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The Hon Josh Frydenberg MP
Treasurer
Parliament House
Canberra ACT 2600

Via email: prebudgetsubs@treasury.gov.au

30 January 2020

Dear Treasurer

2020/21 Pre-Budget Submission

The Property Council of Australia welcomes the opportunity to provide a submission to the Government's 2020/21 Pre-Budget process.

The property industry is the nation's biggest industry and largest employer, providing jobs for 1.4 million Australians. Property Council members shape Australia's cities big and small, and help create prosperity, jobs and strong communities across the country.

We commend the Government for its efforts to return the budget to balance after a decade of deficits. We continue to believe budgeting for a surplus at this time of the economic cycle is appropriate and provides important discipline on the operation of government. This approach must inevitably limit the Government's other fiscal options.

We note that the recent tragic fires cannot help but have an impact on the broader budget process and infrastructure expenditure, and the Property Council reiterates our members' willingness to continue to provide expert capability and resources to assist in the national recovery process.

The May budget will be a critical one for Australia.

Continuing to build confidence in the economy will be essential.

Housing construction – a mainstay of the economy since the end of the mining investment boom – continues to wind down significantly, with the latest ABS Building Activity data showing a 27 per cent fall in dwelling commencements year on year to September 2019.

The Commonwealth Bank estimates that every $1 million reduction in spending on residential construction cuts 7 jobs on a full-time equivalent basis. Using this estimate, we can assume that the Australian residential construction industry lost 13,869 jobs in the year to September 2019, according to the most recent ABS data.

It is therefore important that the budget lays a platform for economic growth, both now and into the future. We strongly support your calls for an urgent new productivity agenda to create prosperity, jobs and economic security for everyday Australians. We urge the Government to structure the 2020-21 budget around this central task.

The Prime Minister has flagged that the Government will focus on resilience and adaptation issues as it evolves its emissions reduction policies.

The Property Council has published a practical plan for emissions reductions in the built environment – *Every Building Counts* – and we recommend that the forthcoming budget include measures to deepen its response for a sector that accounts for 50% of Australia's energy use and 23% of national carbon emissions.

This submission presents five key priorities for the Government's consideration:

1. Strike bilateral **'Housing Deals'** with state and territory governments to address productivity blockages, create new jobs, grow the economy and deliver much-needed housing supply. Ideally this fund would be set at $400m to leverage circa $3 billion per annum of planning productivity gains and tens of thousands of new houses across the country.

2. Give **Australians more housing choice** by facilitating a greater array of housing options, including affordable housing options for those that need it.

3. **Invest in the productivity of our cities** (big and small) as the growing anchors of our economy by building on the Government's strong infrastructure commitments and established cities policy.

4. Strengthen Australia's **investment frameworks** and broaden **investment allowances** to ensure we are able to continue to attract the capital our growing nation needs from both home and abroad.

5. Deliver a **practical plan for climate resilience and emissions reductions in the built environment**, including by using a quarter of the Climate Solutions Fund, some $500m, to unlock these cost-effective improvements.

The recommendations supporting each of these priorities are backed by extensive Property Council and third-party research and are consistent with the Productive Commission's 2017 *Shifting the Dial* productivity blueprint.

We also note that the structural failure of the professional indemnity insurance market around combustible cladding, among other insurance challenges for building professionals, apartment investors, constructors and owners, presents a looming headache for the Federal Government.

If governments do not act collectively and soon, what partial and inadequate cover that is left will becomes prohibitively expensive for building owners and professionals. Large numbers of industry professionals, apartment owners and commercial building owners risk being uninsured, and so unable to operate their businesses or fund rectification works.

We welcome strong Federal leadership through the Building Ministers Forum to unite governments and industry to manage these pressing insurance risks and build the conditions necessary for local insurance solutions.

We would be delighted to have the opportunity to discuss these reform ideas with you and your colleagues in more detail. Please do not hesitate to contact Richard Lindsay, Government Relations Manager, on +61 2 6276 3664 or rlindsay@propertycouncil.com.au.

Yours sincerely

Ken Morrison
Chief Executive

Property Council of Australia

Submission:

2020-21 Pre-Budget Submission

January 2020

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Executive summary

The Property Council of Australia welcomes the opportunity to provide a submission to the Government's 2020/21 Pre-Budget process.

The property industry is the nation's biggest industry and largest employer, providing jobs for 1.4 million Australians. Property Council members shape Australia's cities, big and small and help create prosperity, jobs and strong communities across the country.

The May budget will be a critical one for Australia. Economic growth is mild. Business and consumer confidence is sporadic and the impact of the summer fire tragedy is still playing out. Housing construction – a mainstay of the economy since the end of the mining investment boom – continues to wind down significantly, resulting in housing price spikes in larger capital cities.

It is therefore important that the budget lays a platform for economic growth, both now and into the future. We strongly support Treasurer Frydenberg's calls for an urgent new productivity agenda to create prosperity, jobs and economic security for everyday Australians. We urge the Government to structure the 2020-21 budget around this central task.

We commend the Government for attempting to return the budget to balance after a decade of deficits. We believe budgeting for a surplus at this time of the economic cycle is appropriate and provides important discipline on the operation of government. We note that this disciplined approach will continue to limit the Government's other fiscal options in the near term.

This submission presents five key priorities for the Government's consideration:

1. Strike bilateral **'Housing Deals'** with state and territory governments to address productivity blockages, create new jobs, grow the economy and deliver much-needed housing supply. Ideally this fund would be set at $400m to leverage circa $3 billion per annum of planning productivity gains and tens of thousands of new houses across the country.

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4. Strengthen Australia's **investment frameworks** and **broaden investment allowances** to ensure we are able to continue to attract the capital our growing nation needs from both home and abroad.

5. Deliver a **practical plan for climate resilience and emissions reductions in the built environment**, which currently accounts for 23 per cent of Australia's carbon emissions, using a quarter of the Climate Solutions Fund to unlock these building improvements.

The recommendations supporting each of these priorities are backed by extensive Property Council and third-party research and are consistent with the Productive Commission's 2017 *Shifting the Dial* productivity blueprint.

