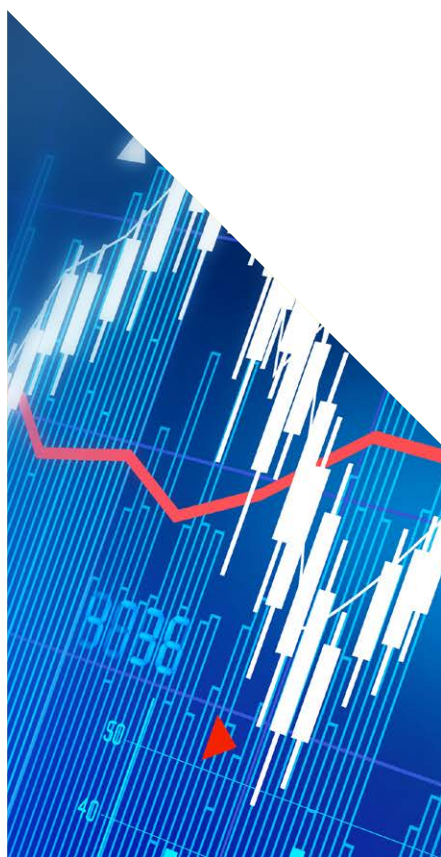




MASTER BUILDERS
A U S T R A L I A

CHANGING THE TAXATION REGIME

for investors in the property market



c|e



Denita Wawn

Chief Executive Officer, Master Builders Australia

Foreword

Home ownership is a cornerstone of Australian life and prosperity.

The housing sector provides shelter for Australians to raise their families, while home ownership is the single biggest contributor to the wealth of lower and middle income households.

The construction industry has also been a critical source of jobs and growth. It is the second largest industry in Australia and provides jobs for more than 1.1 million skilled workers. Around 1 in every 11 people work in the construction industry.

But while owning your own home remains a fundamental aspiration it is becoming increasingly difficult to achieve. For more than a decade Master Builders has been the leading voice lobbying successive federal governments to increase housing supply, with a focus on affordability and home ownership for all Australians.

This is why it is crucial that we get the property tax settings right.

Most importantly, we need a tax system that works to complement other government programs and helps to boost new housing supply and homeownership.

This research shows that policies which propose to limit negative gearing and reduce the Capital Gains Tax discount on property will reduce new housing supply and jobs in the construction industry.

Tax reform is important and if done right can yield big benefits for the community and the construction industry. But getting these tax settings wrong is a risk to jobs, a risk to the wealth of ordinary Australians and could present a greater risk to the financial system.

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Executive Summary

It is the policy of the Australian Labor Party (ALP) to limit negative gearing to investments in new housing and to halve the capital gains tax (CGT) discount to 25 percent for all properties.

It is claimed by the ALP that these measures will increase the housing supply by providing an impetus to invest in new stock and create new jobs in the building industry.

Master Builders Australia commissioned independent economic modelling by Cadence Economics to test these assertions. The results provide estimates on the impact of these proposed policy changes on activity, new housing starts and jobs in the building and construction industry.

The modelling shows in the five years following the implementation of the ALP policies:

- The construction of new housing is expected fall by between 10,000 and 42,000 dwellings;
- there will be between 7,500 and 32,000 fewer jobs in the building industry;
- a reduction of between \$2.8 billion and \$11.8 billion in the value of residential building activity, largely as a result of less new housing being built; and
- a \$50 million to \$210 million reduction in renovation activity over a five year period.

The ALP claims that these measures will increase housing supply by providing an impetus to invest in new stock. The impact is greater in larger housing markets, but for markets like Perth and Darwin, where new housing construction activity is already struggling, it is likely to further depress activity. It may also extend the time it takes for these markets to recover.

Introduction

This work examines the impact of changes to property taxation on construction activity and jobs in the construction industry.

The ALP has suggested that this policy could boost new housing supply.

