Dear Treasurer Perrottet,

We write to thank you for the leadership required to meet the accelerating challenges of emerging generations.

On the numbers we have calculated, and with the understandings gained from [our analysis of the ACT reform process], we expect:

- The $19,000 in estimated savings (year 1, $400,00 site value) via the removal of Stamp Duty (SD) will provide added purchasing power for home buyers. They will use the SD savings to bid up prices for lower land value properties under the threshold, including for those who otherwise might not want to.
- The addition of the $25,000 first home buyers grant will add to demand side drivers, increasing opt-in but also driving up prices.
- Strata title owners are likely to have a higher uptake of opting in to Land Taxes (LT).
- House and garden packages on the sprawl may opt out, remaining with SD
- Increased asset liquidity may partially offset the financial disadvantages of higher long term taxes for investors and increase opt-in rates.
- Homebuyers get a tax advantage over investors under most circumstances.
- Long term investor demand would shift to higher land value segment of the market (within the threshold and above it), providing less competition for homebuyers looking to purchase lower land value properties
- Investors who hold properties for short periods to redevelop or renovate, or speculatively flip, would benefit at the expense of investors who engage in long term property investment or land banking.

On the negative side we expect:

- Land price inflation will continue despite the reform process. With interest rates approaching zero, the price growth could well be exponential.
- The reforms will marginally reduce the deposit gap shortfall in the short term, but prices will eventually grow until buyer constraints either reach mortgage serviceability, or a deposit gap.
- Price rises under the reform threshold may spill over into properties above the threshold, if wealthier investors believe they can get better value with less competition from tax advantaged homebuyers. This could reduce rental stock (increase homeownership) at the lower end, and increase rental stock further up the market.
- Revenue losses from the top 20% of properties will require a different, future transition model, potentially featuring higher progressive marginal rates.
- Grandfathered long term investors holding land under the current $755,000 threshold will hold such sites vigilantly. This could deter efficient land use. Nudging into the new system will be required.
- With prices still expected to increase alongside limited wage growth, access to credit may require even longer mortgage periods, pushing 35 - 40 years. A 30 year ceiling should be encouraged.
- Grandfathered master planned communities, will continue to drip feed properties over 20+ years at ever higher prices.

- Due to the exploratory nature of the transition process, first home buyers could well be market hostages to unforeseen circumstances. They must be clearly informed of the positives and negatives of the reform process.

We note that the weighting of the cost savings to both investors and households is relatively even to begin with, with a cost advantage for owner occupiers early on until year 18. For investors that is much tighter at year 8, although given this is the median turnover for investors it is reasonable. This should result in early support for the reform, with prices increasing, the tax burden shared more evenly and no major losers.

When comparing the effect on investors (figure 1), the property tax cost base (SD + LT) has increased for investors, with a noted improvement in the taxation of low value properties. For those investors that opt-in, this will assist access to housing in the most needed locations. However, we expect these sites to be closely held by those opting out.

