Labor's Negative Gearing Policy - A Market Update

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SQM Research, Australia's most recognised property investment research house, today released a report into the likely housing market effects of The Labor Party's proposal to change negative gearing, taking into account current housing market conditions.

This research is an update on its initial paper released in June 2016 - a time when the housing market was in a considerably stronger state than the current weak conditions.

In this update, SQM Research assumes negative gearing and capital gains tax concessions will be changed on 1 July 2020.

Key findings

Yields to Rise

International comparisons, historical precedents and the effective grossed up yield benefit all indicate that acquisition rental yields are likely to rise between 0.85% and 1.2% (85 to 120 basis points) over a two to three year period post the implementation of the new tax policy. Average acquisition yields therefore may rise from approximately 4.0% up to 5.2%. If interest rates are cut by 50 basis points, the rise in yields will be smaller, with a rise to between 65 and 95 basis points. Much would depend how much of the interest rate cut is passed on by the banks.

Rents to Remain Stable – Initially

Rental changes are initially likely to remain stable at -1% to +1%. However there is likely to be upward pressure from 2021 due to the current slump in building approvals which will be aggravated by the loss of negative gearing. The slump in approvals has now fallen below underlying demand requirements which may create a shortage of dwellings from late 2020.

SQM Research believes market rents could accelerate rise between 7% to 12% over the period 2020 to 2022, assuming there is an interest rate cut. Brisbane and Perth are likely to record the largest rises in rents.

2020 - 2022 Dwelling Rents Forecasts

City / Region	2019 Forecast	2020 - 2022 Scenario 1 Total % change	2020 - 2022 Scenario 2 Total % change	2020 - 2022 Scenario 3 Total % change
	Published November 2018	• Cash rate cut 50bp in late 2019, early 2020 • Rental Yields rise between 60 to 95 bp • Labor Government (May 2019) • Negative Gearing changed 1 July 2020	• No Cash rate change • Rental Yields rise between 85 to 120 bp • Labor Government (May 2019) • Negative Gearing changed 1 July 2020 • CGT Increased	• 50 bp rate cut • Negative Gearing stays • Stable economy
Perth	+3% to +5%	+11% to +17%	+12% to +20%	+8% to +13%
Brisbane	+3% to +4%	+12% to +19%	+13 to +22%	+8% to +13%
Darwin	-10% to -6%	-7% to +4%	-1% to +4%	-9% to +2%
Melbourne	+0% to +2%	+7% to +13%	+9% to +15%	+4% to +10%
Sydney	-6% to -3%	+3% to +8%	+3% to +10%	-2% to +5%
Adelaide	+3% to +5%	+9% to +14%	+9% to +15%	+5% to +9%
Hobart	+5% to +8%	+3% to 9%	0% to +10%	-2% to +7%
Canberra	+5% to +9%	+3% to +9%	+4% to +10%	0% to +6%
Capital City Average (weighted)	-1% to +1%	+7% to +12%	+8 to +15%	+3% to +9%

Dwelling Prices to Fall

Given the forecast of initial negligible rental growth and a rise in gross rental yields, SQM Research forecasts further price falls in the housing market over the period 2020 to 2022. There may be a brief rally in the lead up to the proposed change of negative gearing, especially if there is an interest rate cut prior to legislation passing. This would also be as a result of grandfathering opportunities and, potentially a mild loosening of the current lending restrictions by the banks.

Thereafter, dwelling prices would likely fall again due to a rapid decline in investor demand.