It has been reported that the ALP policy will create up to 25,000 new construction jobs, in reference to a paper published by the McKell Institute.¹

“Our new economic policy will encourage the building of thousands of new homes every year and increasing housing supply, it will help lower costs for renters and it will return the Commonwealth budget to a sustainable foundation”.²

The ALP has said when questioned on these policies that, “by encouraging investors to move into new housing if they want to continue negatively gearing... we get a boost in housing supply”.³

These comments are based on an assumption that more favorable tax arrangements for new dwellings compared to existing dwellings will shift investor activity into new dwellings.

There is little by way of detailed analysis of the proposed ALP policy in the public domain, although some related analysis can be found in:

- Hot property: negative gearing and capital gains tax reform published by the Grattan Institute in 2016.⁴
- Economic Impact of Limiting the Tax Deductibility of Negatively Geared Residential Investment Properties published by BIS Shrapnel in March 2016.⁵

While each of these papers considers certain elements of the proposed ALP policy, it is unclear what the overall economic impacts will be.

- In terms of new dwelling construction, the BIS Shrapnel analysis (which did not consider changes to CGT) concluded that the impacts would be large, while the Grattan Institute paper concluded that the impacts would be negligible.
- What is known is that the policy will raise the effective tax rate on all types of investment housing. Those investing in existing homes will face higher increases in taxes than those investing in new homes as they will lose both negative gearing provisions and face a halving of the CGT discount. But those investing in new homes will experience a halving of the CGT discount.

To test the assumptions made by the ALP – that their proposed changes to negative gearing and CGT will boost housing supply and employment – Master Builders commissioned research firm Cadence Economics to look into the impacts of these policies on the construction sector. In sum this research has found that:

- New housing construction and construction employment is projected to fall in all states/territories as a result of the ALP’s proposed property tax changes; and
- The impact is greater in larger housing markets, but for markets like Perth and Darwin where new housing construction activity is already struggling, it is likely to further depress activity. It may also extend the time it takes for these markets to recover.

1 <https://mckellinstitute.org.au/app/uploads/The-McKell-Institute-Switching-Gears-Addendum-II.pdf>

2 <http://www.abc.net.au/news/2016-02-13/bill-shorten-negative-gearing-capital-gains-tax-plans/7165462>

3 http://www.andrewleigh.com/a_fair_fix_for_housing_affordability_abc_774_drive

4 Daley, J., Wood, D., and Parsonage, H. 2016, Hot property: negative gearing and capital gains tax reform, Grattan Institute (referred to in this paper as Grattan Institute (2016)).

5 BIS Shrapnel 2016, Economic Impact of Limiting the Tax Deductibility of Negatively Geared Residential Investment Properties.

Methodology

This research applies the same kind of modelling technique (Computable General Equilibrium – CGE modelling) that was used in the Henry Review.

The research establishes a plausible range of outcomes that might result from the proposed tax changes for housing investors. These outcomes are derived from scenario analysis of the marginal tax burden of the ALP property tax policy changes.

At the lower end, we adopt the tax burden from land tax as estimated in the Henry Tax Review, calculated at 8 cents per dollar raised. This provides a lower bound for the estimated policy impact on the construction industry.

This is broadly consistent with the position taken by the Grattan Institute in terms of the overall impacts of changing the taxation regime for investors in the housing market.

At the upper end, we adopt the estimated tax burden for Conveyancing stamp duties, calculated at 34 cents per dollar raised. This provides an upper bound for the estimated policy impact on the construction industry.

These tax burdens are then applied to estimate the relative change to residential construction activity, new housing starts, and employment across each major housing market in Australia.

