

Senate Select Committee on Housing Affordability in Australia

Inquiry into: Housing Affordability in Australia

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Preamble

Thank you for the opportunity to make a submission to this Senate Select Committee Inquiry. This submission is made on the basis of our expertise as housing researchers and our contributions over a long period to housing policy development in Australia. It represents our views and does not reflect any formal position by Swinburne University of Technology, nor the Australian Housing and Urban Research Institute which has funded some of the research to which we refer.

1. Introduction

There has been a good deal of debate about housing affordability in the last few years and a considerable amount of research has been conducted into the causes and consequences of housing affordability more broadly. For example, the Report of the Productivity Commission's Inquiry into First Home Ownership in Australia in 2004 provides much useful analysis of the problems facing this group.¹ However, since the release of this Report, it appears that expectations of a counter-cyclical response to improve housing affordability have not been realised; indeed, problems of housing affordability have worsened.

The most recent and comprehensive program of research into housing affordability in Australia has been completed by the Australian Housing and Urban Research Institute (AHURI), and the publications from this National Research Venture into Housing Affordability for Lower-Income Australians provide detailed analysis on this topic. The research includes what we understand by affordability problems, the drivers of such problems, why lack of affordability matters, how these problems have changed over time, and an assessment of whether these problems will remain in the future. The AHURI research also provides a policy framework for considering policy options to improve affordability, particularly for lower-income households, and some specific policy suggestions.²

The headline findings from the AHURI National Research Venture were articulated by Associate Professor Judith Yates (Sydney University), Director of the research program, at the recent National Housing Conference in Sydney. Housing affordability problems:

- are structural as well as cyclical;
- are greater for renters than for purchasers;
- create risks for the economy as a whole;
- arise because of the actions of those who do NOT have an affordability problem; and
- are serious and are going to get worse.³

¹ Productivity Commission (2004) *First Home Ownership*, Report no. 28, Melbourne.

² See http://www.ahuri.edu.au/nrv/nrv3/nrv3_assoc_docs.html for full list of publications from this program of research.

³ http://www.nationalhousingconference.org.au/downloads/2008/DayOne/Yates_NHC2008.pdf

We commend the AHURI research to the Select Committee. In this submission, we take as given this analysis of housing affordability problems and focus more on possible solutions rather than causes.

2. Key to the problem: the private rental sector

There is every reason to be concerned about the difficulty facing first home buyers in Australia, as evidenced by the most recent data from the Australian Bureau of Statistics which shows that the number of first home buyer financed dwellings had shrunk to 18% of all financed owner occupier dwellings in January 2008.⁴ The Select Committee is likely to receive submissions from those who suggest barriers and posit solutions, such as reduction in State Government taxes and charges, release of land by State Governments on urban boundaries, and the degree and type of planning and other regulations.

The research evidence base indicates, however, that the problems facing aspirant home buyers are not reducible to simple explanations such as lack of developed land, developer charges or planning laws, but are the product of the specific institutional environment in which Australian housing markets operate. By institutional environment, we mean taxation regimes, the financial system and its lending instruments, the regulatory environment, the small size of the social housing sector, and the specific forms of housing assistance in Australia. This institutional environment, combined with rising affluence and demographic change, has encouraged over-consumption of housing, both to live in and as an investment, but under-production of lower price or affordable housing.

It is not possible to consider barriers to home ownership without also addressing problems of the private rental sector. The rental market of Australia compounds the first home buyer problem in three ways.

First, it is structured in such a way as to discourage long-term residency. For example, lease lengths are typically very short, rents can be increased at regular intervals, and tenants have little control over their home, and in most jurisdictions can be asked to leave with very little notice. It is not surprising then that most households want to exit private rental, but pathways out are blocked by demand pressures for purchase of residential property, which have increased house and unit prices, and declining availability of social housing.

