

When the Henry Tax Review reported it readily acknowledged that its proposals would mean higher rents.  
But the Grattan Institute and others seek to play down this prospect.  
The Henry Tax Revi

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But the chief beneficiaries would be buyers (first time and established) with substantial equity, particularly high income households. For those first home buyers with minimal equity, in the absence of very sharp falls (unlikely), the hurdle of high interest rates will remain.

Moreover, if you look at affordability in terms of renters, affordability will decline. That matters for the 28% of mostly low and middle income households that rent.

The Henry Tax review recognised this outcome but suggested that fiscal measures (other than maintaining 100% negative gearing) might be more efficient in dealing with higher rents. The Henry Tax review also





The boom in the first half of the 1980s (Figure 1 over) meant that oversupply was starting to emerge, putting downward pressure on rents, just at the time the tax changes came in. That is cyclical factors were weighing heavily on rents in the short run. Those cycles muddied the waters in judging the long term impact of tax changes. Poterba (1990, 1992) estimated that rents would rise 10-15% in the long term but that in the short term most of the impact would be on prices. He also noted that at the time declines in interest rates were working in the other direction, to lower rents and required returns and encourage investors into the market. In terms of activity, Poterba observed a sustained decline in the unit market in the US (which persisted well after his observation). This could be seen as a response to the lower rents/oversupply but it went beyond that. The contrast between detached housing/owner-occupied vs unit/rental market was evidence of investors leaving the market.

In Note No. 1 I discussed user cost framework set out by James Poterba in 1984 to assess the economic effects of taxes on housing.

The user cost framework has the following (simplified) formulae for rents and prices:

For rent: [1]

For price: [2]

(S = value of structure,  $r$  = rent on land,  $n$  = shares of land,  $s$  is share of structure, and  $u$  = user cost or cost of capital. User cost discussed in detail in first report.)

The first thing to note is that land here refers to the component that is location premium. At the urban fringe, the value of land contains a high component of structure (infrastructure and cost of conversion to urban use). So, while the ABS statistics have land more broadly defined representing about 66% of the value of residential property in Australia and structures just over 33%, allowing for infrastructure in land, the truer measure of structure is about 60%.

The important thing to note in equation is that rent on land is set independently of interest rates/user cost. The second point is that user cost for land and structure will differ. Land does not depreciate so depreciation is not a relevant expense, which lowers user cost on land. More significantly, land is the source of capital gains, so expected capital growth also lowers



would push the new dwelling share up over 20% which would compare with the 31% share of owner-occupier's loans being for new dwellings.

An important point to note is that these figures exclude the equity investment by owner-occupiers and also exclude the indirect financing as change-