The level of tax raised by the policy change is calibrated to the findings of the Grattan Institute (2016). It suggests that the changes will raise \$1.5 billion owing to changes to capital gains, and \$2 billion owing to changes to limit negative gearing.⁶

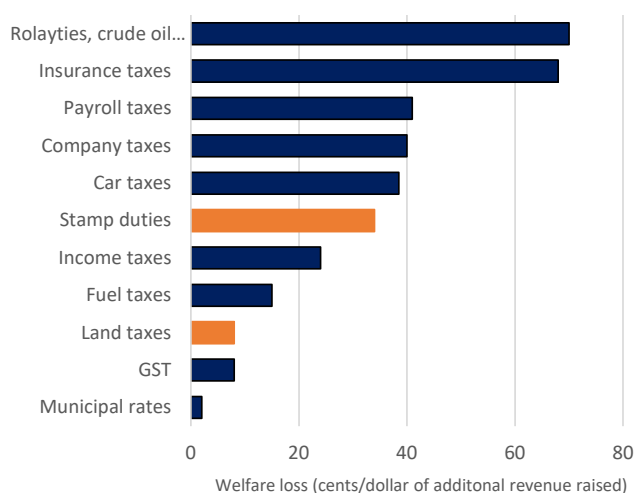
The modelling does not account for the grandfathering of existing arrangements, and the impact this would have on the housing investor market – as noted by Shadow Assistant Treasurer Andrew Leigh.⁷

Given that ‘grandfathering’ will only apply to existing arrangements, it should not change the outcomes of the modelling on new dwelling construction and construction employment.

This research does not estimate the impact of the ALP policies on house prices or the cost of rents. It also does not attempt to make assertions around behavioral effects or the flow of investment as a result of possible distortions coming from the ALP policies, particularly to limit negative gearing to new housing developments.

This research deliberately excludes price impacts in the housing market so as to focus on the outcomes for the construction sector in terms of the level of activity and jobs growth. In doing so, it tests the assertions directly made by the ALP that their policy will boost new housing supply and jobs.

Chart 1: Marginal welfare loss from a small increase in selected Australian taxes



Source: Henry Tax Review (2010)

⁶ Daley, J., Wood, D., and Parsonage, H. 2016, Hot property: negative gearing and capital gains tax reform, Grattan Institute (referred to in this paper as Grattan Institute (2016)).

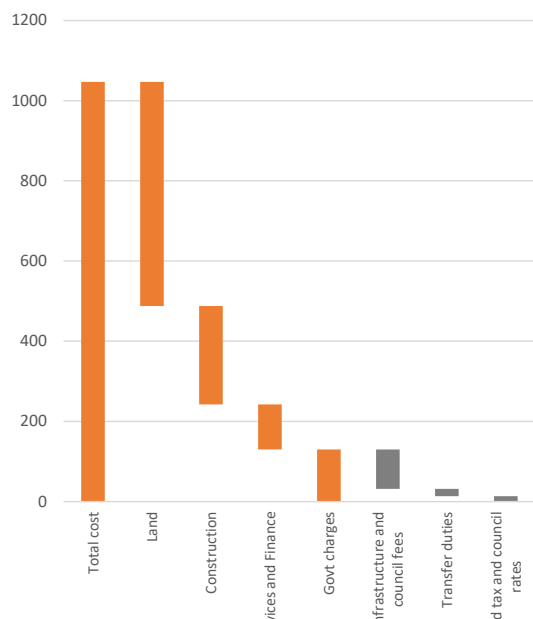
⁷ http://www.andrewleigh.com/a_fair_fix_for_housing_affordability_abc_774_drive

What We Know

Master Builders' long held position is that the first step to fixing housing affordability is to boost supply. This research clearly shows that the ALP policies to limit negative gearing and reduce the capital gains discount will not boost new housing supply and will likely cost jobs in the construction industry.

We know that planning and zoning restrictions and other embedded costs in the price of land can add up to 40 per cent to the cost of building a new house. The price of land has grown 3.6 times faster than construction costs. If the aim is to improve housing affordability then policies which aim to reduce regulatory costs and the price of land would have a much greater impact than tax policies and would encourage greater investment in new supply.