2020 - 2022 Dwelling Price Forecasts

City / Region	2019 Existing Forecasts Published November 2018	2020-2022 Scenario 1 • Cash rate cut 50bp in late 2019, early 2020 • Rental Yields rise between 60 to 95 bp • Labor Government (May 2019) • Negative Gearing changed 1 July 2020	2020-2022 Scenario 2 • No Cash rate change • Rental Yields rise between 85 to 120 bp • Labor Government (May 2019) • Negative Gearing changed 1 July 2020 • CGT Increased	2020-2022 Scenario 3 • 50 bp rate cut • Negative Gearing stays • Stable economy
Perth	-1% to +3%	+3% to +10%	-4% to +2%	+9% to +17%
Brisbane	-2% to +2%	-3% to +2%	-7% to +1%	+7% to +13%
Darwin	-8% to -4%	-5% to +5%	-9% to -3%	0% to +9%
Melbourne	-9% to -6%	-13% to -8%	-16% to -8%	+8% to +14%
Sydney	-9% to -6%	-12% to -7%	-14% to -9%	+8% to +14%
Adelaide	-1% to +3%	-2% to +2%	-2% to +2%	+9% to +16%
Hobart	+5% to +9%	-5% to +3%	-8% to -1%	+11% to +19%
Canberra	+2% to +5%	-7% to -1%	-10% to -3%	+9% to +14%
Capital City Average (weighted)	-6% to -3%	-8% to -4%	-12% to -5%	+8% to +14%

Sales Turnover and Stamp Duty Revenue to Fall

Property sales turnover is predicted to fall another 8% to 15% from 2019 levels with most of the declines in sales to occur in calendar 2020. This would result in a fall in aggregate state stamp duty revenue of $2.3 billion dollars.

Build-to-Rent Schemes will increase

With the housing market potentially trading at a higher gross rental yield, we anticipate an increase in interest in the housing market by financial institutions, particularly industry super funds who will invest via build-to-rent schemes. This is a concept that has had some success in improving rental affordability overseas and could be useful for improving long term affordability in Australia.

Off-the-plan Investors at Risk

Investors seeking to benefit from negative gearing remaining on new properties/off-the-plan developments are exposed to a substantial risk of their property being valued below purchase price, especially if the investor is seeking to sell their investment within the first three years.

Comments

Managing Director of SQM Research, Louis Christopher, said “In short, if Labor’s Negative Gearing policy is legislated in its current form, we expect a rise in rental yields which will occur through a combination of additional falling dwelling prices and, eventually, a rise in rents.

Our analysis suggests the market impact would last by around three years. There is, right now increased consensus that the RBA may have to cut rates this year. If we were to see a cut of say 50 basis points, this would provide some cushion to the effects of Negative gearing changes. Even so, the market would still record dwelling price falls. Housing construction; already in a slump, would likely fall further due to the lack of investor demand. This would set up a shortage of housing come later 2020, based on current strong population growth rates.

Such a tax change during a housing downturn is in our opinion a risky move for the economy and so we encourage discussion of perhaps a phase in period for such legislation that would reduce the economic shock that this tax change could create.

Once again, strongly encourage Labor to consider some of the investor issues, particularly surrounding the distortion their policy may create on pricing of off-the-plan developments and the likely losses investors in those properties would face come resale time to those who won't have the tax concession.

While we take the view that negative gearing reform is a good thing over the long term, such reform should be executed as part of a wider property tax reform that should be phased in over time."

About SQM Research

SQM Research Pty Ltd is a respected Australian investment research house, specialising in residential property research and data as well as investment fund ratings.

It is founded and run by one of the Country's most recognised and respected property analysts, Louis Christopher (former Head of Research and General Manager of Australian Property Monitors), whose objective, candid and honest approach to the real estate market is one of the foundations on which SQM Research has been built on.

The company was launched in 2006 and has now expanded to cover research and all major asset classes.

Recent forecasting history

• SQM Research was judged by *The Australian Financial Review* to be the most accurate Australian residential property market forecaster of 2015, 2016 and 2017.

http://www.afr.com/real-estate/2015-house-price-forecasts-the-good-the-bad-and-the-hopeless-20151230-glx5ih

•SQM Research correctly predicted the Sydney property boom 2013, 2014 and 2015

http://www.moneymanagement.com.au/news/financial-planning/sqm-optimistic-about-housing-market

• SQM Research correctly predicted the housing market downturn of later 2010/2011

http://www.smh.com.au/business/property/clearance-rates-under-60-point-to-correction-to-come-20100628-zcx2.html

A full list of media stretching back to 2002 can be found on www.sqmresearch.com.au/media.php

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