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Real Estate & Construction industry insights - property taxes

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Welcome

The improved performance of the property sector in recent times means greater revenue to the State Governments from increased transaction activity and higher valuations. The proportionate tax burden borne by the Real Estate & Construction industry means the topic of property taxes and their impact on the economy is more relevant than ever.

With the Federal Government White Papers on our tax system and the federation model in the pipeline, now is the time for the industry to voice its concern on the impact that the current model has on housing, investment and development activity, along with recommendations for change.

Our report draws on interviews conducted with a cross-section of Real Estate & Construction participants around the country, who shared their views on the impact of property taxes on housing, investment and development generally. I sincerely thank those who gave up their time to participate in these interviews and share their own experiences and insights.

Sian Sinclair
Global and National Head of Real Estate & Construction
Grant Thornton

Insights at a glance

This report explores the opinions of those in the industry about the impact that property taxes have on the decisions of homeowners, property developers and investors.

While there were no surprises with the overall unpopularity of property taxes, what was evident from our conversations were the shared views around the impact on the wider economy and exploring what alternatives would be palatable to the industry if real tax reform was on the table.

A snapshot of our key findings is listed below:

1	**Levies, duty, charges and contributions – are they taxes?**	Across the states we found little consistency in what was categorised as a property tax. It seems the different names applied to government charges in their various forms are creating the desired confusion around what is a tax, despite the State Governments themselves categorising them as such.
2	**Property taxes distort home owner decisions**	While the decisions around the purchase of a home were acknowledged as highly emotive, almost 75% of respondents agreed that property taxes had a significant impact on the decision making of home owners in terms of selling or buying. Many believed that Stamp Duty swayed home owners to renovate rather than sell and also hindered employment relocation decisions.
3	**Housing affordability**	Over 80% of respondents agreed that property taxes had a significant impact on housing affordability. While the blame is widespread when it comes to affordability, the level of property taxes imposed on housing is a commonly identified culprit. Housing affordability will only be improved if all levels of government commit to addressing this issue.
4	**Investor decisions impacted**	Almost all respondents (91.8%), agreed that property taxes need to be considered when making investment/project decisions and 80.33% stated that property taxes had a significant influence on how their transactions are structured. Sadly, 45.9% of respondents had considered not proceeding with a transaction, due to the additional costs of property taxes.
5	**GST over Stamp Duty**	The most popular alternative to maintain state revenue if Stamp Duty was abolished, was an increase in the rate of GST or broadening the base it applies to. Also popular was the broadening of the Land Tax base through removal of exemptions.
6	**The year ahead**	The top five challenges identified for the industry this year were: regulatory framework, land supply, affordability, financing and consumer confidence levels. While the majority of respondents had positive performance expectations this year, many predicted stability. The residential property sector was the clear stand out for performance expectations and opportunity.

What are property taxes?

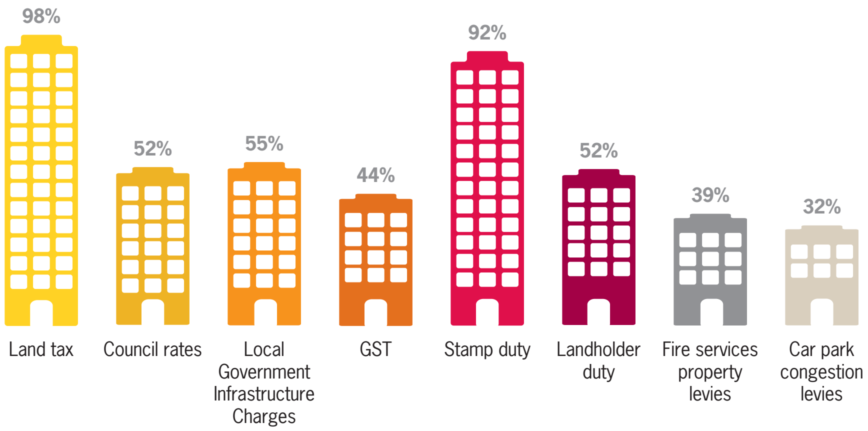
Too often, governments that need to reduce the budget deficit or increase the surplus look to property as an easy way to raise additional revenue.