Chart 2: Development inputs costs (\$'000), Sydney greenfield development



Source: Master Builders, *Unlocking Supply Volume 2* (2017)

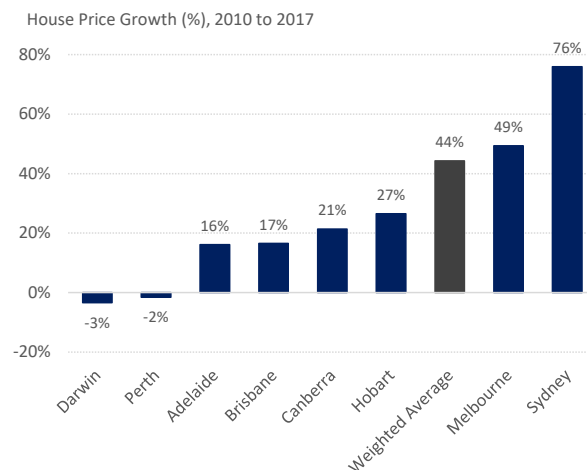
We know that a housing shortage has put upward pressure on the price of housing in recent years and the industry is only now starting to catch up.

“Dwelling construction fell short by 165,000 over the last decade, causing house prices to be higher than they need to be.” (Unlocking Supply Volume 2, 2017)

We know that some housing markets outside of Sydney and Melbourne are at very different stages in their construction cycles. Some regional

markets are in decline and have a shortage of rental properties. Australia's housing market is a very diverse one, housing tax settings must be equitable across different regions at different stages of the housing cycle.

Chart 3: Average house price growth, Capital Cities, 2010 to 2017



Source: ABS, Master Builders

We know that if the proposed changes to tax policies lead to lower supply then housing affordability might get worse not better and could act to counter the objective of boosting homeownership, particularly for first home buyers.

In a market facing supply constraints, these reforms could place further pressure on the availability of affordable rental accommodation within the private rental market.” (Henry Review, 2010)

There is also evidence to draw from which shows rental prices increased as a result of removing negative gearing from property investments last time attempts were made to reform negative gearing on residential property. This is not to say the same thing would happen as a result of the ALP policy changes. But it does suggest there is a possibility that limiting negative gearing and reducing the CGT discount could add to housing costs and put another roadblock in front of potential first home buyers.

“Changing or removing negative gearing rules from property investments, presents a greater risk to Australia's financial stability and the stability of the housing market” (RBA, 2012).

Results

At the national level the implementation of this policy reform is likely to lead to a reduction in construction activity and lower employment across all major housing markets in Australia.

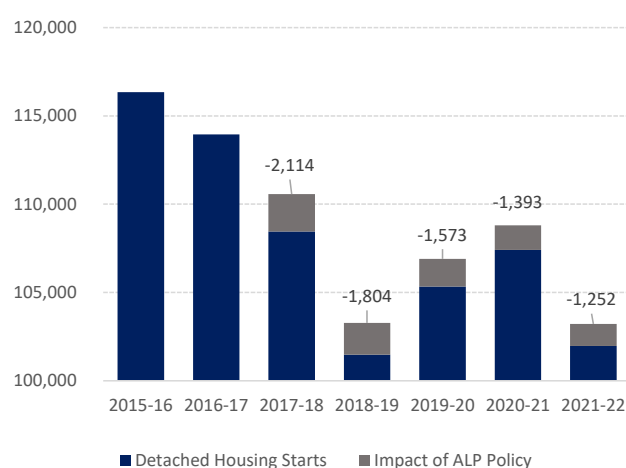
The results are presented as a deviation from the baseline or “business as usual” in absolute terms. The baseline is derived from Master Builders National Forecasts for Building and Construction.⁸

Changes to limit negative gearing to new dwellings and reduce the CGT discount to 25% are estimated over the next five years to reduce new dwelling starts by between 10,000 and 42,000.

