SUBMISSION BY THE

Housing Industry Association

to the

Financial Services Inquiry

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HIA:

Graham Wolfe
Chief Executive, Industry Policy & Media
Housing Industry Association
79 Constitution Ave
Campbell ACT 2600
Phone: 02 6245 1361
Email: g.wolfe@hia.com.au

Harley Dale
Chief Economist
Housing Industry Association
79 Constitution Avenue,
Campbell ACT 2600
Phone: 02 6245 1329
Email: h.dale@hia.com.au

HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 40,000 builders, trade contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.

1. Introduction

The Housing Industry Association (HIA) welcomes this opportunity to respond to the Financial System Inquiry Interim Report ('the Report').

HIA notes the Report's observations around funding, particularly with respect to housing and the associated systemic risks. Our submission provides a response to these observations, to related observations on the tax system as well as the use of macroprudential tools. In particular, our submission highlights the implications of these policies for housing affordability and activity in the residential construction sector.

Australia's residential construction sector is constrained in numerous ways in its ability to adequately house the country's growing population. The Report correctly observes that new dwelling construction has not been sufficient to meet population growth over the past decade. Looking ahead, HIA finds that, on quite conservative estimates, Australia's needs to be building around 186,400 dwelling per annum to adequately house a modestly growing population. While housing starts are expected to peak at around 185,000 dwellings in 2014, having recovered from recessionary lows, the average number dwelling starts in the past decade is around 158,000 dwellings. The unique interdependence between the financial system and the new home building industry means that the changes stemming from this Inquiry on the industry will be significant.

2. Funding – housing and the financial system

HIA notes that the Report, in assessing housing as a savings vehicle, observed that relative to other savings vehicles, housing is very attractive due to its tax preferential treatment:

Households' appetite for housing debt also reflects the favourable treatment that the tax and transfer system applies to housing. [2-52]

Assessing housing from a different angle, however, shows the heavy tax burden on this sector. Independent research commissioned by HIA, however, shows that in absolute terms, housing is the second largest contributor of tax to Australian governments. Furthermore, this tax burden falls heavily on home buyers. For example, when all taxes, charges and delays are accounted for, the taxation on a new house in Sydney is an estimated 44 per cent of the purchase price. For Melbourne the figure is 38 per cent and for Brisbane the figure is 36 per cent.

Many of these taxes levied on new housing are highly inefficient, a situation acknowledged by the Henry Tax Review. More than half of the taxes falling on housing can be considered as inefficient. These taxes primarily exist at state government level, although there are a number of inefficient taxes at local government level as well. The most prominent of these taxes include stamp duty. The Henry Review identifies stamp duty as a key source of inefficiency in the consumption of housing services; stamp duty discourages people to relocate to homes that are best suited to their needs as well as discouraging the development of new housing stock, given that they are paid up to three times in the supply chain of new housing.

HIA notes the Report's particular comments regarding the role of investors in housing and the financial system:

The tax treatment of investor housing, in particular, tends to encourage leveraged and speculative investment in housing. Investors are attracted by the asymmetry in the tax treatment of expenses and capital gains on investor housing. Investors can reduce their tax liabilities by deducting borrowing costs and other related expenses against total income at the individual's full marginal tax rate. However, nominal capital gains, when realised are effectively taxed at half the marginal rate [2-53].

HIA, however, notes that the negative gearing incentive that is applied to property and other investment vehicles has two major benefits. First, negative gearing lowers the cost of supply to the rental market, something which is of most benefit to lower income households. Second, negative gearing ensures that the rate of new home building is higher and thereby helps alleviate Australia's housing shortfall.

Overall, taxes on housing represent significant barriers which constrain the responsiveness of housing supply to steady increases in underlying demand. Changes that will increase the tax burden on housing will act as a further constraint on the efficient operation of the housing sector. While tax is indeed an issue for the coming tax white paper as well as the federation white paper, the overall tax burden on housing, new housing in particular, is excessive and a major barrier to the supply of new housing to meet rising demand

3. Macroprudential toolkits

HIA notes the Report's observation that:

A number of jurisdictions have implemented new macroprudential toolkits to assist with managing systemic risks. The effectiveness of these for a country like Australia is not yet well established, and there are significant practical difficulties in using such tools [3-24].

One example of a macroprudential tool is that which has applied in New Zealand since October 2013. Then, the Reserve Bank of New Zealand (RBNZ) introduced temporary restrictions on residential mortgage lending. Banks were required to limit high LVR lending to no more than 10 per cent of total new residential lending. However, in March 2014, the RBNZ began an interest rate tightening cycle. It is therefore difficult to disentangle the effects on conditions in New Zealand's housing market resulting from the use of the macroprudential tool compared with monetary policy.

Another example of a macroprudential tool is one which requires lenders to stress test potential mortgage borrowers, in order to establish their capacity to withstand interest rate increases of several percentage points. The efficacy of such a policy is not substantiated by any evidence.

Regarding macroprudential tools in general, HIA notes that by their nature, they tend to have a disproportionately negative impact on younger borrowers and this actually harms housing affordability and have access to home ownership for this segment of the market.