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Budget context

Australia's economy has shown considerable resilience to international challenges. However economic growth has been modest, business investment is weak, consumer spending is soft, and our strong employment growth has tapered somewhat.

The property industry is the largest industry in Australia, accounting for 13 per cent of national GDP and employing 1.4 million people, more than mining and manufacturing combined.

The property industry has helped to underpin Australia's economy since the end of the mining investment boom and property industry confidence remains positive overall. The March quarter ANZ Property Council Survey results show confidence at 123 index points, up slightly from the previous quarter. However, these results are tempered by negative expectations about national and state level economic growth.

Commercial property sectors continue to perform strongly, particularly office and industrial property, while retail continues to be impacted by soft consumer spending and online retailing.

House prices in Sydney and Melbourne have recovered strongly, with house price growth also occurring in Brisbane, Adelaide, Perth and many regional areas.

However, housing construction – a mainstay of the economy since the end of the mining investment boom – continues to wind down significantly. There will be a considerable lag before this sentiment will be converted into new projects coming out of the ground.

This continued short-term decline in residential construction will have significant GDP and employment impacts through 2020 and 2021. It is also likely to mean that the industry will begin undersupplying housing markets at some point during 2020.

"Conditions in established housing markets had continued to strengthen over the previous month. Housing prices had increased further in Melbourne and Sydney and this experience had been broadly based across both cities. Growth in housing prices had increased in Brisbane, Adelaide and regional areas, and housing prices had increased in Perth for the first time in two years…

By contrast, conditions in the new housing construction market had remained subdued. Residential construction activity was expected to continue to contract for several quarters, despite conditions in established housing markets having strengthened. Although there had been tentative signs of an improvement in conditions in some of the earlier stages of building activity, most indicators had remained weak..."

Minutes of the Monetary Policy Meeting of the *Reserve Bank Board*, 3 December 2019

The Reserve Bank Governor has called for governments to focus on economic reform as a response to sluggish economic growth. We agree. The challenge is the limited fiscal capacity to deliver such an agenda.

Key Government budget settings have played a crucial role in supporting the economy to date. The legislated personal income tax cuts, the $100 billion ten-year infrastructure commitment and eschewal of the alternate tax increase agenda the Opposition took to the election are all contributing factors. However, it is clear that more will need to be done to support growth and living standards.

We therefore urge the Government to focus on reform areas where there is a substantial productivity dividend that can be delivered through workable and affordable policy solutions. This submission provides several options for the Government to consider.

1. Strike 'Housing Deals' with the states to boost productivity, jobs and housing supply

The Federal Government has taken many welcome steps over the past year, including appointing a Minister for Housing, introducing the First Home Deposit Scheme and resourcing housing research to better inform policy makers at all levels of government. These initiatives are essential to driving lasting productivity improvements.

The blueprint for future reform exists in the Productivity Commission's 2017 *Shifting the Dial*[1] report which places solid emphasis on better planning frameworks as one of five priority areas which could deliver a $29 billion long term increase in GDP.

The next step is for the Federal government to strike new Housing Deals with states and territories to incentivise greater housing supply, more rapidly and to drive more productive planning for our growing cities.

THE CHALLENGE

House prices are a product of demand and supply.

The productivity of housing construction and supply, and therefore the cost of houses, is substantially impacted by friction in the relevant state and local planning systems.

State and territory Governments have made slow progress in planning reform over the past five years and NSW, one of our fast-growing states, has gone backwards. Leadership is needed to drive the necessary micro-economic reforms in the planning system.

A big driver of the increase in housing prices over the past decade has been the imbalance between supply and demand, alongside low interest rates.

In many markets, supply has only just met demand and now we are at the low ebb of a construction cycle. Over the past year residential construction levels have dropped more than 20 per cent year on year. The RBA and most analysts expect this contraction will continue for several quarters to come. Such a significant contraction in housing supply will lead to further reductions in employment and upwards pressure on house prices in major cities over the life of this Parliament.

The risk for the nation is that our current inefficient approaches to planning are sowing the seeds of further declines in housing affordability over this decade.

The economic gain through better planning for homes has been estimated at approximately $3 billion a year[2].

As it has done before, the Federal Government can play a role in helping achieve these benefits by working with the states and territories who have direct control over planning outcomes.

THE SOLUTION

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[1] Productivity Commission *Shifting the Dial: 5 year productivity review*, 24 October 2017
[2] Deloitte Access Economics, *A Federal Incentives Model for Housing Supply*, 2016

The National Competition Policy reforms of the late 1990s showcase the successful precedent of the Federal Government driving a reform agenda across the states and territories using strategic incentives.

Under these reforms the Federal Government provided incentive payments to the states and territories in exchange for them making observable one-off reforms aimed at enhancing competition and strengthening productivity.

In 2016 the Property Council commissioned Professor Ian Harper and his colleagues at Deloitte to consider how this National Competition Policy incentive model might be applied to the challenge of housing supply and affordability[3].

Professor Harper found that this incentive-based reform model was a good fit for this purpose and that the economic benefits were substantial – around $3 billion a year in additional Gross Domestic Product.

The report outlined five steps to implementing a financial incentives framework:

1. Set targets. Identify and agree on performance metrics with the states. States already collect data relating to their planning systems and these could be standardised and reported to a dedicated housing policy body (see 2 below). The metrics chosen will depend on the reform initiatives agreed, but could consist of housing targets by relative affordability, and the development of metro plans with specified targets and measures of the system's efficiency. Targets and metrics need not be identical across States. Some states will face location-specific issues and should be given sufficient flexibility to choose targets and metrics appropriate to their situation. However, this should not be open-ended.

2. Make someone responsible. This report suggests establishing a housing institution which could sit within a Commonwealth agency, with a broader role than the National Housing Supply Council, to collate consistent data on housing. The proposed Australian Council for Competition Policy, with responsibility for incentive payments, could receive recommendations and input from this institution, and ultimately decide on issuing payments.

3. Model the benefits. Economic modelling that estimates the impact of state housing outcomes on Commonwealth revenues will inform the size of benefits achievable through reform, and where these benefits accrue.

4. Link payments to action – upfront and ongoing. Metro plans could form the basis of up-front payments at the commencement of the incentives framework. Ongoing payments should be based on realised performance against metrics. The creation of plans alone should not be sufficient grounds for receiving ongoing payments but should be sufficient to attract a start-up incentive payment.