- Between 2,000 and 8,000 fewer housing starts, and
- between 8,000 and 34,000 fewer apartment starts.

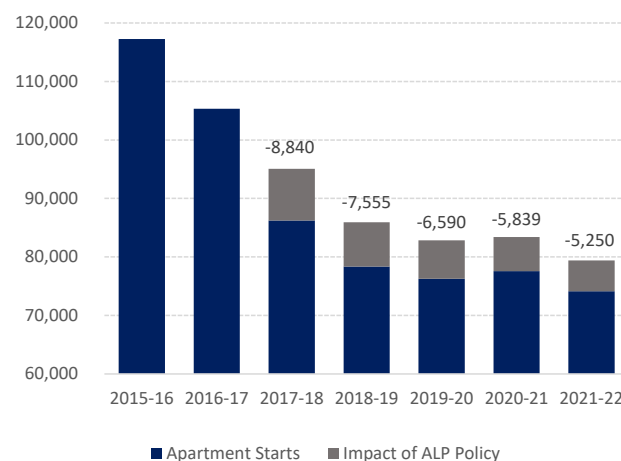
The value of residential construction activity is estimated to be between \$2.8 billion and \$11.8 billion lower over the five years following implementation of the ALP policy. Most of this due to a fall in the number of new houses to be built. However, renovations activity is also estimated to be lower by between \$50 million and \$210 million over five years.

Chart 4: Impact of ALP policy on new detached housing starts



Source: Cadence Economics, MBA

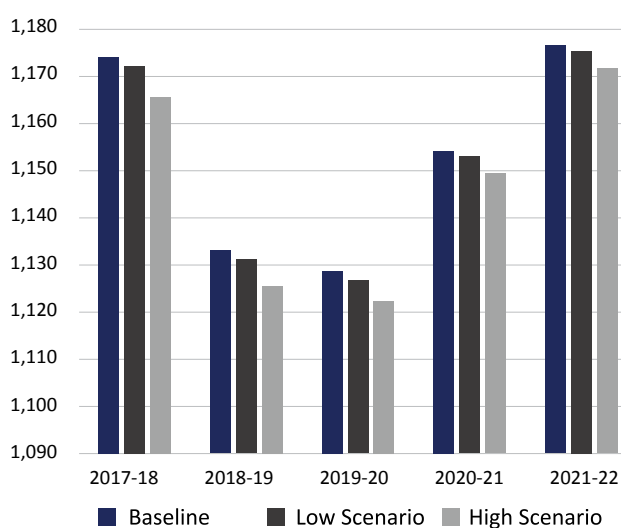
Chart 5: Impact of ALP policy on new apartment starts



Source: Cadence Economics, MBA

Jobs growth is expected to be between 7,500 and 32,000 lower over five years depending on the effective tax burden of the ALP policy. Importantly, the modelling shows that employment in the construction industry, which has been a key driver of skilled jobs growth in the last 12 months, is projected to be lower in all major housing markets over the five years following implementation of the ALP policy.

Chart 6: Total construction employment 2017-18 to 2021-22



Source: Cadence Economics, MBA

⁸ Master Builders National Forecasts for Building and Construction, December 2017

Broken down by state, Table 1 below shows where activity is likely to fall most under the assumptions of the upper bound scenario.⁹ For example, in the first year following the implementation of the ALP's tax changes, output in the residential construction industry is expected to be \$1.399 billion lower in NSW than if the tax settings remained unchanged. This is equivalent to a fall of around 6 per cent on the total value of work done in the residential sector in NSW in 2017.

A detailed breakdown of the expected fall in residential construction activity in each state and across each scenario is provided in the Appendix.