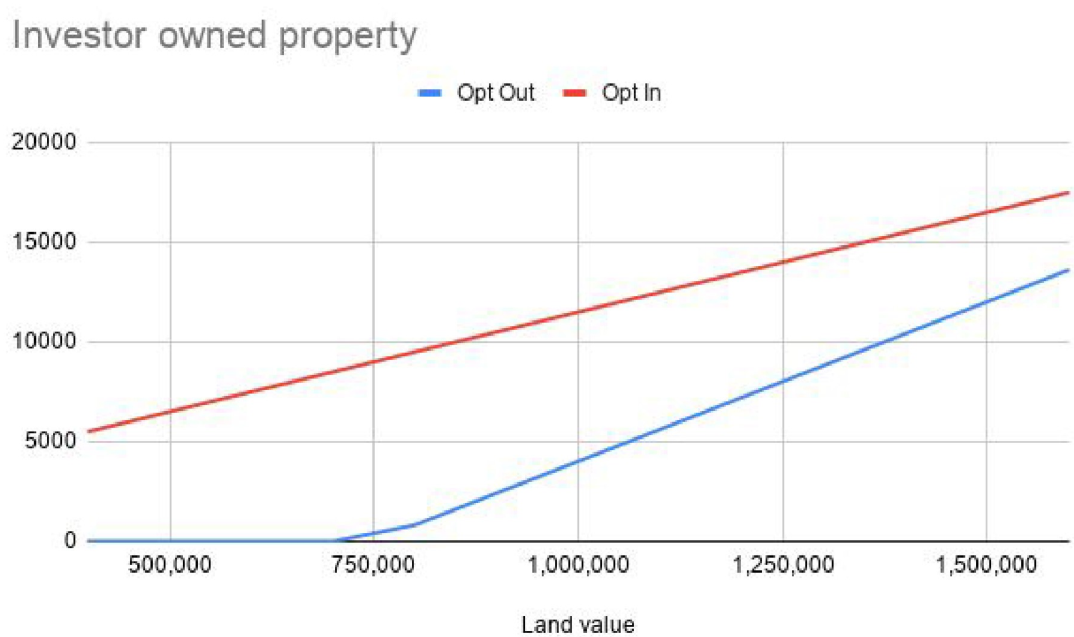

Figure 1

Investors gain an advantage over ~$1.45m in land value (assuming 60% land value and assuming 0% land value growth expectations). Investors would be more disadvantaged by higher expectations of land value growth. This indicates that there are few circumstances for thresholds under $2m where investors would have an edge over homeowners, although the details should be more heavily modelled to check for various improvement ratios and land value growth expectations at all price points.

For residential developers of commercial sites, we believe allowing an opt-in for the reform will be highly beneficial for the residential market. However care must be taken in the planning system to ensure massive demand for converting commercial land to residential use does not result in a shortage of commercial property, putting pressure on rents and businesses in the medium term.

It is not clear if or how opt-in thresholds will be indexed. The problem with indexing thresholds is run away price growth would keep feeding into the thresholds in a vicious cycle. We recommend thresholds are only increased by discretion as to give policy makers more flexibility during the transition.

Once these reforms are underway, it will be essential for the State to move to annual valuations for land. Victoria has benefited greatly from this move, and with such a broad base it will be necessary to ensure fairness between taxpayers and maintain efficient pricing.

Pricing Effects

The repeated referral to housing affordability as a prime driver of this reform should be wound back. We have reservations that the combined effect of a 0.3% tax rate and the removal of some $45,000 in stamp duties will improve affordability. Pent up demand from Gen X & Y should result in strong bids, where any SD savings will be quickly capitalised into higher prices. The addition of the grant will neuter any potential for affordability. Future buyers will be undermined by rising prices, once the first round of buyers enter the market.

Despite the support we have for the reform, we expect that land prices will increase by between 45% (10 year NSW average land price inflation) and 59% (20 year average NSW land price increase) over the next five years. Record low interest rates will compound existing housing pressures.

Questions on notice

- What happens to Greenfield developers who purchase farmland and opt-in to the property tax system, and then have it rezoned to residential land?
    - Do they undo the land tax shift?
    - Do they pay existing state land tax?
    - Do they pay the residential investor tax rate on land that has now gone up massively in value beyond the op-in threshold? Or do they pay the commercial land tax rate?
- What will happen with the treatment of existing greenfield estates? With their ability to influence market prices in a region, how will they assist pricing competition by remaining outside the new system?
    - Are escalating land taxes over time on such developments a possible phase 2 of the reform process? I.e. 2% Land Tax after 7 years of staged release drip feeding?
- With SD removals expected to assist purchasing capacity, what provisions are in place to capture for public benefit the one-off land price windfalls enjoyed by major

developers? These are likely to be in the billions and should be given careful consideration.