5. State Governments to lead but involve local governments. While policy reform will ultimately be driven by the states, local governments will be a key part of the process and they should qualify for incentive payments for participation and achievement of significant objectives.

The Productivity Commission's 2017 *Shifting the Dial*[4] report identified key reform focus areas being:

- Reducing the number and complexity of restrictions on land use created by overly prescriptive zoning systems, which discourage investment and create unnecessary barriers to business entry and diversification.

- Ensuring the coherence of state and local level planning strategies and the efficient provision of infrastructure to greenfield or new release areas.

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[3] Deloitte Access Economics, *A Federal Incentives Model for Housing Supply*, 2016
[4] Productivity Commission *Shifting the Dial: 5 year productivity review*, 24 October 2017

- Adopting the known best practice model for development assessments to reduce unnecessary costs and complexity by moving towards a risk-based approach to the assessment of development proposals.

It would be possible to pursue such a reform agenda as either an economy-wide initiative under the auspices of COAG, or as bilateral reform agreements with individual states and territories.

Either method provides an effective reform model with the potential to deliver lasting productivity improvements in a way that is affordable in the current budget context.

Based on the 1990s experience, we estimate that federal financial incentives of some $400m over 3 years would be sufficient to leverage the reform agenda identified by the Productivity Commission and deliver several billion dollars' worth of economic benefits.

2. Helping people into the right housing

Housing supply and choice are essential to the liveability, opportunity and competitiveness of Australia's growing cities. While the states and local governments hold many of the relevant policy levers, the Federal Government can have an important role to play in the sustainable, effective delivery of housing.

Policy makers have long understood the relationship between housing and the economy through the multiplier effects of housing investment on national income and employment. Parliaments also rely heavily on housing as the taxation bedrock of federal, state and territory budgets.

A coherent approach, combining demand and supply side productivity solutions is needed to address the challenges of housing affordability, security of tenure, right-sizing, job creation, economic growth and increased productivity.

Strengthen the First Home Buyer Deposit Scheme to boost new homes

THE CHALLENGE

The Government's announcement of the First Home Loan Deposit Scheme to help eligible first home buyers purchase a house with a deposit as low as 5 per cent came at a very important time in the residential property cycle.

One clear improvement to the Scheme would be to ensure that this can be accessed by eligible first home buyers wishing to purchase off-the-plan apartments purchases, or house and land packages (particularly where the land is unregistered, which also typically involves extended timeframes between entering into a contract and settlement on the land).

The Scheme must recognise that the settlement timeframe for the purchase of new dwellings differs to that of established dwellings, meaning eligible first home buyers need certainty that they will be able to access the Scheme at the point of entering an unconditional contract. The Scheme must also allow for a diversity of loan products, recognising that the financing of new dwellings requires different draw down features to a standard 'principle plus interest loan'. Specifically, construction financing must be available.

Construction of new homes has fallen more than 20 per cent year on year. This construction contraction will have a significant broader economic impact. Australia's residential property market is worth more than $6.2 trillion and generates over $100 billion directly into the economy.

The Investment Mandate governing the Scheme references the inclusion of new housing, including off-the-plan apartment purchases and house-and-land packages.

Clearly it is the Government's intention to allow eligible first home buyers to have the choice of purchasing eligible properties whether they be newly constructed or existing.

First home buyers actively seek to compare off-the-plan apartment and house & land purchases given that they often provide more affordable options and customisation of home choice when compared to established stock.

The three distinct benefits for first home buyers of new product are:

- Choice and tailoring of product that meets their current and future needs (e.g. those with mobility challenges can design an accessible property just as a couple with a growing family can potentially plan and allow for the future needs of the household).
- Additional savings time to build on current deposit size while locking in a price in today's market.
- Access to targeted state and territory First Home Buyers' grants and/ or stamp duty incentives.

The current detailed design of the Scheme will need further work to allow eligible first home buyers to purchase off-the-plan apartments at the beginning of the project and house-and-land packages where land registration has not yet been secured.

Simple design enhancements to the Scheme will ensure it can boost new dwelling construction that:

- Adds to the total stock of homes nationally.
- Exerts downward price pressure, especially for new homes.
- Creates significant direct construction and sales jobs and indirect supply chain and retail jobs as well as additional government employment, not otherwise generated by sales of existing homes.
- Increases GDP through additional utilisation of commodities and materials beyond the boosted labour contribution.

THE SOLUTION

Expand the Scheme with an additional 10,000 loans per financial year targeted only to new builds to support jobs and economic growth.

Technical amendments to the Scheme's design can also be made with a simple addition of a Provisional Guarantee. A Provisional Guarantee would enable a participating financial institution to give an eligible first home buyer the certainty to purchase a newly constructed property with the knowledge they would be provided with a Scheme guarantee at the time of settlement.

A Provisional Guarantee would operate as follows:

- An eligible lender can reserve a guarantee from a future year's 10,000 cap allocation to give the First Home Buyer certainty that they have secured a guarantee when their pre-approval has been secured and the First Home Buyer has entered into an unconditional contract to purchase a new dwelling.
- At the time of property settlement, when unconditional financing is granted, the First Home Buyer's eligibility (income and price cap) is reconfirmed and the guarantee issued to the loan.
- The reservation of a guarantee by is upheld regardless if the lender is no longer a part of the eligible panel at the time the First Home Buyer's loan is made unconditional.
- The guarantee can be extended up until the unconditional contract sunset clause has been reached.

Help Build-to-Rent housing be a faster pathway to home ownership and another source of housing supply

THE CHALLENGE

We need to give Australians who rent the choice of a faster path to home ownership.

Expanding the availability and security of tenure of rental housing to meet the needs of Australia's growing population and the increasing proportion of Australians who rent is now possible.

Build-to-Rent housing has been proven internationally to improve the resident experience. It is purpose-built to offer longer-term tenure and professional lease management.

Build-to-Rent housing adds to the spectrum of housing choices and increases housing affordability by providing more supply even at the bottom of the build-to-sell cycle.