Second, households wishing to buy housing must compete with household and other investors in the residential property market. For the most part, this competition is centred on established rather than new housing, which by definition is restricted. Australian households are buying residential property for two distinct reasons: for their own consumption and as an investment product. For the first group (owner occupiers), home ownership provides security and control over their own living arrangements and a hedge against poverty, particularly in older age. The costs of home ownership generally decrease as people age and it can provide stable housing for families with children at school and for those who require increased levels of care increasingly to be provided in the community. Owner occupation can therefore contribute to family stability and to social cohesion, although excessive household debt can place added stress on family relationships and the economy. In other countries, particularly in Europe, it is worth noting that affordable rental arrangements also provide some of the same benefits.

⁴ Australian Bureau of Statistics (2008) *Housing Finance, January 2008*, Cat. no. 5609.0, Canberra.

By contrast, the investor is unlikely to occupy the property but is primarily interested in how the (housing) investment performs against possible alternatives. To this investor, the tax treatment of capital gain and the capacity for negative gearing against other sources of income are key considerations in assessing the property value. Under the current institutional environment, referred to earlier, there are advantages to the investor over the first home buyer, in particular the availability of negative gearing provisions. Thus the first home buyer is being priced out of the market at the time they are seeking secure and affordable homes for their own use, usually at the time of household formation and/or the birth of the first child. The extent of this investment cannot be under-estimated, with the most recent figures showing that a third of all housing loans outstanding to households are for investment rather than owner occupation.⁵

In effect, households who are rental investors are competing with aspirant purchasers for the same housing. This competition is focused predominantly on established housing, rather than newly constructed housing, and high demand coupled with restricted supply has led to increased prices.⁶ Household rental investors can often outbid first home buyers as they are older, have higher incomes, already own their own home (and possibly other rental property) and have little difficulty in securing a loan against the equity in property they already own. In response to the widely reported sub-prime problems in the US, it is likely that Australian financial institutions will be more inclined to lend to such 'low risk' borrowers rather than riskier first home buyers.

Third, despite considerable increase in investment in residential property since the late 1990s, very little of this has been made available at the lower end of the rental market. Indeed, there is a documented shortage of low rent stock in Australia, with lower-income households having to rent properties with rents higher than they can afford.⁷ The consequent hardship for some households has recently been documented.⁸

Many households in this situation want to exit to ownership but cannot save enough to buy a home or contemplate paying off a mortgage. The increase in housing prices and the decline in first home purchases has increased demand for alternate sources of housing, in particular, the private rental market. But as investment has flowed to the higher cost end of the rental market and pressures have intensified at the lower end, many moderate- and low-income households and many young Australians no longer enjoy the ability to save for a deposit while in this tenure. Apart from the housing affordability factors already mentioned, many have other debts such as HECS and significant credit card debt. Growing numbers are locked into a labour market where casualised or part-time employment is increasingly common. It would be naive to ignore the influence of labour market changes over recent decades on

⁵ As above, Table 12. These figures include loans to households only and exclude institutional investors who also invest in residential property.

⁶ Only 11% of housing finance commitments in January 2008 to owner occupiers were for construction of dwellings or purchase of newly constructed dwellings, and 15% of housing finance commitments for investment housing were for construction of dwellings for rent or resale (source: as above, Table 11).

⁷ Yates J., Wulff M. and Reynolds M. (2004) *Changes in the Supply and Need for Low Rent Dwellings in the Private Rental Market*, Final Report, Australian Housing and Urban Research Institute, Melbourne.

⁸ Burke, T. and Pinnegar, S. (2008) *Experiencing the Housing Affordability Problem: Blocked Aspirations, Trade-offs and Financial Hardships*, Research Report no. 9, National Research Venture 3, Australian Housing and Urban Research Institute, Melbourne.

the ability of many people and families to participate in the benefits of home ownership.

We argue, therefore, that problems facing home purchasers, particularly first home buyers, need to be considered in the context of the private rental market as well as the owner occupied housing market, as these are interlinked. This submission continues with a number of policy recommendations that are targeted at better outcomes for the private rental market, in particular, options to expand the supply of affordable rental housing, as we believe that this will have flow-on effects for first home ownership.

3. Suggested policy options

A sustainable solution to housing affordability requires action across all tenures. The most effective results will be obtained by coordinated action involving all levels of government, preferably through a National Affordable Housing Agreement which has designated housing outcomes and a coordinated approach to housing and housing related programs.

