1. Introduction

1.1 I have a proposal that I believe will encourage high-income earners to contribute to the provision of low-cost housing for first-time buyers and/or low-income earners. And the good news is that most of the building blocks are already in place.

1.2 All that remains to be done is to harness the political will and make a few changes to the legislation.

2. A Proposal to Better Utilise the State-Owned Housing Stock

2.1 The purpose of the proposal is to increase the supply side of the equation, by more efficiently utilising the existing stock of low-cost housing. Therefore, it's not a solution to the whole problem but may go some way to stemming the tide of rising prices.

2.2 There already exists a large supply of low-cost housing in Australia. The only issue is that it is owned by the State Governments and rented out (and sometimes sold) to low-income earners and/or other welfare recipients. According to the Annual Report of the Department of Housing, the Queensland Government had some $4.8 billion worth of land and rental dwellings on its books at 30th June 2002. Although I haven't looked, presumably all States have some and I expect NSW and VIC will have more.

2.3 What I propose is an arrangement whereby:

- Some of this stock is sold to the private sector. In practice, the purchaser would be a Special Purpose Vehicle (SPV) set up specifically to pool the funds of such investors.
- In return, the Federal Government allows a tax break, at the individual's highest marginal rate, on the investment by the individual in the SPV.
- After a suitable qualifying period of, say 5 years, during which time the housing stock would continue to be rented out to existing eligible tenants, the stock becomes available to be sold.
- Depending on the state of the housing market at the time, the properties could be sold either on the open market, to the tenant (if they were then in a position to afford it) or, at worst, back to the State Government under a buy-back guarantee.

3. The Rich are happy to pay

3.1 To the extent that the investor is allowed an up-front tax break at their highest marginal rate, the proposal will attract investment from predominantly top rate (48.5%) taxpayers. Hence, you would have a situation where high-income earners are effectively contributing to the provision of low-cost housing, albeit an attractive investment to them.

3.2 Together with the buy-back guarantee (AAA-rated and which is essentially a capital guarantee), this up-front tax break makes for an extremely attractive investment in low-cost residential property. In recent times, this segment of the property asset class has struggled to attract investment.

3.4 I have assumed for the purpose of this discussion that the rental yield on the house during the qualifying term of the investment is sufficient to meet the costs of the upkeep of the property.

4. Problem Solver

4.1 Unless I'm missing something, such a proposal would appear to assist in addressing a myriad of current social issues, including the dwindling supply of low-cost housing and the seemingly unstoppable advance in housing prices.

4.2 What's more, no party to the suggested transaction need end up any worse off than they are at the present time. In fact, with a modicum of sensible negotiation, all parties to the transaction can have a win.

5. A trade-off between State and Federal Governments

5.1 The tax break given by the Federal Government could be "recouped" by reducing the GST allocation to the State but, importantly, the State need not be any worse off financially. This is because for each dollar that the State gets from selling the housing stock to the private sector, only 50c (rounded) is effectively contributed by the Federal Government in the form of a tax break. The balance comes from the investors.

5.2 An example may serve to illustrate the point:

Investor to State Government on Sale of Housing Stock = $50m.
Investor receives tax break from Federal Government (@ highest marginal rate, rounded to 50c) = $25m
Net cost of investment to private sector = $25m
Cost to Federal Government = $25m

5.3 Therefore, although "theoretically" the Federal Government could reduce the GST allocation to the State by up to $50m, as this is what the State Government has received as a result of the proposal, it has only cost the Federal Government half of that amount. Any number in between means that both parties will be better off.

5.4 For example, if the Federal Government reduced the GST allocation to the State by $40m then the Federal Government will have saved $15m (saved $40m in GST but "spends" $25m in tax breaks). At the same time, the State will be better off by $10m because it gets $50m from investors on the initial sale of the housing stock but only has the GST allocation reduced by $40m.

6. A Win for the Investor

6.1 As far as the investor is concerned, they get $50m worth of property for a net initial outlay of $25m (after the tax break) and has a State Government guarantee that the property will be bought back at the expiry of the term at, for the purpose of this example, the price they paid for it today ie. $50m. A triple-A guarantee that you're going to double your money in 5 years has got to be attractive (in fact, it equates to a compound annual rate of return over 5 years of near enough 15%).