The property sector is a significant contributor to revenue in all states. The table below compares the total property taxes taken by state as a portion of total revenues for the 2014 financial year.

State	Land taxes	Stamp duties	Other property taxes	Total tax revenues	Total property taxes	Property tax share %	Tax share 2017 - 18
ACT	$75.8m	$236.3m	$74m*	$1.31b	$386.1m	29%**	↓
NSW	$2.39b	$5.898b	$801m	$24.13b	$9.09b	38%	↔
NT	$0***	$207.4m	$0	$699.1m	$207.4m	31%	↑
QLD	$980m	$2.42b	$390m	$11.83b	$3.8b	32%	↔
SA	$345m	$809m	$148m	$4.12b	$1.3b	32%	↑
TAS	$89.8m	$131.5m	$52.7m	$940m	$274m	29%	↑
VIC	$1.63b	$4.19b	$868m	$16.8b	$6.68b	40%	↓
WA	$662m	$1.85b	$660m	$8.9b	$3.1b	34%	↔

* Excludes general rates.
** ACT Government collects general rates which combined contributes a total 55% Property Tax Share, which is forecast to increase to 59% by 2017-18.
*** Land tax not collected.
Source: Property Council of Australia - Residential Development Council, publication "Australian Residential Development Outlook Spring 2014"

There were no surprises that the headline taxes identified as property taxes by almost all contributors, were Land Tax and Stamp Duty.



Overall, our findings highlighted confusion as to what is a property tax. Whilst there are quite a number of Local, State and Federal Government taxes on property, many people do not register them as a tax, either because they are hidden by titles such as levy, contribution or charges, or they are an embedded cost of doing business and viewed as a fee for service.

A review of State Government budget papers provides an interesting source of truth. South Australia, Tasmania, Victoria, and Western Australia all separate their tax revenues into major categories, of which property taxes is one. The income for this category includes the various levies, contributions and charges discussed, along with the headliners, Land Tax and Stamp Duty.

The charges imposed on property as an asset class goes well beyond the headline taxes and various levies or developer contributions that are charged, are not always reflective of the value of services provided in return (if any). For example, development application fees, infrastructure charges or fire service levies. Interestingly, only a bare majority of respondents identified these items as property taxes. This may be due to the anecdotal feedback from a number of respondents, that Local and State Government development charges are a cost of doing business that are implicitly passed on to the eventual purchaser of the property.

Landholder Duty (formerly known as Land Rich Duty) is still not widely recognised, despite being a form of Transfer Duty. This tax is imposed on acquisitions of interests in certain land holding entities. The reason for this may be highlighted in the state by state results: Landholder Duty was identified by 76% of Western Australian respondents as a property tax, which would be expected as Western Australia was one of the first to introduce this tax in 2008. In comparison, Victoria only introduced Landholder Duty in 2012, which may explain why only 37% of Victorian respondents identified this as a property tax.

Interestingly, GST was identified by 44% of respondents as a property tax notwithstanding it is imposed on most other goods and services throughout Australia. Unlike many suppliers who can add to their price a 10% GST, property developers are generally price-takers when they sell their completed product and therefore it represents a real cost to their business.

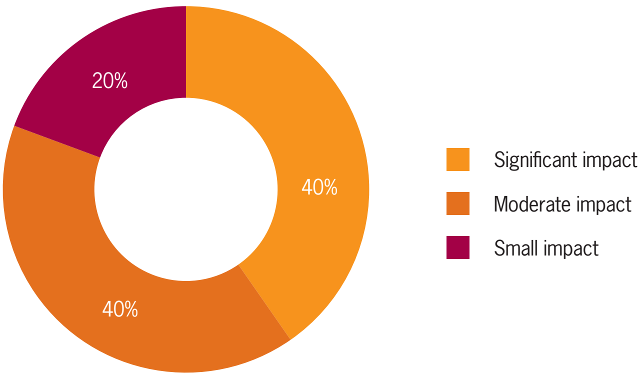
Finally, what came from the conversations we had with many of our respondents was that they don't mind paying property taxes if the revenue generated is properly applied by the relevant Government body in providing services and infrastructure, commensurate to the charges.