An important part of the solution is to make fundamental changes to the two current forms of housing assistance in Australia: Commonwealth Rent Assistance for private renters, and social housing funded under the Commonwealth-State Housing Agreement. We are confident that the Select Committee will receive submissions about options for reform in these two areas and here we focus our own proposals on improving affordability for households who have the potential to achieve ownership. These will build on reforms already announced by the Commonwealth Government such as the National Affordable Rental Scheme, Commonwealth Property Disposals Policy and First Home Savers Account.

We believe that, in some instances, current policies have exacerbated some of these impediments to home ownership for low to medium income households, and thus suggested reforms largely focus on existing programs. A not dissimilar set of proposals were put to the Productivity Commission Inquiry into First Home Ownership.

3.1 Taxation reforms: Commonwealth Government

To reduce the rapid price escalation in existing housing markets we believe taxation reforms are urgently required to (a) moderate demand and (b) increase supply of new housing.

However, any reforms should be phased in to reduce impact on investors who have taken advantage of these existing but distorting concessions, in particular, negative gearing. They would nevertheless send a needed message to investors and speculators about the ongoing investment environment.

We distinguish between existing and new dwellings. In particular we propose an incentive for investment in new affordable rental housing and, in the medium term at least, designated low-income rental properties such as rooming houses.

Recommendation 1

Reform negative gearing

1 Reform negative gearing to encourage increased supply (construction) of affordable housing that is targeted to low to medium income households. This would apply to new developments and redevelopment. The proposal is not anti-negative-gearing. We accept that there are legitimate business costs that should be tax deductible. However residential property, unlike stock and shares, is a different kind of good with important social and urban form implications flowing from the product of that investment. In a context of over-investment in high-end rental housing and a contraction of supply of low cost rental housing, we believe there is justification for some targeting in the application of negative gearing.

- a) For existing negative gearers, **no change** in current tax arrangement.
- b) For new investors (post some nominated date) in existing (already constructed) housing, negative gearing *of the interest component of loan payments* to be phased down to 75%. Other expenses, e.g. repairs, upgrades and maintenance, at the full 100% deduction.
- c) For newly constructed housing, a sliding scale from 125% of interest on loan payments at the affordable end, e.g. under \$300,000 indexed annually, to 75% at the expensive end, over \$500,000 indexed annually. The idea here is that a greater incentive be provided to encourage landlords to invest in new and more affordable rental housing rather than turnover and inflate the price of existing property. Other expenses, e.g. repairs, upgrades and maintenance, at the full 100% deduction.

The ideas here simply illustrate principles. Percentages and values can be modelled for most effective results in terms of revenue and housing outcomes

Recommendation 2

Depreciation allowance

2 Increase depreciation allowance for construction and upgrade of defined affordable accommodation, including multi-unit development and other forms, e.g. registered rooming houses. Owners and operators of this kind of low-income housing are seldom able to use negative gearing to their financial advantage, and current arrangements are driving out this tenure. In the absence of concerted Commonwealth and State Government programs to bridge the gap, it is important to stabilise this accommodation in the medium term.

New scales could be arranged to be generally expenditure neutral for Commonwealth and State budgets.

Recommendation 3

Capital gains tax

3 The 50% concession on the application of capital gains tax should be removed for non-home-occupiers. The full concession for home occupiers would be retained for the principal place of residence.

π Auditing procedures should be strengthened to reduce abuse of this exemption.

3.2 Taxation reform: reform of State stamp duty (State Governments)

Existing policies and practices in stamp duty design and administration vary somewhat between jurisdictions. These are general recommendations, recognising that some jurisdictions have already made some changes.

Recommendation 4

Reforming basis of collection of stamp duty

4 This tax adds to the expense of home purchase for many people on low or moderate incomes who wish to purchase a dwelling for their own use. The basis for administration of stamp duty could be switched from purchasers to sellers which effectively excludes all first home buyers. To achieve revenue neutrality, rates would have to be increased and graduated for sellers.