Table 1: Projected construction output impacts under the Less efficient scenario, \$m[^]

Region	Year 1	Year 2	Year 3	Year 4	Year 5
NSW	-1,399	-1,163	-989	-857	-756
VIC	-728	-620	-539	-475	-425
QLD	-539	-455	-395	-348	-312
Rest of Australia	-384	-367	-349	-333	-317
National	-3,049	-2,605	-2,272	-2,014	-1,812

Source: Cadence Economics. [^] Real 2017 dollars (figures may not add due to rounding)

Table 2 shows the expected fall in construction employment by state under the Less efficient scenario. For example, in the first year following the implementation of the ALP's tax changes, employment in the construction industry in NSW is estimated to be 3,603 jobs lower than it would otherwise have been if the tax policy setting remained unchanged.

Table 2: Projected total employment impacts under the Less efficient scenario, FTE

Region	Year 1	Year 2	Year 3	Year 4	Year 5
NSW	-3,603	-2,963	-2,502	-2,155	-1,890
VIC	-2,064	-1,737	-1,495	-1,308	-1,162
QLD	-1,681	-1,401	-1,202	-1,053	-938
Rest of Australia	-1,088	-1,009	-938	-875	-818
National	-8,436	-7,110	-6,136	-5,390	-4,807

Source: Cadence Economics. Figures may not add due to rounding

The results show that getting these tax settings wrong is likely to have a very significant negative impact on the housing construction industry.

The ALP policy is not likely to boost housing supply or jobs in the residential construction industry. On the contrary, new housing construction activity, new housing supply, and new jobs are all expected to be lower over the five years following the implementation of the policy.

⁹ The results therefore show what the impact on construction output will be if the tax burden of negative gearing and CGT changes are similar to that for Conveyancing Stamp Duties.



Conclusion

Since Labor announced its property tax policy over three years ago, we have seen a boost in new housing supply which, combined with a tightening of regulatory constraints on domestic and overseas investors, has taken the heat out of the housing market.

House prices in Sydney have begun to fall and house price growth in Melbourne has moderated considerably.

It's important that tax settings are not targeted at addressing particular points in the housing cycle, such as the peak, because this risks exaggerating issues at other stages in the housing cycle.

Master Builders' long-held policy position is that removing supply constraints is the critical first step to building a fairer, more equitable, and more sustainable housing sector. A number of these constraints, such as costs associated with planning and zoning inefficiencies, still need to be addressed.

The modelling in this report shows that limiting negative gearing to new homes and reducing the CGT discount to 25 per cent will reduce new

supply at a time when the construction cycle has already turned. The ALP policy is a risk to the property industry and will exacerbate the downturn. New dwelling construction is forecast to fall in every major housing market as a result of the ALP policy.

Importantly it shows construction employment and new housing starts are estimated to be lower in all major housing markets in Australia as a result of the implementation of these proposed tax policies. This means few opportunities for new home buyers to enter the market and fewer job opportunities for skilled tradespeople and apprentices in the construction industry.

"A range of other policies are likely to have a more significant impact on housing supply than tax settings. The tax system is unlikely to be an effective instrument to move housing prices toward a particular desired level and the tax system is not the appropriate tool for addressing the impact of other policies on housing affordability." (Henry Review, 2010)

Appendix A

Additional Scenario Outputs

Table A1: Projected construction output impacts under the More efficient scenario, \$m^A

Region	Year 1	Year 2	Year 3	Year 4	Year 5
NSW	-329	-273	-232	-201	-177
VIC	-171	-146	-126	-111	-100
QLD	-127	-107	-93	-82	-73
Rest of Australia	-90	-86	-82	-78	-75
National	-718	-612	-533	-472	-425

Source: Cadence Economics. ^ Real 2017 dollars (figures may not add due to rounding)

Table A2: Projected construction employment impacts under the More efficient scenario, FTE

Region	Year 1	Year 2	Year 3	Year 4	Year 5
NSW	-848	-696	-587	-505	-443
VIC	-486	-408	-351	-307	-273
QLD	-396	-329	-282	-247	-220
Rest of Australia	-256	-238	-221	-206	-192
National	-1,985	-1,671	-1,441	-1,265	-1,128