The application of patient capital at suitable scale means that significant new projects can be developed even when individual households have withdrawn from the broader market for cyclical or confidence reasons. This will help support jobs and economic growth during cyclical residential downturns.

Build-to-Rent housing will also spur investment by international institutional capital, including global pension and sovereign wealth funds which are experienced in capitalising these projects.

Clearly state governments have a significant role to play in using land tax, zoning and planning levers to encourage investment and this is beginning to occur.

The Federal government has the opportunity to encourage experienced overseas capital in particular.

For institutional capital, investing in Build-to-Rent housing is akin to long term investing in an office or shopping centre.

In offshore markets, Build-to-Rent housing is categorised as a low-risk, core commercial real estate asset class for institutional investment, often with outperformance in total returns to office and retail.

However, our Managed investment trust (MIT) withholding tax rates do not recognise this and such investments are taxed at double the withholding tax rate, or 30 per cent, of other forms of institutional real estate. Capital from 122 'exchange of information' countries – representing the vase bulk of Australia's inbound investment – is eligible for withholding tax rate of 15 per cent when investing into traditional commercial real estate, except for build-to-rent housing which is fixed at 30 per cent in the legislation.

The investment vehicle and tax settings should align with similar arrangements available to other commercial real estate investments, such as the use of a MIT and access to MIT withholding tax rates.

THE SOLUTION

- Remove a key barrier to investment in Build-to-Rent housing by adopting a 15 per cent withholding tax rate for eligible exchange of information countries consistent with the other forms of institutional real estate.
- Encourage state and territory governments to remove disincentives in their land tax and planning regimes to facilitate the emergence of Build-to-Rent housing.

Incentivise the institutional supply of affordable housing to the market

THE CHALLENGE

Large private investors are increasingly willing to invest in affordable housing where market returns are possible.

They recognise the need for this type of housing and are prepared to invest as long as the risks and returns are acceptable relative to the returns from other asset or investment classes.

Structural changes to the cost of land, access to land and additional development rights including height and floorspace allowances are important contributions that states and territories can make in this space.

Likewise state and local government taxes and charges are a significant proportion of the cost of a new home[5].

Across Australian capital cities these taxes and charges represent between 17 per cent and 25 per cent of the acquisition costs of houses and between 17 per cent to 22 per cent of the acquisition costs of apartments. These numbers include the GST.

In greenfield developments, government taxes and charges are more than three times the cost of land in Brisbane and Melbourne, more than double the cost of land in Perth and Darwin, and nearly $85,000 more than the cost of land in Sydney. Taxes are 3.9 - 7.3 times the maximum concessions available to First Home Buyers in capital cities if the eligibility requirements and relevant price thresholds are met.

In infill developments, government taxes and charges are higher than the cost of land in each capital city in Australia, except in Sydney where taxes and charges are broadly the same as the costs of land. Taxes are 2.5 – 6.4 times the maximum concessions available to First Home Buyers in capital cities if the eligibility requirements and relevant price thresholds are met.

At all levels of government, tax incentives are the most straight forward and effective mechanism to attract institutional scale investment into affordable housing and to drive down the cost of the final offering to the customer.

THE SOLUTION

- Provide a stronger incentive for investment in affordable rental housing by applying a 10 per cent withholding tax rate to affordable housing components of any Build-to-Rent developments held within a MIT – similar to that provided under the current MIT legislation for clean building MITs as the current 15 per cent withholding tax rate does not provide an effective incentive.
- Develop a US-style Low Income Housing Tax Credit to operate as an indirect subsidy encouraging individual and institutional investors to invest in the development, acquisition and rehabilitation of affordable housing.

[5] ACIL Allen Consulting, *Taxes and Charges on New Housing*, June 2018

Remove disincentives to right sizing for older Australians

THE CHALLENGE

While many people choose to continue living in their family home in old age, their homes are often poorly designed for ageing well: whether they have lots of stairs, no hand rails, are too big, require a lot of maintenance, contribute to falls and injuries or are otherwise socially isolating.

'Right sizing' can be a positive move for seniors – moving into a smaller, less expensive residence is more manageable. This accommodation is often lower maintenance and, for seniors who right size to age-specific living, such as a retirement village, may have age appropriate design features, offer beneficial health and wellbeing services and facilities, and a ready-made community of peers to socialise with. Right sizing can also free up capital to use on health care or day-to-day living expenses.

Social security legislation creates a barrier to right sizing as the surplus proceeds from selling the family home are counted towards the age pension assets test. This can deter seniors from right sizing for fear of losing the pension, trapping seniors in larger, unmanageable homes.

THE SOLUTION

- Incentivise right sizing by enabling full rate age pensioners aged 75 years or older who own their homes to quarantine a portion of their surplus sale proceeds from the age pension assets test.

Address failure in the professional indemnity insurance market

THE CHALLENGE

The structural failure of the professional indemnity insurance market for combustible cladding, among other insurance challenges for building professionals, apartment investors, constructors and owners, presents a looming headache for the Federal Government.

In the absence of any national plan to deal with the cladding issue, building surveyors are only able to secure insurance with cladding-related exclusions. These are stopgap measures and insufficient to deliver affordability and certainty to the market.

A professional indemnity options paper, developed in consultation between NSW and Queensland, was to have been released for targeted consultation with insurers and industry and the outcomes reported back to the BMF by September 2019.

If state and territory governments do not quickly and collectively resolve the underlying causes of this problem, a replacement insurance scheme or an insurance backstop would need to be implemented as a national scheme coordinated by the Federal Government.

THE SOLUTION

Federal leadership through the Building Ministers Forum is vital. This body has yet to seriously tackle these issues.

Industry is also calling for a consistent model pathway for rectification of existing commercial and industry buildings that were built with combustible cladding.

3. Productive cities underpinned by infrastructure and strong City Deals

Our cities generate 80 per cent of Australia's GDP, and 40 per cent of GDP comes from Melbourne and Sydney alone. Our cities also provide two thirds of all national employment.

Productive and well-planned cities create additional jobs and drive a strong economy. Their smooth functioning, economically and socially, is essential to Australia's future prosperity.

Recognising this, the Federal Government has brought forward infrastructure spending, taken a strong interest in faster rail and introduced the City Deals concept to Australia.

