Charter Insight

Implications of Proposed Stamp Duty Changes to Melbourne's Off the Plan Apartment Market

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Homes for Victorians – a New Housing Policy

The Victorian Government's housing policy (Homes for Victorians) announced in March 2017 contains a suite of positive initiatives and new funding from Government. Charter supports these efforts to improve the community's access to more diverse and affordable housing choices across the social and private housing sectors.

After careful and independent consideration, Charter is concerned however about the potential for unintended market consequences to arise for purchasers and renters alike. Proposed mechanisms that seek to boost participation of First Home Buyers (FHBs) and owner-occupiers in the Off the Plan (OTP) housing markets and removing incentives for investor participation in these same markets are considered problematic in their current form.

As an independent analyst, Charter believes that the proposed stamp duty changes will greatly undermine the development industry's capacity to deliver projects of scale to meet identified new housing requirements (as identified in VIF 2016) within Melbourne's established suburbs. The flow-on effects will actually reduce affordability for private purchasers and renters alike.

Proposed Off The Plan Stamp Duty Concessions Will Have Significant [Unintended] Effects

The single measure with the greatest expected impact is the withdrawal of OTP stamp duty concessions for investors.

Capping of OTP stamp duty concessions for non-First Home Buyer (FHB) owner occupiers to a dutiable value threshold of $550,000 and the introduction of a Vacancy Tax will create additional challenges but these will have less effect on new supply opportunities.

Impacts from these proposed changes are expected to become most pronounced in Melbourne's new apartment market relative to other housing types. This is because investors have always been more highly represented in this dwelling type. For example, 43% of all flats and apartments in Melbourne (2011) are already owned by investors (compared to only 11% of detached dwelling stock owned by investors).

A summary assessment of the proposed changes to stamp duty costs for OTP purchasers in Melbourne compared to Sydney and Brisbane apartments is provided below:

- Most FHBs of OTP apartments in Melbourne will face lower duties than the current situation with no stamp duty payable for contracts up to $600,000 and reduced stamp duty up to $750,000.
- These costs will be $12,000 - $13,000 lower than for the equivalent $600,000 FHB apartment in Sydney or Brisbane where FHBs also receive discounted stamp duties (in Sydney for prices up to $650,000 and in Brisbane for prices up to $550,000).
- Most owner-occupier purchasers of OTP apartments in Melbourne (where dutiable value will be below $550,000) will also still enjoy a comparative lower stamp duty cost relative to purchasing the same apartment in Sydney or Brisbane where purchasers do not receive any discounts or concessions. There is no change to the prevailing situation for these OTP purchasers in Melbourne unless the dutiable value exceeds the $550,000 threshold which triggers an exponential increase in stamp duty.
- Investors buying an OTP apartment in Melbourne will however face an increased impost of $23,000 -$29,000 for apartments priced $500,000 - $600,000 from July 1 which represents a near 12 times increase from current charges for an OTP purchase.
- OTP investors in Melbourne will go from having a current $14,000 - $20,000 lower stamp duty charge for apartments priced $500,000 - $600,000 relative to Sydney and Brisbane to a situation of facing a $9,000 to $11,000 higher stamp duty charge because of the prevailing higher stamp duty rates in Victoria.

Importantly, this policy change is also occurring at a time when apartments are emerging as an increasingly important dwelling typology to facilitate the achievement of a range of social, economic, planning and housing c such as highlighted throughout *Plan Melbourne 2017-2050* as well as in *Homes for Victorians* itself.

The relevance of this concern about the impending changes is that the private development industry's primary opportunity to deliver more affordable housing and living options is via its participation in the new apartment market which itself is most aligned to delivering projects of meaningful scale. This opportunity to provide consistent levels of high apartment supply, as required in response to population growth settings, is now being placed at some risk by the proposed stamp duty changes. This is occurring at the same time as the development and finance industries, as well as purchasers, are all adjusting to a changing and more complex investment framework distorted by a range of cooling measures, and regulatory changes.

Whilst occupier demand for apartments will continue to mature and be supported by the range of strong fundamental and structural factors, the ability for purchasers [and now particularly investors] to access affordable or financially-attractive apartments is being challenged by a range of changes including the proposed stamp duty provisions.

The Melbourne apartment market has matured considerably over the last 25 years and has proven its resilience in the face of many other headwinds over this time. Inevitably, the market will transition to address these new challenges and take advantage of the new opportunities that will emerge.

From a policy perspective, it should be recognised that there is a material risk of a lower supply of affordable apartments stemming from the private market. This outcome could make the task of delivering other worthy affordable housing policy initiatives more difficult.

Will Changing The Off The Plan Stamp Duty Concessions Actually Achieve Affordable Housing Policy Objectives?

The proposed changes to OTP stamp duty concessions represents a significant shift from one a very successful policy intervention that has contributed to fundamental changes in Melbourne's housing form and city structure.