Impact of property taxes on housing

From our conversations, the Australian property taxes regime was generally seen as a set of Federal, State and Local tax arrangements that distort the use of property in ways that impair the efficient operation of housing markets and reduce the volume of transactions in the market. When asked if property taxes impacted or distorted the buy sell decisions of homeowners, 98% agreed.

Stamp Duty, in particular, was seen by many participants as a tax on geographic mobility and a disincentive for people to move to new job locations. It was also seen as a contributor to the underutilisation of housing stock, by deterring empty nesters from downsizing to more appropriate housing for their stage of life.

Impact of property taxes on housing affordability



Over 80% of those that we spoke to agreed that property taxes have an adverse impact on housing affordability and impede access to home ownership. The consensus among participants was while higher income households pay more for housing and therefore the related taxes, there was a higher impact on lower income households.

In their submission to the Senate Inquiry into Affordable Housing in March 2014, The Urban Development Institute of Australia stated "the development and construction industry is one of the most heavily taxed sectors in the Australian economy, with various government taxes and charges accounting for up to 44% of the price of a new house in some cities."

Australia's growing population, along with limited land releases in major urban areas and the cost of bringing new product to market (including taxes, fees and charges applied), continues to put pressure on the affordability of housing in Australia. It will take a collective effort from all levels of government to address this issue, which can only worsen once interest rates start to rise.

The following initiatives were the most common suggestions to assist housing affordability:

- removing Stamp Duty on all houses up to a minimum threshold
- further concessions for first home buyers
- reducing/restructuring the current property tax rates
- lowering infrastructure charges to encourage development
- allowing home buyers to pay property taxes over a period of time (land tax based system) rather than up front (Stamp Duty system)

> *"Sadly, State and Local Government have become so addicted to the revenue from property taxes that it is highly unlikely that they will do anything about it. I fear our children will not have the same opportunity for home ownership that we enjoyed."*
>
> **Bob Sharpless**
> Deputy Chairman
> Springfield land Corporation

Impact of property taxes on investors

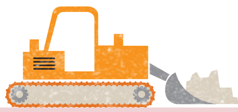
Property taxes certainly receive due consideration by those in the industry, with nearly all of those asked (91.8 %) agreeing that property taxes must be considered in making investment or project decisions. This was not surprising considering the higher the value of the transaction, the more impact property taxes can have on the feasibility. Property taxes can be crippling on large greenfield projects in the early development stage and financing these before the end product gets to market can be challenging.

Certainty around the level of property taxes payable for any development or transaction is critical to enable accurate forecasting and assist with feasibility decisions around investments.

Almost half of the participants had considered not proceeding with a transaction because of the additional cost of property taxes. This is a sad reflection of the inhibitive nature that transaction taxes such as Stamp Duty, can have on the level of investor activity, especially as they add no value to the asset.

Following from this, it was no surprise that over 80% of participants agreed that property taxes (particularly Stamp Duty), had a significant influence on how transactions were structured. Many respondents were concerned about the complexity and costs involved in structuring to legitimately minimise property tax liabilities. The outcome is often a less optimal structure, that can be costly on exit.

> *"Transactions with long settlements often need to be structured using put and call options to defer payment of stamp duty to match timing of settlement."*
>
> **Frik Jankowitz**
> General manager - Property
> Property Development Management Pty Ltd



Foreign investors

When asked if they thought our property taxes regime discouraged foreign investors, the majority of participants (62.3 %) indicated that any impact would be minor. The comparative yields available, Australia's stable economy and access to invested funds were considered of more relevance to foreign investors and our property taxes are simply accepted as a cost of investing here.