Continue the infrastructure boost to provide a double dividend for the economy

THE CHALLENGE

The Property Council strongly supports the Government's commitment to a $100 billion ten-year infrastructure funding pipeline.

This represents a welcome and major step up in the Commonwealth's commitment to the infrastructure that our growing nation needs. Infrastructure investment provides the 'double dividend' of expanding the longer term productive capacity of the economy, while also supporting nearer term economic activity through the construction phase.

Delivering on this expanded ten year commitment involves continuing to roll this infrastructure funding into the forward estimates period of the budget. This creates challenges in a tightly balanced budget environment, but it is vitally important that it be done.

It is also fundamentally important that funding is provided to the right infrastructure projects. Infrastructure Australia has rightly, and often, warned that one of our greatest infrastructure risks is scarce public funds being employed on projects that make insufficient contribution to economic and productivity growth.

Projects should be selected from IA's Infrastructure Priority List where appropriate business cases have been developed and reviewed.

There is also a strong case for some Commonwealth investment to be allocated to smaller scale, nearer term infrastructure requirements to support more immediate economic activity. Government, and taxpayers, need to be confident that any such commitments have been subject to rigorous assessment.

We recommend that Infrastructure Australia be tasked with drawing up a list of investment options with a near-term impact for inclusion in the budget.

Finally, the Commonwealth also has a very important role in encouraging state and territory governments to maximise their infrastructure commitments. A number of state governments, most notably NSW and Victoria, are doing this to great effect. Other governments, most notably Queensland, are held back by their failure to invest in new infrastructure by recycling public investment from assets they do not need to own completely.

Analysis undertaken in 2019 by the Australian Financial Review found that, "Queensland has the most publicly-owned saleable assets on its books, with $67.4 billion, followed by NSW ($60 billion), Western Australia ($34 billion), Victoria ($24 billion), ACT ($15 billion) and South Australia ($10 billion)."

We recommend the Government reinstate the highly successful Asset Recycling Fund to incentivise states and territories to maximise their own infrastructure commitments.

THE SOLUTION

- Deliver on the Government's $100 billion ten-year infrastructure commitment by continuing to expand the infrastructure investments within the forward estimates period.
- Ensure that the Government's infrastructure commitments are directed to projects that have been assessed as priority projects and included in Infrastructure Australia's Infrastructure Priority List.
- Task Infrastructure Australia with preparing a set of high value infrastructure options with near-term economic benefits for inclusion in the budget.
- Bring back the Asset Recycling Fund, where just over $3 billion of Federal incentives to the states kick-started more than $20 billion of new projects.

Strengthen Australia's City Deals – business input and measurement

THE CHALLENGE

Australian cities need to grow around new and existing transport infrastructure to boost productivity, give people access to jobs, create new high-amenity and high-liveability hubs and boost investment in new services.

A City Deal is an incentive scheme that shifts from a project-by-project investment approach to one that invests in a city's plan for growth considering federal, state and local needs.

City Deals can deliver the much needed long-term, evidence-based planning and infrastructure shaping strategies, supported by investment from each level of government that enhances overall economic development beyond the capacity of individual projects outside a strategic framework.

City Deals are complex to select, negotiate and implement, requiring appropriate resourcing to ensure they are done properly and achieve the desired aim of better managing growth.

Deals have been finalised in Townsville, Launceston, Hobart, Darwin, Geelong, Adelaide and Western Sydney; and additional Deals are being negotiated for South East Queensland, Perth, as well as Melbourne's southeast and northwest.

Australian City Deals, anchored by investment in city-shaping infrastructure and smart land use planning, need to be retained and expanded in all major capital cities.

THE SOLUTION

- Strengthen City Deals through an additional focus on strategic business input across the design and delivery phases and through measurement of performance.
- Deliver exemplary City Deals where these have already been announced in South East Queensland, Perth and Melbourne, with appropriate resources.
- Initiate a competitive City Deal bidding framework and provide expertise for the initiation of deals for growing cities outside of the major capital cities.

Fast track fast rail

THE CHALLENGE

Australia's population is concentrated in our major cities – this is driven by a desire to live close to jobs and vibrant centres. This can create 'growing pains' as our major cities struggle to keep up with the demand for infrastructure and housing.

Compared to our fast-growing cities, some of our smaller cities have the capacity to expand their populations but they need major road and rail connections to employment centres which are typically located in the major cities. Planned well, these 'satellite' cities can play a fundamental role in becoming both service centres and new residential precincts for major capitals.

Fast rail is a proven mechanism used in overseas jurisdictions to connect regional communities to urban centres.

The Property Council of Australia welcomed the Federal Government's announcement of funding for a new business case for fast rail as part of the Plan for Australia's Future Population to take pressure off the big cities and support the growth of the regions.

The commitment to a 20-year fast rail plan that invests $40m for detailed assessments of five additional corridors is a financially sensible approach to exploring rail options.

As the business cases for Sydney to Newcastle, Melbourne to Greater Shepperton and Brisbane to the regions of Moreton Bay and the Sunshine Coast have been completed, it is now necessary to fast track the next tranche of business cases:

- Sydney and Wollongong.
- Sydney and Parkes (via Bathurst and Orange).
- Melbourne and Albury-Wodonga.
- Melbourne and Traralgon.
- Brisbane and the Gold Coast.

Rail connectivity is the key to managing population growth, creating economic development opportunities and shaping our cities. This potential is most evident when bidding to host international events such as the Olympics Games that require long-term co-operation and co-ordination between federal, state and local governments. The success of the 2032 Olympic bid opportunity will heavily rely on the delivery of rail transport infrastructure to connect the three centers where Olympic Villages will be situated — Brisbane, the Gold Coast and Sunshine Coast.

THE SOLUTION

- Submit completed business cases to Infrastructure Australia for review and inclusion on the Infrastructure Priority List.
- Commence the next tranche of fast rail business cases, prioritising the Brisbane/ Gold Coast given the 2032 Olympics deadline.

4. Globally attractive investment framework

As Australia's cities and regions grow, we will need significant real estate investment to create livable, productive and vibrant precincts.

