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Why South Korea's property tax bombshell would backfire in Australia

Soaring property prices, feverish investor speculation, skyrocketing household debt and an increasingly risky banking sector.

Bet you think we're talking about Australia, right? In fact, this is happening in South Korea right now.

The big difference is their new government is making bold policy moves to address these issues and that makes South Korea the most interesting property market in the world for Australians to be watching right now.

But policymakers should take note: the South Korean path could be best treated as a "what not to do guide".

The moves essentially boil down to a three-punch combo on multiple property ownership and unsustainable lending practices. Here's what they've decided and what experts think the impact would be if it was implemented here.

From April, an additional 10 per cent capital gains tax will be squeezed out of individuals in Seoul, Gwacheon and Sejong City who own a single investment property. Those with two investment properties will cop a 20 per cent hike when they sell.

The increases are on top of the current 6-40 per cent capital gains tax, depending on the size of the gains and the holding period.

"The tax system is really there to collect revenue," BDO tax partner Mark Molesworth told Domain. "The risk you run with using the tax system to try to influence social behaviour is that you can have unintended consequences."

For example, a higher capital gains tax applied at the time of selling is a disincentive to sell and could therefore have the effect of constricting supply coming onto the market.

As it stands, Australian property investors only pay their marginal tax rate on half the overall capital gain made when selling the property. The family home, or main residence, is exempt.

A "hike transfer tax" of 50 per cent will be introduced for investors who re-sell an apartment purchased off the plan, regardless of the holding period.

This measure will have a direct impact on construction investment, according to Citi economists.

"Going forward, apartment pre-sales in 2017-18 are expected to fall after their peak in 2015-16 alongside the tightening measures," economists Jin-Wook Kim, Jeeho Yoon and Johanna Chua said.

"Thus, residential building investment should also moderate particularly from 2018 due to time lag (2.5 years) between pre-sale and construction."

A tax of this kind would also lead to fewer landlords who own multiple properties and therefore favour short leases, which tend to mean greater control and liquidity for owners, according to Grattan Institute chief executive John Daley.

"Whether you want to do those things? I'm not so sure," he said.

The South Korean government will also implement tougher minimum requirements for loan-to-value ratios and debt-to-income ratios on individuals.

Specifically, those with no mortgage will have a 40 per cent maximum in terms of loan-to-value and debt-to-income, while those with more than one mortgage will have a loan ceiling of 30 per cent.

This one might sound familiar.

In 2014 the Australian Prudential Regulation Authority capped investor housing credit growth at 10 per cent year-on-year, then earlier this year limited new interest-only home loans to a 30 per cent overall share.

The difference is that South Korea put the limits on individuals, whereas APRA put them onto the banks. That sees the banks lift rates on those investor and interest-only loans.

How this all plays out should be fascinating to Australia

Both Sydney and Seoul house around 20 per cent of their respective national population. Seoul has seen house prices rise 20 per cent in four years, while Sydney prices have more than doubled in eight years. South Korean household debt has doubled over the past decade and Australia's sits at a record-high 190 per cent of income.

So, there are a few noticeable similarities.

The reaction from those in the know in Australia is that "unintended consequences" could flow from South Korea's haymaker-style strategy, but local regulators and property investors should be keenly watching what happens next in Seoul's property market.

If it blows up in the form of nosediving apartment construction or a sharp drop in property turnover then it could be confirmation that Australia's "gently, gently" approach is best.

Besides, it'll be a welcome distraction from what's going on less than 200 kilometres to the north in Pyongyang.

South Korea looks to cool property market with tax rise

Seoul boosts capital gains levy on owners of multiple homes and tightens lending rules

South Korea's new government has launched measures to stabilise the country's surging property market, including tighter mortgage rules and a jump in capital gains taxes on owners of multiple homes.

The government on Wednesday designated the capital Seoul — home to 20 per cent of the country's 50m population — and two other cities as targets for a crackdown on property speculators.

From April, owners of multiple homes in the selected areas will face capital gains tax increases of 10 to 20 percentage points — on top of the existing levies of between 6 and 40 per cent.

Within the designated areas, homebuyers will be prevented from borrowing more than 40 per cent of the property value, and mortgage payments will be capped at 40 per cent of the buyer's annual income.

The latest round of curbs — the third in 10 months — underline the Moon Jae-in government's determination to control the property market. South Korea has seen signs of a bubble in wealthy districts such as Gangnam in Seoul after previous conservative governments eased mortgage rules to stimulate the economy.

"There are concerns of a bubble forming in the property market and this could lead to household defaults and financial risks if the economy slows further and interest rates rise," said Lee Sang-jae, economist at Eugene Investment & Securities.

"The new measures underline the government's determination that it will not use the sector as a tool to prop up the economy."

The property market was a rare bright spot in South Korea's slowing economy in 2016, with construction investment jumping 10.8 per cent year-on-year — four times faster than the nation's economic growth of 2.6 per cent. The economy is forecast to grow 3 per cent this year.

The average apartment price in Seoul has risen more than 20 per cent over the past four years to exceed Won600m ($535,000). In July, average apartment prices in Seoul were 4.8 per cent higher than the same month a year ago, according to Kookmin Bank.

The latest curbs are also aimed at reining in household debt, which has doubled over the past decade to a record high of Won1,360tn ($1.2tn) as of the end of March, with low interest rates making borrowing cheaper. Some economists have described household debt as a time bomb that threatens the country's economic recovery, holding back private consumption.

"High household debt remains a structural factor that could destabilise the economy. It already seems to have reached its limit," said Mr Lee.