Going Green

We found respondents were generally supportive of incentives such as discounts to property taxes being offered, where a property or building is environmentally friendly. While almost 75% agreed with incentives, one third of these were concerned with the implementation and believe administration and assessing would be costly.

Options for reform

The improved market has increased the revenue to the states from property taxes. It also means they are not willing to reduce their revenue base from property tax without a replacement income stream. Many of the reforms desired by industry would reduce the state's revenue collection and therefore are unlikely to take place without wider tax reform supported at the Federal level. The Abbott Government has committed to reviewing the Australian taxation system and the Federation model. A White Paper on tax reform is due for release in 2015 (prior to the next election).

The Real Estate & Construction industry is a heavy lifter in the Australian economy. It represents 11.5% of GDP, employs 1.3 million people and contributes $34 billion of property taxes[1]. The Federal Government must come to grips with the reform wish list of the industry and the reasoning behind them.

Public debate in the lead up to the White Papers will be important. The business community and taxpayers generally, need to give Government the mandate to make some significant changes to our tax system. Until that happens, the Government will continue to tinker around the edges of our tax system without effecting any real change.

Almost 90% of those we spoke with expressed support for a comprehensive tax review, and the majority of these respondents were happy with a review on a 'no exceptions' basis.

There was a definitive response from our industry participants, calling for Stamp Duty to be abolished and the most popular option for funding this change was an increase in the rate of GST.

The most commonly suggested reform for addressing housing affordability was the removal or reduction to the rates of states taxes imposed on residential property (particularly Stamp Duty). It was also suggested that First Home buyer incentives be expanded to all residential premises, rather than to new homes only. This would address concerns around these grants creating artificial price increases for new housing, while encouraging first home buyers to enter the market and enabling 'upgraders' to build new homes.

Other reforms suggested around housing, were:

- the provision of "opt in" scenarios for Land Tax in lieu of paying Stamp Duty up front
- discounting Stamp Duty if the property is a primary place of residence
- introduction of a reasonable value threshold that Stamp Duty does not apply below (e.g. $500,000)

[1] Figures courtesy of Property Council of Australia.

> *"The property industry is the nation's single largest tax payer, contributing $34 billion in real estate specific taxes in 2013. That's before you count the corporate tax and GST the industry pays.*
>
> *Abolishing Stamp Duty is essential to encouraging greater productivity in our changing economy and must be considered as part of the Federal Government's tax reform agenda."*
>
> **Ken Morrison**
> Chief Executive, Property Council of Australia

Industry snapshot - current opportunities and challenges

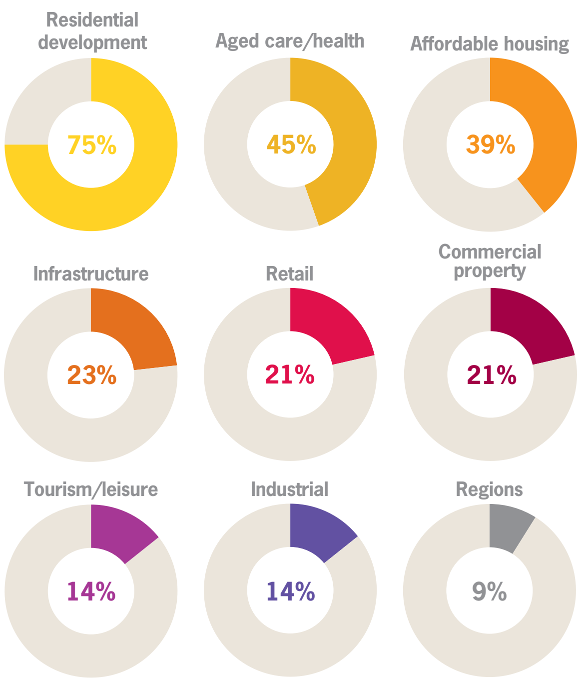
Opportunities

The respondents to our survey highlighted a number of growth opportunities for the industry in 2014 and beyond. Despite ongoing challenges expected from red tape and the regulatory environment, the outlook appears confident with 48% of respondents having positive expectations for the year ahead and the balance generally predicting stability.