Without strong and stable flows of both domestic and international capital, the pressure to fund these significant investments will fall back to governments and will put further strain on their budgets. Or worse, Australians will simply not have the real estate assets needed to sustain our quality of life.

We need to have the right tax and regulatory policy settings to ensure governments have sufficient revenues to provide the services that Australians need.

This must be carefully balanced with the critical need to attract and retain domestic and international investment to underpin our economic growth and prosperity.

In particular, we must avoid unproductive changes to state tax systems that create unintended or perverse outcomes like additional taxes on businesses.

Maintain Australia's globally competitive Managed Investment Trust regime

THE CHALLENGE

Funding our future real estate investment needs will greatly depend on Australian property funds, which are well placed to benefit the community and investors with their world class sustainability, management and commercial skills in asset management.

Property funds bring together institutional and 'mum and dad' investors – both domestic and international – and provide them with the opportunity to:

- Invest in large scale real estate assets they could not own directly.
- Benefit from the market experience and insights of professional asset managers.
- Provide liquidity to investment in large real estate assets that would otherwise be highly illiquid.
- Diversify their investment portfolio to reduce the risk from market downturns.

These funds are typically established as Managed Investment Trusts (MIT) or stapled groups. Over the past decade, we have had extensive reviews of the MIT regime and stapled structures which have resulted in the introduction of the Attribution MIT (AMIT) regime and changes to stapled structure arrangements. Importantly, throughout these reviews, there has been strong support for the important role the 15 per cent MIT withholding tax rate has in attracting mobile foreign investment to Australia's property funds management sector.

The critical importance of having stable and fair tax settings, such as tax flow through collective investment vehicles, globally competitive tax rates and stapled groups for the property sector shouldn't be overlooked. The success of the MIT withholding tax regime can also be leveraged to accelerate investment in purpose built rental accommodation (see section 2) and energy efficient buildings (see section 5).

In addition, there is an anomaly in the current tax legislation that prevents AMITs and their unitholders from accessing the CGT roll-over provisions for common commercial restructures – in particular, certain

CGT rollover provisions require that "CGT event E4" is capable of applying to all of the units and interests in the trust. However, while CGT event E4 continues to apply for trusts and MITs, the relevant CGT provision for AMITs is CGT event E10. As such, the references to CGT event E4 in the CGT rollover provisions need to be updated to also reference CGT event E10. Based on previous discussions with Treasury and the ATO, we understand that this is an anomaly in the current legislation that arose due to the lack of required consequential amendments when the AMIT rules were introduced and that there is no policy intention to prevent AMITs and their unitholders from accessing the CGT roll-over provisions.

THE SOLUTION

The Australian economy would benefit from a robust and globally competitive tax framework for collective investment in passive real estate through the following recommendations:

- Maintain the tax flow-through treatment for collective investments in passive real estate.
- Maintain the 15 per cent withholding tax rate for passive real estate products for eligible investors.
- Leverage the MIT withholding tax regime to accelerate investment in rental accommodation (see section 2) and energy efficient buildings (see section 5).
- Maintain the ability for the real estate sector to establish and operate under a stapled groups structure.
- Introduce a technical amendment to ensure the interaction between the AMIT regime and the CGT rollover rules operates as intended.

Boost investment in Australia by sending the right signals to international investors

THE CHALLENGE

Commercial real estate is an attractive investment for long-term patient capital investors such as superfunds and sovereign wealth funds. It provides a relatively predictable rental income return and helps diversify portfolios beyond equities and bonds.

Australian superfunds play a significant role in financing the Australian commercial real estate sector – however, Australian superfunds cannot meet all of the potential investment opportunities available, and many superfunds are also looking to diversify their portfolios by investing in offshore markets.

Without additional international capital, many investment opportunities in Australia would be delayed or not proceed. International capital is vital in getting new commercial projects off the ground (including offices, shopping centres and manufacturing precincts), increasing housing supply and boosting tax revenue for government.

While Australia has been an attractive investment destination for many years, competition for capital is increasing. Australia's competitiveness has been put under pressure due to increased uncertainty around ad-hoc restrictions for international capital and repeated increases in state and territory taxes targeting international investors. The lack of comprehensive and timely data on foreign investment can also hinder public understanding of the benefits of investment from offshore and the ability to deliver evidence-based policy.

THE SOLUTION

Australia can continue to attract a steady and sustainable flow of international capital to support our growing cities by ensuring:

- No further tightening of the international real estate investment framework.
- No further increases in fees for Foreign Investment Review Board (FIRB) applications.
- No Federal Government tax surcharges on foreign investors and encouragement of states to remove or limit their charges.
- Increase the frequency and depth of information regarding FIRB applications and investments to allow an informed conversation around the role of global investment in the Australian economy.

Foster greater business investment by incentivising investment allowances

THE CHALLENGE

Recent falls in capital expenditure and new business investment are just some of the headwinds that the economy is currently facing. Targeted tax incentives for business can help encourage the private sector to bring forward investment and help drive a stronger economy.

To start with, existing investment incentives such as the instant asset write-off should be retained and extended in this period of economic uncertainty.

There has also been a lot of commentary on the introduction of an investment allowance to boost capital expenditure and business investment. This allowance can be granted as an additional tax deduction available to businesses for the purchase of plant, equipment and other depreciable assets which encourages businesses to invest in income-producing business assets.

The last time an investment allowance was introduced was in 2009. ATO data shows that businesses claimed at least $15 billion of extra deductions under the 2009 allowance. Analysis of the 2009 investment allowance by the RBA concluded that it had a strong effect on business-level investment and was important on a macroeconomic level.

For the property industry, several issues would need to be addressed in order to make an investment allowance a workable incentive scheme:

- Make it practicable for trusts – an investment allowance is simple to implement for corporate entities.

  However, for tax flow-through trust structures such as MITs and AMITs, through which the vast majority of property investment is made, the benefits of the allowance may be 'washed out' through cost base reductions for unitholders upon distributions. It will be critical to ensure there is no cost base reduction to ensure investors benefit from the allowance.

  In addition, the scheme should ensure that legitimate property investment businesses aren't excluded by applying an overly narrow definition of a 'business' that may have access to the allowance (i.e. rules should include property trusts and special purpose vehicles).