- Will there be a property tax and/or stamp duty surcharge retained for foreign investment? Significant SD savings, alongside land tax savings could lead to a rise in foreign ownership.
- Will BTR developers be allowed to opt into the new system?
  - If so, how will 50% land tax deductions apply to the new property tax system?
  - Will they be on the new residential investor tax rates?
  - If commercial rates apply before occupation, will the BTR tax discount apply to the commercial tax rates too?
- With the state's credit ratings already under pressure, and the Federal government adamant it will not bridge short term deficits, has the potential increased cost of financing been included in growth projections?
- Any housing grants (indicated at up to $25,000) should be voided as an income source when banks are calculating mortgage size.
- Will a significant public education campaign be enacted? One capable of foregrounding issues that may be used to critique the transition?

Transition turnover issues

We were concerned by this statement at budget estimates (8/3/21):

JOANN WILKIE, Deputy Secretary, Economic Strategy and Productivity, NSW Treasury: "We expect transaction volumes will increase significantly, ... because if you are talking about a couple who has just recently gotten married, they do not have children, they are buying their first home as a couple, at the moment what tends to happen is people will buy a four-bedroom house in anticipation that they are going to have a family."

Treasury expects first homebuyers to buy a strata property first.

Wilkie raises questions about turnover because it is assumed that the land price inflation one could expect between the strata purchase and the need to upsize would be less for the detached home than the opt-in stamp duty savings.

On our numbers it appears that the larger land value and relative growth over say a 4 year period, alongside the greater transition savings accompanying the more valuable site, puts those who buy the 4 bedroom $900,000 house at a $53,000 advantage over the $660,000 townhouse. They also benefit from not having to move.

With such indications, the potential spur to turnover may be optimistic.

When making purchasing comparisons, we should also look at the cost differential between renting or buying a house. Certain conditions need to align for potential homebuyers to consider buying a smaller, more affordable “transition” property and enter the market earlier at a more affordable price point:

- How do rental costs on their current housing type compare with mortgage and ownership costs?
- What are the returns on their savings/investments they make as renters compared to homebuyers?
- Is it more worthwhile to delay purchasing their current dwelling type needed in favour of purchasing a larger dwelling type at a future point in time when needed?
- For apartments when comparing renters to purchasers, renters appear to save significantly in dwelling costs in the 1st year on a cost basis alone, and may get better returns on other investments.

Grandfathering impediments on turnover not addressed by these reforms include:

- Grandfathered rattly homes for pensioners
- Grandfathered investors in once affordable neighborhoods
- Grandfathered master-planned communities, ensuring land banks continue their 20+ years of drip feeding at ever increasing prices.

Those most likely to opt-in and therefore increase turnover include:

- Investors with a shorter investment window
- Owner occupiers (OO)
- Buyers of apartments
- Detached dwellings with higher land values that have not yet transitioned will be highly sought after, increasing their price growth relative to other dwelling types.

Further incentives to opt-in should be explored, including:

- Land tax thresholds should be removed for grandfathered investors, staggered over 3 years. The indexation of land tax thresholds to median land values should be halted at a bare minimum. With Land Price Inflation expected to continue, too much of the land tax base would be whittled away if it was to remain indexed to median land prices. As it stands, the most affordable land will be the most profitable for opt-outs.
- Downsizers to be incentivised with prioritisation into the public nursing home system. Additional incentives could include deposit assistance into the private nursing home sector.
- Enabling recent purchasers to retrospectively opt-in - crediting recent SD payments and allowing opt-in to property taxes may help bring more properties into the system and thus improve turnover.

Conclusion

We see that the rebalancing of advantages away from investors and towards OO's a clear directive of this reform proposal. The reduction in the number of investors relying on passive income delivered by long held assets will deliver many benefits for society in the years to come.

However concerns remain for the price growth effects these reforms will cause, the subsequent undermining of housing affordability over the longer term, and the impact on the budget. Nonetheless, the consultation paper meets many of our concerns and is a good first base.

Thank you for considering our work.

[redacted]