Source: Cadence Economics. Figures may not add due to rounding

Table A3: Projected impacts on the number of housing starts, More efficient scenario

Region (GCCSA)	Year 1	Year 2	Year 3	Year 4	Year 5
Greater Sydney	-156	-130	-110	-95	-84
Rest of NSW	-46	-39	-33	-28	-25
Greater Melbourne	-102	-87	-75	-66	-59
Rest of Vic.	-19	-16	-14	-12	-11
Greater Brisbane	-57	-48	-41	-37	-33
Rest of Qld	-41	-35	-30	-27	-24
Rest of Australia	-75	-71	-65	-62	-57
National	-497	-424	-369	-327	-294

Source: Cadence Economics. Figures may not add due to rounding

Table A4: Projected impacts on the number of apartment starts, More efficient scenario

Region (GCCSA)	Year 1	Year 2	Year 3	Year 4	Year 5
Greater Sydney	-673	-558	-474	-411	-362
Rest of NSW	-200	-166	-141	-122	-108
Greater Melbourne	-421	-358	-310	-274	-245
Rest of Vic.	-78	-66	-58	-51	-45
Greater Brisbane	-164	-138	-120	-106	-95
Rest of Qld	-119	-101	-87	-77	-69
Rest of Australia	-427	-388	-356	-329	-307
National	-2,080	-1,775	-1,547	-1,370	-1,231