More conservatively, stamp duty could still apply to purchases, but scales could be reformed to provide relief at the more affordable end of the market and increased at the luxury end. This could be arranged to be revenue neutral. Additional relief to first home buyers could be easily incorporated with threshold change.

- π Reducing (if this has not already been done) the rate to a minimum amount up to a certain level of purchase price for all first home buyers (set and adjusted to cater for regional differences and CPI changes).
- π Progressively increase the rate from then on, with a higher than existing rate for homes over certain price ranges, e.g. \$1 million.

Recommendation 5

Restructuring the use of stamp duty revenue

5 The purpose and usefulness of this State tax could be made more transparent to the public if a proportion of the increased revenue was directed to relevant housing programs. State Governments could simply do this by legislating, or at least announcing as part of its annual budget, the purposes for which a definite proportion of stamp duty was to be used. A number of important projects to increase the supply of affordable housing could be established and sustained in this way:

- π Community building, neighbourhood renewal and area improvement activities in both country and metropolitan areas. This would be administered to involve local communities and local government in the development and implementation of projects.
- π Urban and regional infrastructure investment to foster the sustainability and diversity of housing development and redevelopment.
- π This funding line could support 'housing affordability partnership projects' with local government and could be linked with the Commonwealth's new National Affordable Rental Scheme.

3.3 First Home Owner Grant (Commonwealth Government)

Most housing experts see this as much as part of the problem as the solution. As recent research has demonstrated,⁹ most first home purchasers would have purchased without the assistance of the current First Home Owner Grant, and being untargeted simply wastes resources for no clear housing outcomes.

Recommendation 6 First Home Owner Grant

- 6 Funds for the First Home Owner Grant should be rolled into a National Affordable Housing Agreement with clear guidelines attached to outcomes.
- π Funds should be only made available for properties purchased below some minimum benchmark, e.g. \$500,000, which as well as rationing funds sends a price signal to sellers to keep price expectations down.
 - π Funds should only be made available for purchase of new construction or to existing properties where the purchasers commit to spending the money on property upgrade, e.g. to meet certain environmental standards.

3.4 Assistance with mortgage distress (Commonwealth Government)

A small minority of purchasers fall out of ownership into private rental, typically when there is a change in income circumstances either through loss of employment or more commonly relationship breakdown.¹⁰ There is no national program of assistance in such circumstances yet when they drop back to rental they can, in most circumstances, avail themselves of Commonwealth Rent Assistance. A small program of financial assistance could be designed to keep some of these households in ownership but implemented in such a way as to prevent the moral hazard of people purchasing in the knowledge they can be bailed out by government.

Recommendation 7 Mortgage relief

- 7 Mortgage assistance be available to designated 'at risk' mortgagees at the same level as Commonwealth Rent Assistance.
- π Assistance only available for mortgagees who have held mortgages for a minimum of five years.
 - π Eligibility to be based on Commonwealth Rent Assistance guidelines but modified to enable moderate income earners to be embraced by the program.

⁹ Burke, T. and Pinnegar, S. (2008) *Experiencing the Housing Affordability Problem: Blocked Aspirations, Trade-offs and Financial Hardships*, Research Report no. 9, National Research Venture 3, Australian Housing and Urban Research Institute, Melbourne.

¹⁰ As above. See also Burke, T. and Hulse, K. (2002) *Sole Parents, Social Wellbeing and Housing Assistance*, Final Report, Australian Housing and Urban Research Institute, Melbourne.

3.5 Regional infrastructure investment (Commonwealth and State Governments)

There is clearly a growing imbalance in our major cities between those established areas with extensive physical and social infrastructure, the newer areas with minimum services barely able to support low-density development, and the older outer suburbs where the infrastructure is in decline and where there are perceptions of poor amenity and an unsafe environment, e.g. parts of South-East Melbourne and Western Sydney.

The established areas are booming but at the price of escalating land values and loss of affordable housing. There is greater affordability in the other areas (houses under \$300,000) but these may not be attractive to first home buyers for other reasons. The lack of transport infrastructure connecting affordable housing and labour markets is a key issue here and, in an environment of rapidly increasing petrol prices, there is a danger that households buying in these areas will exchange a housing affordability problem for a transport affordability problem.