The encouragement of a high volume of more affordable dwellings in key locations has supported Melbourne becoming a more dynamic place and economy.

The foundation of this policy's success was its ability to induce purchasers, especially investors given the compelling financial benefits, to unlock sites and underpin project delivery.

To date, owner-occupiers including FHBs, have been a somewhat smaller purchaser group for new apartments relative to investors who are estimated to represent 50% - 60% of all OTP purchasers across Melbourne. Under the proposed stamp duty provisions, the former groups will retain their current advantages of OTP concessions whilst investors will soon face a much less attractive financial equation than at present.

The implication from this proposed setting is that owner-occupiers will have no new incentive to purchase so it is unclear how or why their historic level of participation in the OTP apartment market will change or actually increase.

At the same time, however the removal of stamp duty concessions for investors is expected to place this larger group's ongoing participation at risk, especially over the short term.

It is unlikely that the reduced involvement of investors will be replaced by an equal increase in participation from owner-occupier and FHB purchasers.

Impacts on Supply and Affordability

Investors (local, national and international) have played a disproportionate and increasingly important role in supporting the completion of new apartments across Melbourne. This is due to investors' greater propensity to purchase apartments OTP relative to the traditional behaviour of more conservative owner occupiers whose purchase motivations are different to investors.

The critical influence of investors is magnified by financiers' prudential requirements to fund projects with demonstrated market acceptance achieved via the OTP sales process.

The expected reduction of relative attractiveness for investors to participate in the OTP apartment market post July 1, will challenge developers' capacity to secure sufficient OTP sales and ultimately, their ability to attract construction funding and deliver new housing supply.

The rental market, and by definition including the participation of private investors, is an increasingly important conduit for delivering affordable housing, especially for those who do not have the financial capacity or perhaps aspiration to become purchasers. With fewer investors likely to participate in the future, the rate of new dwellings entering the rental market will also correspondingly reduce with consequent negative impacts to housing availability and rents. This situation is perhaps exacerbated by the absence of institutions with longer-term investment horizons in Australia's residential markets.

It is noted that without investor participation across the apartment markets in recent years, Melbourne's affordability issues would now be even more acute. Charter estimates that 10,000 dwelling units will enter the rental market in 2017 through investors' role in the OTP market. This new supply is in addition to the near 40,000 apartments delivered into Melbourne's rental market over the past 5 years.

The proposed stamp duty changes must also be considered in context of the cumulative effects already flowing from the range of cooling measures introduced by regulators and governments since 2015 that have been targeted at slowing house price growth primarily by reducing investor demand and restricting project finance.

These measures have already had a pronounced effect on Melbourne's OTP apartment market with purchaser demand, especially from international purchasers, already retracting significantly. Accordingly, lower future supply has resulted with Charter Research now projecting 5,000 fewer apartments for delivery across Melbourne in 2017 relative to expectations from early 2016.

The proposed policy change is expected to actually result in the perverse outcome of reducing the already slowing rate of new apartment completions post-2018. It can also be anticipated that second-round effects upon the market is likely to include a changed mix of apartments with new apartment pricing likely to rise as projects become smaller and apartments invariably become larger to meet the changed market context compounded by recent introduction of apartment design guidelines.

These outcomes are in direct contrast to the overall policy intention of increasing supply of more affordable housing.

Unintended Policy Consequences

The State Government this month also released its updated metropolitan strategy, *Plan Melbourne 2017-2050*, which seeks to locate 65% of new housing in established areas of Melbourne and no more than 35% in Greenfield areas. High and consistent apartment completions are critical to realising this broad policy objective especially given the impact that new residential zones (introduced since 2014) have already had across established suburbs.

Charter is concerned that the proposed stamp duty changes may unintentionally undermine this longstanding urban consolidation objective by stimulating and redirecting purchaser demand to Greenfield markets. The resultant higher risks to be faced by apartment developers (in achieving sales and finance) and longer presales periods, are likely to manifest in increased prices to reflect developers' required higher return hurdles.

Perversely, these first and second-round effects may lead to Greenfield markets increasing their volumes and share of future dwelling completions in excess of policy targets.

Impacts to Melbourne's Competitiveness

At face value it may appear that the removal of OTP stamp duty concessions will bring Melbourne's apartment markets closer to the tax situations in competing cities. Whilst most FHBs and owner-occupiers in Melbourne will still face lower stamp duty costs than in competing Sydney and Brisbane markets, the larger investor cohort will face a significantly increased stamp duty cost that will also be considerably higher than in Sydney or Brisbane.

The magnitude of this change for investors in Melbourne's OTP apartment market, and the absolute difference in costs between competing cities, will likely have an impact on investor decisions post July 1. It is expected that investors will reconsider their capital allocations until overall financial returns adjust to make investment in Melbourne more attractive again.

The proposed removal of OTP concessions for investors will represent the loss of a significant competitive advantage for Melbourne in a market that is increasingly facing national and global competition for investment from developers and purchasers alike.

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