxpayers should subsidise the on-going costs of property investment, as well as forego tax revenue on the capital gains on the property they have subsidised.

If concessional capital gains tax continues in existence, then it may be appropriate to similarly limit the tax benefit associated with negative gearing losses to a maximum of 24.25 cents per dollar of loss.

3.3 Maximum Deduction/Income Cap for Negative Gearing

A final alternative would be to leave negative gearing unaltered, but to impose a cap on the maximum tax deduction claimable per year with respect to negative gearing. Alternatively, it would be possible to only allow tax deductions for persons with incomes below a certain threshold. In this respect the AWU would propose only allowing negative gearing deductions for people with annual incomes less than \$120,000 per annum.

As with the reforms suggested above, such a reform may help shift investors' focus from the tax benefits associated with a particular investment, to the actual viability of the investment in question.

I. Conclusion

The AWU believes that the assistance currently given to first home buyers in relation to housing accessibility is positive, and should remain in place and possibly be further enhanced. However, additional reform is needed so that the competitive advantage presently given to investors in the form of negative gearing is balanced.

As noted above this achieved by either:

- increasing affordability assistance available to owner occupiers through subsidies in the tax system; or
- reducing the focus of investors on the immediate tax advantages they can receive through negative gearing, and instead require them to examine more closely the reasonableness of the prices paid for property investments.

The AWU is hopeful that the recommendations arising from this inquiry will be of positive assistance to our members and to all Australians generally.

Bill Shorten
National Secretary
Australian Workers' Union