This means that housing affordability interventions should have two foci: one concerned with putting more affordable housing into high cost areas (multi-unit redevelopments), and the other with improving the amenity in affordable areas so that more first home buyers will choose to live there. The maintenance and creation of liveable cities and the provision of affordable housing in outer and new areas is important for creating balanced sustainable cities as well as for maximising choice for housing consumers.

This change needs to be led by key infrastructure investment. This investment is beyond that provided by private developers and requires coordinated action by Commonwealth and State Governments.

Hence we recommend that:

Recommendation 8	
Infrastructure development	
8	Commonwealth and State Governments increase infrastructure expenditure to generate more choice, diversity and range of affordability in new housing supply.
π	The Commonwealth to provide a new urban and regional infrastructure program with specifically designed to increase liveability in non-inner urban areas.
π	States could match Commonwealth contributions from the restructured stamp duty revenues previously recommended.
π	Additional funding to be obtained from the issue of infrastructure bonds to attract long-term low interest funds from institutional investors.

3.6 Getting local government on board (all levels of government)

The success of the infrastructure and affordable housing initiatives discussed above are very dependent on the local and regional planning environments. The important positive role that can be played by local government is often neglected by other levels of government and others advocating for more flexibility in housing provision. Local government can be parochial and conservative when faced with housing

change but it is also under-resourced and, like any democratic institution, sensitive to the views of its constituents. To better facilitate the involvement of municipalities:

Recommendation 9

Strategic approach involving local government

9 That barriers to the further involvement of local government in the facilitation and provision of affordable housing outcomes be determined and resolved with reference to the following issues:

- Local housing policy development including local housing need and strategic land use planning frameworks.
- Effective use of inclusionary zoning and developer contribution schemes.
- Removal of legislative constraints to future partnerships or joint ventures with the private sector and for designated affordable housing initiative generally. This could include removal of third party appeal rights for such projects.
- Identification of local government land holdings and land assembly opportunities.
- Effective approaches to the social housing development approvals process.

Recommendation 10

Local housing strategies

10 State Governments should encourage municipalities to prepare housing strategies with three to five year operating periods. Such strategies to be periodically updated and binding on municipalities, and include minimum housing roles of:

- Documenting housing need.
- Encouraging and supporting social housing projects, including support through the statutory planning permit process for reasonable periods for obtaining planning approvals.
- Encouraging and supporting private sector affordable housing initiatives.
- Facilitating projects from other social housing providers.
- Dedicating resources to implementation of strategies.
- Identifying and promoting land opportunities for social housing.

These housing strategies would be integrated and supported by broader policy frameworks within local government such as local planning schemes and their municipal strategic statements, corporate plans and supported by relevant other municipal policies.

Seeding grants should be available to municipalities that elect to prepare housing strategies.

On completion of strategies, such municipalities should become eligible for implementation funding from Commonwealth and State Governments.

4 Conclusion

The most pressing housing affordability problem is faced by households with low to medium incomes renting private housing. Many are potential first home buyers and some have fallen out of home ownership because of family breakdown or insecure employment.

These households require decent, well located, appropriate and affordable housing. As they have limited wealth, they are unable to compete with higher income households, and particularly investors, for a declining stock of lower price housing. Increased demand is driving up prices that consumers with low to medium incomes are unable to pay. The market is failing to supply what historically most Australian took for granted, that is, secure and affordable housing.

Furthermore, increased household expenditure on housing is resulting in less disposable income for other forms of consumption. The research indicates that this means some people are having to make tough choices about what they can and cannot afford to buy in terms of daily requirements. This situation has consequences for the economy and in terms of social cohesion. Concerted and coordinated action is required by all levels of government to address the structural and underlying problems, notwithstanding any short-term improvements attributable to cyclical change. The policy recommendations outlined above are intended to stimulate discussion and debate about a more comprehensive strategy to tackle problems of housing affordability in Australia.

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