The consensus was that there will be many opportunities for those involved in residential development, with 75% of respondents identifying this as a favoured sector for the coming 12 months. While acknowledging challenges around affordability and land supply, it was noted that developers achieving the right balance of medium and high density living would achieve strong growth.

Our survey also identified the Aged Care sector as presenting significant opportunities for developers, given the increasing focus on Australia's aging population and health care generally. However, it is widely viewed that this industry is still in its early stages and easing red tape and greater Government support is needed to support further development and growth.

With an increased level of optimism in the market, where do you see the opportunities?



Challenges

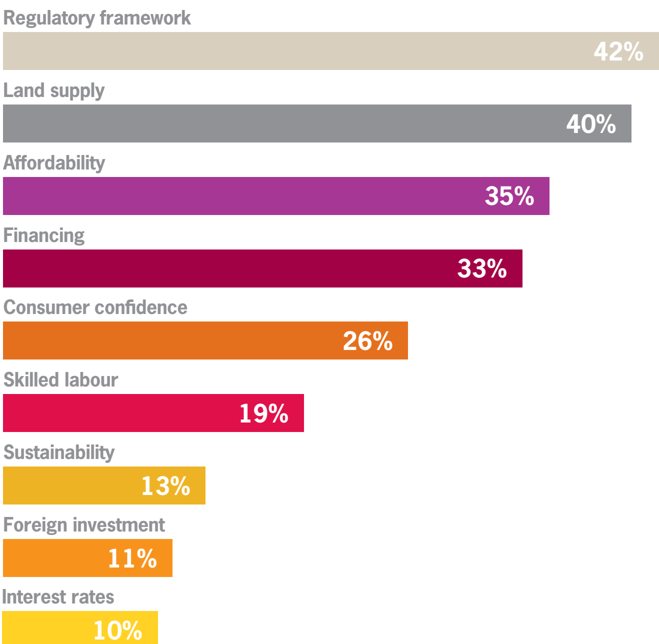
Developers continue to feel restricted by the high levels of red tape associated with projects, particularly in relation to development approvals and environmental offsets. The general view was that the many layers of red tape contribute to uncertainty around developments, impacting confidence to proceed.

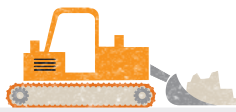
Respondents identified land supply and affordability as key challenges in the residential sector, with many noting increasing competition leading to inflationary pressure in the residential property market.

Obtaining finance for projects was identified as a continuing challenge for the industry (by 33% of respondents). However recent months have seen an easing in loan-to-value ratio requirements which should see a freeing up of much needed funds. Nevertheless, respondents continue to feel pressure from financial institutions as a legacy of credit tightening during the Global Financial Crisis.

As a whole, the outlook for the industry in the coming 12 months is strong. Tax reform that can ease the burden and uncertainty for the industry can only improve the otherwise positive outlook and allow the industry to contribute to real growth.

Key challenges





"The supply of land and delivery of infrastructure determines whether precincts come on. Too often we are at the mercy of Government for both…"

Michael Tilt
Chief Executive Officer
MacroPlan Australia Pty Ltd

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Our Industry Insights Report

Grant Thornton is committed to providing the Real Estate & Construction industry in Australia and overseas, with real insights into the issues and challenges facing the sector. As part of this commitment, we have put together this report, focusing on the impact of property taxes. We have drawn on interviews with a range of industry participants to gain their first-hand perspectives. Our findings are based on these interview discussions. We have collated the responses to questions raised and highlighted common themes that arose in the interviews.