- Make it effective for projects with lengthy lead times – property development pipelines can stretch out for many years, with investments taking time to plan and finance. This should be reflected in the design of any investment allowance, by providing a longer-term time frame of at least three to five years for the scheme.

- Turbo-charge incentives for investments that boost emissions reductions – as discussed further at section 5 below, financial incentives can drive accelerated uptake of energy efficiency and distributed technologies in new and existing buildings. This can include modernising the 10 per cent green building MIT withholding tax regime, extending the instant asset-write off for energy efficiency upgrades of buildings and introducing green depreciation.

THE SOLUTION

Government can boost capital expenditure and business investment through the following targeted tax incentives:

- Extend the instant asset write-off for, at a minimum, a further three years to 30 June 2023.
- Develop broad-based tax incentives like an investment allowance with the input of industry to create workable and effective means of strengthening the economy.
- Provide for tax incentives which can increase business investment levels and help drive low-cost emissions abatement in the built environment (see section 5).

Don’t incentivise harmful tax increases via ‘land tax, stamp duty swaps’

THE CHALLENGE

Swapping stamp duty for a new broader land tax may seem like a simple idea, but there are significant problems with this proposal that make it practically and politically unfeasible.

The Property Council is a long-standing advocate for the abolition of stamp duty. It is widely acknowledged that stamp duty is a highly inefficient tax that does significant damage to the economy – it is 50% worse for the economy than company tax (measured in terms of marginal excess burden) and is a highly volatile revenue source for state and territory governments.

We understand that some state governments may be seeking Commonwealth support to undertake a land tax for stamp duty tax mix switch.

However, there has been very little detailed analysis undertaken on the actual cost impacts for households and businesses if this reform was to be implemented. While the ACT experience is often referred to as a model for reform, there has been little scrutiny of the negative impact of the ACT changes, and the difficulties experienced by local households and businesses over time are poorly understood outside of the ACT.

Our modelling and the ACT experience show a stamp duty land tax swap is not practical or desirable for the following reasons:

1. To abolish stamp duty would require $20 billion of replacement revenue to be found.
2. To raise $20 billion would require land taxes on the family home at significantly high levels.
3. Applying land tax to the family home is deeply unpopular.
4. Business land taxes are already very high and would undoubtedly go up in any changes.
5. The ACT experience isn’t abolishing stamp duty, isn’t a ’swap’ and isn’t revenue neutral.

While the ACT's stated strategy was to phase down stamp duties over time, replacing this revenue with steady increases to land rates, after eight years, several facts are now very clear:

- Total **stamp duty revenue has fallen by just 1%** in nominal terms from $268m in 2011/12 to a budgeted $265m in 2019/20.

- By comparison, **total broad-based property tax revenues have more than doubled over this time,** increasing from $324m to $750m.

- Over this time, **combined property taxes have increased by 71%** in nominal terms, with the ACT Government now receiving $423m more in property taxes (stamp duty, land tax and rates) than it did in 2011/12.

- **Stamp duty reductions for many property types have been modest**. The ACT began their stamp duty abolition process by increasing the top rate of stamp duty from 6.75% to 7.25% for properties over $1m, with moderate reductions in rates for lower value properties. In 2018, the ACT introduced separate stamp duty rates for commercial and residential properties. Commercial properties valued above $1.5m are now subject to a flat 5% stamp duty rate, while lower valued commercial properties are not subject to stamp duty.

- **Stamp duty remains comparable to other jurisdictions that have *not* undertaken reform.** For example, a $650,000 residential property purchase would attract $17,880 stamp duty in ACT compared to $15,100 in QLD or $24,682 in NSW.

- Increases to commercial property rates have been very large. Commercial properties with land values above $600,000 are subject to general rates of up to 5.3216% – **effectively a stamp duty sized tax that is payable *every* year**.

- While owner occupiers are subject to lower property rates than commercial property owners, they have also faced significant year on year increases – **owner occupier rates have doubled** with the top marginal rate increasing from 0.2727% in 2012 to 0.5817% in 2018.

- The ACT Government has **no forward pathway** to eventual stamp duty abolition and what this might mean for the levels of general rates.

THE SOLUTION

- While abolition of stamp duty is highly desirable and would have significant economy wide benefits, replacing this lost revenue with a broader land tax is not a workable solution and should not be supported by the Commonwealth.

- The abolition of stamp duty should be a key objective of comprehensive tax reform led by the Federal Government, with other replacement revenue sources as part of the consideration.

5. A practical plan for climate resilience and reduced emissions in the built environment

Buildings are the places Australians live, work and play and they contribute significantly to our health, productivity and safety. Buildings also account for over 50 per cent of Australia's energy use and almost a quarter of our total carbon emissions.

The potential of Australia's buildings to reduce emissions and increase productivity is huge.

Implementing a comprehensive suite of policy measures could deliver $20 billion in financial savings by 2030[6] and could meet over half the National Energy Productivity Plan (NEPP) target[7], as well as contributing to increased resilience to changing climate and weather patterns, and improved health and productivity for building occupants.

Australia has committed to reducing greenhouse gas emissions by 26 to 28 per cent below 2005 levels by 2030, however we do not currently have an appropriately funded plan containing the targeted policies and programs needed to drive low-cost abatement in the built environment and ensure the buildings we build from today are resilient to average temperatures rises and extreme climate events.

The Property Council, working with aligned industry groups, has developed a deep body of research supporting practical policy recommendations for government at all levels (see www.everybuildingcounts.com.au). This was recently launched by the Federal Minister.

We need to invest in this plan with money from the Climate Solutions Fund that includes a commitment to develop a holistic response for the mitigation of and adaptation to climate change.

Deliver a Zero Carbon Ready building code to ensure efficient, comfortable and climate resilient buildings into the future

THE CHALLENGE

Progress in improving energy efficiency across the building sector has been slow, with overall energy intensity improving between two to five per cent over the decade from 2005 to 2015. This is despite market leaders driving world-class innovation in low-energy buildings, suggesting a widening gap between industry leaders and the rest of the market.

