Discussion paper submission

Here is a submission to the inquiry into better tax consultations titled: Tenant Buyouts of Occupancy Rights from Landlords (Buyouts).

Background

Home ownership is very highly valued by families and individuals, and is central to social and family stability of Australians. I recommend this submission to the government inquiry into better tax consultations. It should be noted that an average tenant paying rent could expect to pay about 60% of their landlord's loan used to purchase the property (if the landlord has a loan). In order to save for a deposit, many aspiring first homeowners are also tenants paying rental. In other words tenants may be paying for most of the landlord's negatively geared loan for a property while tenants themselves are left with no hope of trying to save up for a deposit on their own home.

This submission seeks greater fairness for tenants where both tenants and landlords are encouraged to enter agreements for the sale of occupancy rights of the property that are 'carved out' and sold to the tenant. Thereby the tenant will be both paying for their accommodation and purchasing an interest in their home at the same time.

The advantages for the parties involved depend on their circumstances and are discussed further below. For instance, the landlord can gain access to greater cash / liquidity by selling the occupancy rights in a lump sum.

Buyouts

- the Australian government will:
    - be able to monitor Buyouts that will seek to operate within existing legislative arrangements and determine any impact on government policy settings
    - require no initial support from the government whatsoever as Buyouts rely solely on the demand for such a service in the rental property market
    - note that it is not envisaged that there are any changes necessary to assure prudential requirements in relation to Buyouts. However, Buyouts should be monitored, and some modelling should be done to predict whether or not it will reduce the availability or quality of affordable housing or other potential adverse impacts unforseen at the time of writing this submission
- tenants will:
    - be able to afford a loan from a bank or financial institution by converting their monthly rental payment into a monthly loan repayment equivalent to the net present value (NPV) of the rent as an agreed proportion of the sworn market value of the property
    - the only difference from current tenant arrangements is that there is no more to pay once the loan is repaid to the bank or financial institution other than utilities and routine maintenance expenses
    - subject to the terms of the potential Buyout arrangement entered into with the landlord, the tenant will be able to sell the tenancy to a new occupant (or back to the landlord) only if and when the tenant is ready

to move on. The tenant will have tenure on the property and not be a month to month proposition. This is particularly unfair under the present system whereby under ordinary lease terms a tenant can be given a 1 month notice to vacate after 12 months of occupancy, even where the occupant has been renting for many years and the tenant is otherwise happy to continue renting the property

- landlords will
  - no longer be concerned about unoccupied properties affecting their cashflow as they are now able to obtain a lump sum to improve their short and long term liquidity / cash flow position
- where the landlord holds a large number or properties, is a property developer or an investor such as a large fund, they will:
  - not object to being in a position at the foundation of the property development industry through holding and disposal of Buyout properties
- financial Institutions will:
  - continue funding loans via the banks and other financial institutions and should continue to work under arrangements that are currently in place for home buyers
- real estate agents will:
  - spruik to tenants and landlords in their usual fashion
  - be able to offer Buyout sales and marketing in addition to current prevailing practices for finding or selling a home
- international relations
  - one of the more ambitious components of Buyouts is clearly separating the land from the use that the land is put to, particularly for disputed territories. Peace agreements should be able to Buyout settlements of people on land as a distinguishing matter from sovereignty over the land at and during any particular time in history.

Facts, Figures and Conclusion

- Valuation of a Buyout:
  - will be crucial to the success of Buyouts and needs to set correctly for it to work in the market place
  - an independent valuation is needed to determine the level of equity that is being sold to the tenant by calculating the NPV of the current value of rental and expected future annual rent adjustments as at the date of the Buyout
  - Google defines net present value as the value in the present of a sum of money, in contrast to some future value it will have when it has been invested at compound interest. An example provided explains that *"$110 due in 12 months' time has a present value of $100 today, if invested at an annual rate of 10 per cent"*
  - Further, Buyouts would seek to value the useful life of the property. This could seek to take into account a number of factors including depreciation on the building, and things that cannot necessarily be calculated, such future conditions in the locale; changes to zoning laws; repairs or renovations that may be required and so on.
    Such estimates or forecasts of valuations require legal scrutiny by the respective landlord and tenant's solicitors. However they should be

capable of being performed by expert valuers. It is expected that a detailed valuer report would involve an inspection of the property and review of instruments (documents) that relate to the property such as pending legislation that may affect the title etc. The valuer's report should provide a value in dollar terms as at a particular date and specify what factors have been taken into account and would be subject to negotiation and agreement by all parties to each respective Buyout.

    Another factor that needs to be discussed is where the repayments on a loan are locked in at a rate equivalent to the market value of rental. This parameter may impact on the final % of the total market value of the property that would be offered at that date, as it needs to be set at a level that is accessible to the tenant and be equivalent to the current market rental
  - would require who will be paying for management of outgoings for the maintenance expenses of the property
    - after all, the tenant should be able to chose to maintain or even improve the services used under their Buyout if they so wish
  - sale of the underlying property by the landlord may need to disclose whether the property is subject to a Buyout, which should reduce the value or the landlord's interest in the property to the extent relinquished to the tenant
  - would also need to account for
    - the value of the right of buyback in the first instance
    - the value of making an ad hoc (rebuttable) offer to buyback the Buyout in a specified time frame and at a reasonable rate
    - the right to periodically inspect the property
    - forfeiture rights to evict / forcibly buyback rights in certain circumstances
    - etc
- depending on who, how or where a Buyout arrangement is put in place, there are various State and Federal government requirements / incentives for consideration by potential home owners and their landlords:
  - for instance, the $10,000.00 first homeowner grant in Victoria
  - 50% capital gains tax (CGT) exemption for assets held longer than 12 months
  - Goods and Services Tax (GST)
    - Input taxed financial supplies
    - Supplies of Going Concerns
  - Negative Gearing income tax deductions for interest paid on a loan
- interest tax deductions available to landlords should continue, however over time this could be profoundly changed where the use of Buyouts grows - without the need to quarantine deductions as has been attempted in the past, as the underlying asset will be treated as a capital asset subject to CGT
- it may be best practice in any case to regulate the reduction of available housing caused by the practice of 'land banking' i.e. purchase of a property and left unoccupied over time while land value rises. This could be done by penalising landlords for not using a Buyout or compelling them to register a Buyout agreement in relation to the 'land banked' property

- Buyouts need to be distinguished from other rental mechanisms available and in particular should not be confused with Rent to Own or Seller Financing that operate in some jurisdictions

Buyouts introduce accessibility to own their own home for the first homeowner. For the real estate market in general, Buyouts place a substantive means to address the so called growing deposit gap for first home owners.

Once again, home ownership is very highly valued by families and individuals, and is central to social and family stability of Australians. I recommend this submission to the government inquiry into better tax consultations.