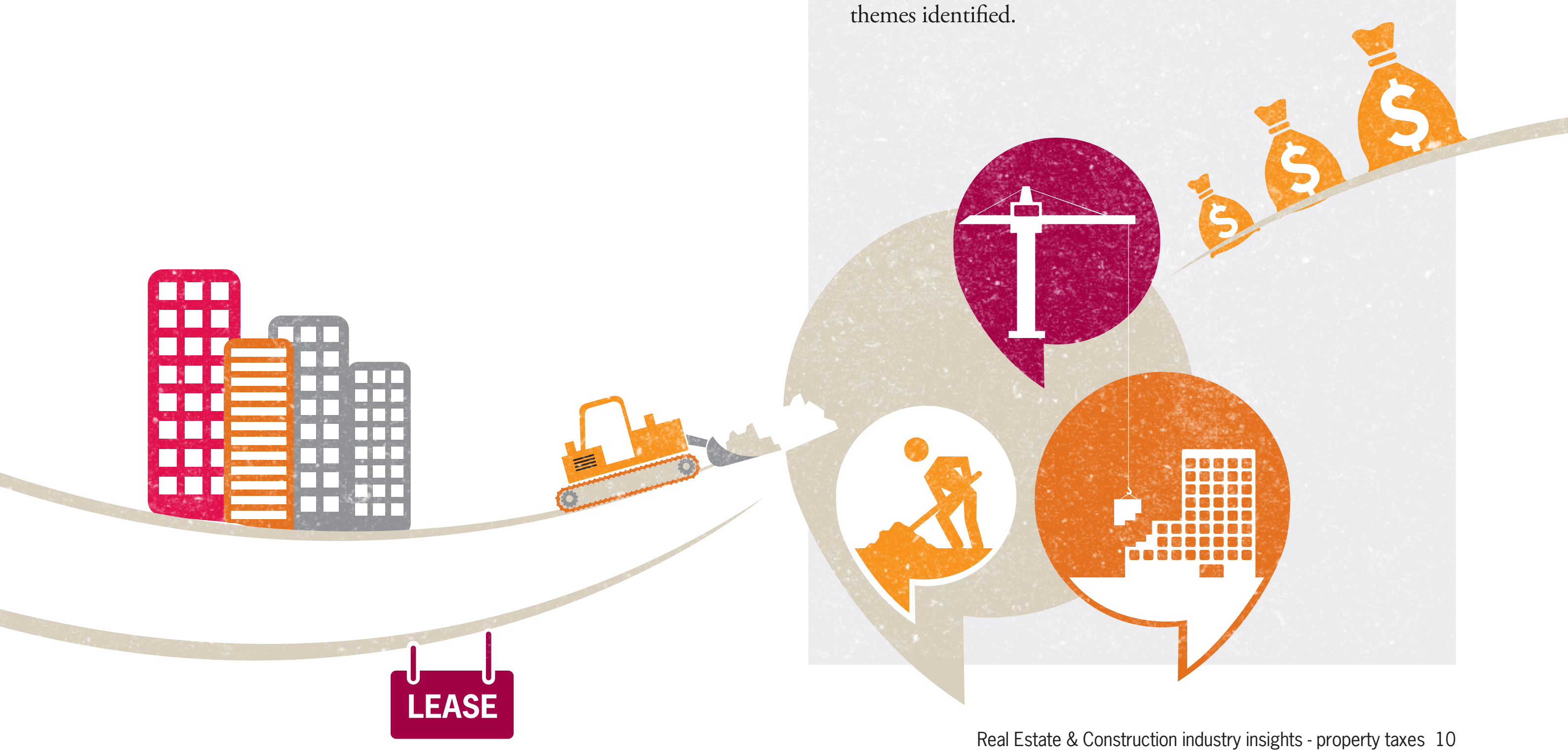
Methodology

Our national Real Estate & Construction industry team met directly with executives from both public and private organisations including:

- developers and owners of commercial and residential property
- builders and civil contractors
- industry consultants

In depth, interview-style conversations were held to gain an independent perspective on property taxes and their thoughts on current industry issues.

The responses to our questions, along with general points raised in the discussions have been collated and key themes identified.



If you would like to discuss property tax issues further and how they may impact you or your company directly, please contact one of our Real Estate & Construction team:

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