Source: Cadence Economics. Figures may not add due to rounding

Appendix B

Construction Output by State — Deviations from Baseline

Chart B1: Construction activity, NSW

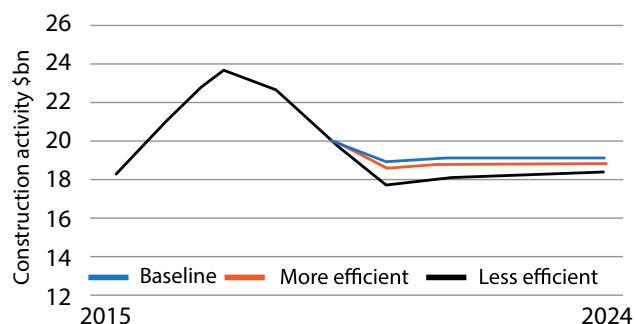


Chart B5: Construction activity, WA

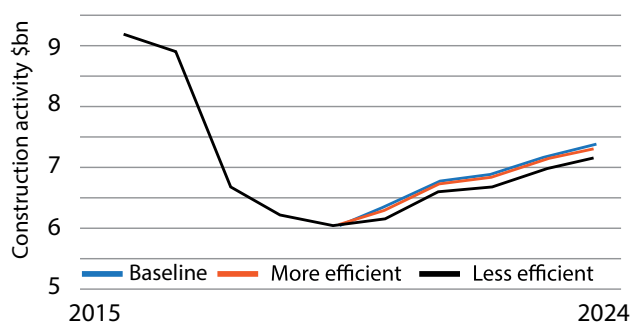


Chart B2: Construction activity, VIC

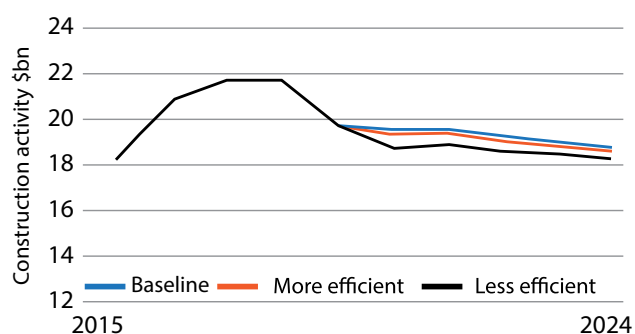


Chart B6: Construction activity, TAS

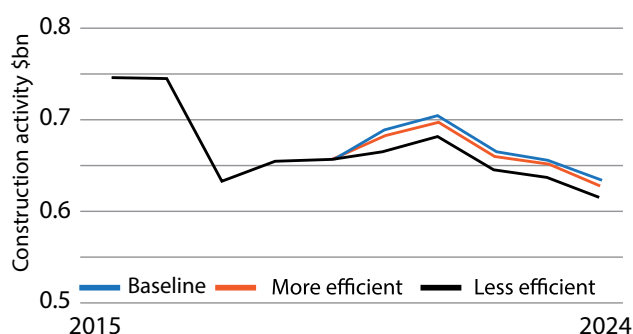


Chart B3: Construction activity, QLD

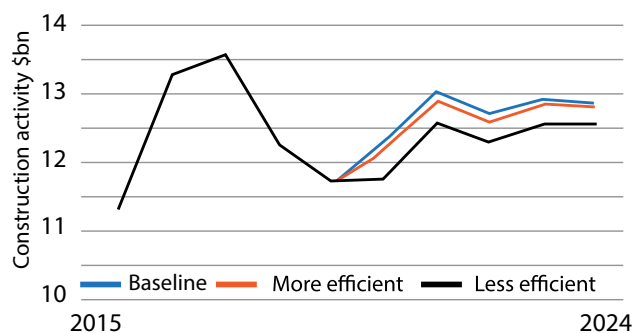


Chart B7: Construction activity, NT

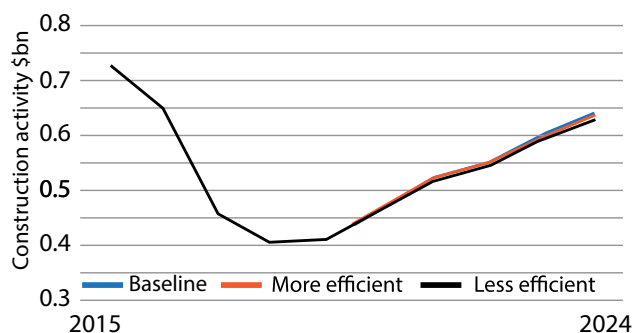


Chart B4: Construction activity, SA

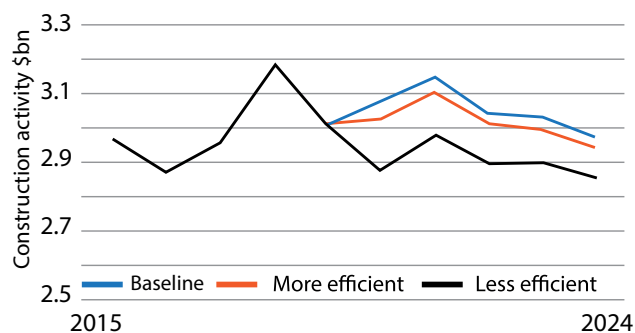
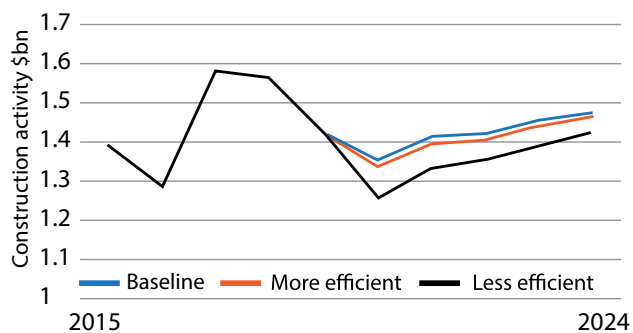


Chart B8: Construction activity, ACTs



Source: Macromonitor forecasts and Cadence Economics estimates

Master Builders Australia

Master Builders Australia is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder state and territory Associations. Over 125 years the movement has grown to over 33,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.

The building and construction industry is a major driver of the Australian economy and makes a major contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter. At the same time, the wellbeing of the building and construction industry is closely linked to the general state of the domestic economy.



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