6.2 The Buy-Back Guarantee Explained

6.2.1 The point about the buy-back guarantee given by the State is that, at worst, the State ends up with the same housing stock it sold 5 years ago ie. it's not actually any worse off than it is now from that perspective and in the interim, the State has had interest-free use of the $50m. If the State did nothing else but invest this cash @ 5% for those 5 years, it would end up with a sum of nearly $65m.

6.2.2 The other point to bear in mind is that even if the buy-back guarantee is "called", the State could simply roll the stock into the next available transaction for a further 5 years and so on until such time as the housing market improves to the point where an offer marginally above the amount of the buy-back guarantee (which is the original cost of the house) becomes attractive to some other party.

6.2.3 The reality is likely to be quite different in as much as one would expect significant demand for housing that comes onto the market in 5 years time at prices that were prevailing 5 years ago. If that situation transpires then the buy-back guarantee from the State Government would not be called and the State Government will have cleared the housing stock off its books forever. Not to mention the Stamp Duty it stands to collect on the sale of these houses to an outside party.

7. The Tenant Can Also Be Better Off

7.1 To the extent that the Federal Government can make it a term of qualifying for (and retaining) the up-front tax break, the rights of the existing tenants of the property can be protected/enhanced. This might extend to limitations over the new landlord as far as their ability to review the amount of rent being paid, security of tenancy, obligations to maintain the property etc.

7.2 Caution would need to be exercised here, however, as an overly prescriptive regime may lead to a negative rental yield which would have to be financed throughout the term and may act as a disincentive to the investor.

8. A Better Chance for First Time Home Buyers

8.1 At the end of the qualifying term, the property will be released onto the open market for resale. The minimum asking price will be anything above the cost of the property 5 years ago. This in itself will act as a constraint on prices; as does any action that increases supply.

8.2 The point is that such a proposal would provide an impetus on the supply side of the equation that might not otherwise be there in its absence. In this case, doing something, however small, is likely to be better than doing nothing at all.

8.3 By extension, the proposal then improves the opportunity for first-time buyers, in general, and perhaps the existing low-income tenants to get into the housing market. As explained above, any offer above the market value of the property 5 years ago is likely to be accepted by the investors (SPV) as it will exceed the amount of the buy-back guarantee given by the State Government.

8.4 Alternatively, it may not be "that" house that the existing low-income tenants end up buying but they may, through the dampening effect on prices generally, be able to afford another.

9. Transitional Arrangements

9.1 For illustration, this paper refers to a qualifying term of 5 years but transitional arrangements for a series of proposals with maturities from 1 to 4 years could also be accommodated quite easily. It's simply a matter of varying the amount of the buy-back guarantee or limiting the up-front tax break, or some combination of sharing between the two (given the competing interests and different political persuasions of the current State and Federal Governments).

9.2 It may also be prudent to suggest that the first proposal (ie. with the earliest maturity) be limited to a trial ie. investor's subscriptions to be closed at a maximum amount, say $20m.

9.3 This staging would achieve a series of proposals with maturity dates at the end of each year for the next 5 years and thereafter 5 year proposals maturing each year ie. a constant flow of low-cost property onto the market and therefore a constant dampening effect.

10. What's missing?

10.1 Apart from the detail (which would add volumes o this submission) and the goodwill and cooperation of all parties, just the enabling legislation.

10.2 Specifically,
The Federal Government has to legislate to:

1. allow a tax break for the initial investment, and
2. set out the qualifying criteria, including any restrictions over the new landlord to protect existing tenants.

10.3 The State Governments have to make the necessary arrangements to allow the existing Housing Commission stock to be made available to these arrangements.

11. Summary

11.1 For the sake of brevity, there is a lot of detail that can't go into this paper but the idea is not totally original. It is a variation on a similar scheme that was popular in the UK in the late 80's/early 90's. The arrangements came under the auspices of the Business Expansion Scheme, a government-sponsored tax-based investment programme, aimed primarily at stimulating the SME sector.

11.2 As the products evolved, they became an efficient means of managing the problem that the Banks and Building Societies had with the high level of repossessed property at the time. I would hope that we can use such a product in this country to avoid rather than treat such an outcome.