Minimum energy requirements for new buildings and fitouts, with a forward trajectory for strengthened requirements over time, can play a role in closing this gap. Encouragingly, in 2019 COAG Energy Council and the Building Ministers Forum endorsed the Trajectory for Low Energy Buildings that provides the policy mechanism to achieve improved energy performance in buildings over time. This progress should be built upon to ensure measures aimed at increasing the resilience of our buildings to a changing climate are included in the National Construction Code and other complimentary policies.

THE SOLUTION

Working with its state and territory counterparts through the COAG Energy Council and the Building Ministers Forum, the Federal Government should leverage the development of the *Trajectory for Low Energy Buildings* to implement a national trajectory for future upgrades to minimum energy performance

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[7] [2] ClimateWorks for the Australian Sustainable Built Environment Council (ASBEC), Low Carbon, High Performance, 2016

and climate resilience measures in the National Construction Code (NCC), starting with a step change for residential buildings in 2022.

The Australian Building Codes Board has already commenced work for these energy performance requirements and should be given further support to ensure their success. The trajectory should have broad industry support and be aligned with the long-term goal of a net zero emissions economy by 2050.

Ensure the Climate Solutions Fund drives low cost abatement in buildings

THE CHALLENGE

Buildings account for 50 per cent of Australia's energy use and about a quarter of our carbon emissions.

There are persistent barriers to the uptake of energy efficiency, fuel switching and distributed generation in buildings and addressing these barriers requires targeted policy and programs.

In recent years the Emissions Reduction Fund (ERF) has been the Federal Government's flagship program for delivering cost effective emissions abatement.

While the ERF has been successful in driving emissions reductions in some sectors like agriculture, it cannot and will not drive the necessary abatement in buildings.

Structural barriers including minimum bid sizes, high transaction costs and the requirement for multi-year contracts have left significant low-cost abatement opportunities on the table.

THE SOLUTION

Australia's transition to a low emissions economy will be smoother if governments see a clear and steady trajectory for emissions reduction in key economic sectors, and a suite of policies that provide industry certainty.

A national plan for net zero emissions buildings by 2050, with interim targets and policies for emissions reduction, would leverage the low-cost abatement opportunities present in the built environment.

At the start of 2019 the Federal Government announced the Climate Solutions Fund (CSF), which included an allocation of an additional $2 billion for purchasing low cost abatement.

Given that buildings account for around a quarter of Australia's emissions, the Federal Government should:

- Use $500 million of the allocated $2 billion of the CSF for targeted programs that drive low cost abatement in commercial and residential buildings, leveraging leverage existing programs like Green Star and NABERS.
- Extend the Trajectory for Low Energy Buildings, agreed by COAG Energy Council, out to 2050 and fund already agreed measures that will accelerate decarbonisation in the built environment.
- The Trajectory for Low Energy Buildings should be built upon to deliver a comprehensive and long-term plan for buildings that includes interim data-based targets aligned with Australia's obligations under the Paris Agreement.

Accelerate the shift to high performance buildings with targeted financial incentives

THE CHALLENGE

Over the last decade, market leading property companies have reduced their emissions intensity by 52 per cent compared to a 2005 baseline[8], however in the same period, overall energy intensity improved by only 2 per cent for commercial buildings and by 5 per cent for residential buildings[9].

The challenge remains for policy makers to extend the substantial progress made by market leaders across the sector as a whole.

Barriers such as the perceived difficulty of energy upgrades, high upfront costs and long payback periods contribute to a lack of engagement and action by many stakeholders.

THE SOLUTION

Financial incentives can drive accelerated uptake of energy efficiency and distributed technologies in new and existing buildings, by helping to reduce the gap between energy efficiency outlays and returns and motivating action by building owners and tenants.

The Government should deliver financial incentives that provide much needed cut-through to encourage better energy performance and bill savings for building owners and tenants.

Priority should be given to:

- Modernising the 10 per cent green building MIT withholding tax regime by:
  - expanding the regime to all buildings held for rental purposes (the regime is currently limited to offices, hotels and shopping centres)
  - applying the rate to buildings that have been refurbished to achieve the necessary Green Star ratings (the regime is currently limited to newly constructed buildings)
  - applying the test on an asset by asset basis (the regime currently requires all of the MIT's assets to satisfy the Green Star rating requirements.)
- Extending the instant asset write-off scheme to include energy efficiency upgrades of buildings up to $100k.
- Introducing green depreciation, which would see the deferment of taxable income in early years in exchange for bringing forward investment in large upgrades that exceed the instant asset write-off threshold.
- Working with states and territories, as well as local governments to provide rates and charges relief for buildings that satisfy a performance standard, for instance stamp duty and land tax concessions for high performing buildings.

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[8] Better Buildings Partnership, Annual Results FY18, 2018
[9] ClimateWorks for ASBEC, Low Carbon, High Performance, 2016

Strengthen the role of ARENA and the CEFC to support energy innovation

THE CHALLENGE

The current energy landscape is very different to the one that existed when Parliament established ARENA in 2011.

The cost of wind and solar generation has plummeted, and penetration of both large and small-scale renewables is expected to reach around 23 per cent of Australia's electricity generation mix by 2020 (and significantly higher in some states). Yet the need for R&D, demonstration and deployment of new energy technologies and solutions has not dissipated. If anything, it has increased, however, the areas in which this activity is necessary are shifting.

The particular opportunities and challenges in key economic sectors, such as manufacturing, agribusiness and commercial buildings needs to be a key area of focus in the 2020s.

THE SOLUTION

As the energy system decentralises, businesses across the economy are playing a more proactive role in the energy system. However, there is also a steep learning curve for businesses that take a leadership position in energy innovation.

Demonstrating and deploying smart energy management technologies in business contexts where they are uncommon or non-existent can have significant risk and cost.

Alongside broader carbon reduction efforts, there is a role for the Federal Government in driving this energy innovation agenda, which will bring down the cost of abatement in the medium and long term.

Leadership and innovation in low-carbon buildings should be further catalysed through the support of best-practice products and services, exposing the benefits of energy efficient buildings, and communicating how they can be delivered.

Australia has a very well-developed set of research and innovation entities.

- The Government should commit to funding a reinvigorated ARENA to support product development, pilots and demonstration projects that drive transformation through the building sector and expand funding for investment by the Clean Energy Finance Corporation.

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