Submission to the Senate Select Committee on Housing Affordability in Australia

The Australian housing market is currently experiencing a crisis in affordability. The problem is both cyclical and structural. In simple terms, supply has failed to keep pace with demand and household incomes have not risen at the same pace as house prices or rents. This situation has arisen through a combination of market failure and poor policy on the part of successive governments over many years.

In the short and longer term, the affordability crisis brings with it significant social as well as economic costs. It also has a negative effect on the distribution of wealth within our economy and on intergenerational equity.

The greatest instance of housing stress is currently being experienced in the private rental market amongst low income households. Another significant group experiencing above average instances of housing stress are first home buyers, particularly those within the so-called generation “X” and “Y” age groups. These two groups present a serious short term policy challenge

In the longer term, as the current crisis interacts with demographic factors, it’s likely we will see increased calls on the Commonwealth purse through required intervention in the housing market.

The housing market interacts with many other spheres of activity. Most notably the labour market, taxation system, welfare system, settings in monetary policy and the equity markets. This means that the problem is highly complex. It also means that there are a variety of policy tools open to government in seeking to address the current crisis in the short and longer term.

The Construction Forestry Mining and Energy Union (CFMEU) has taken a long term interest in housing affordability. As the major union representing construction workers, our members have a direct interest in the housing and construction industry. Further, as a union with a proud history of advocating progressive social policy, proper planning and distributional equity, housing is a key policy focus for the CFMEU.

The CFMEU welcomes the Rudd Labor Government’s focus and energy directed towards this important challenge. We welcome the opportunity to make this submission to the Senate Committee and look forward to working with the Federal Minister and all stakeholders in crafting an effective policy response.

The CFMEU believes the crisis is deep and worsening. However there are a number of practical steps that government, industry, unions and housing providers can take which will have a tangible effect. These are grouped by terms of reference and follow from the analysis contained within this document.

John Sutton
National Secretary
Construction Forestry Mining and Energy Union

Introduction

The Senate Select Committee on Housing Affordability in Australia has been asked to inquire into barriers to home ownership. This is an important issue for our society and economy. The CFMEU believes that a range of factors are at play in the housing market and the broader economy. This submission is therefore structured to provide a broader analysis on housing affordability not limited to the tenure type of ownership before moving on to deal with the committee terms of reference and make recommendations.

Setting the context of the housing market affordability crisis

1.1 Supply and demand factors

1. Supply has failed to keep pace with demand in the Australian housing market. Over the ten years to June 2006 the stock of housing increased by 1.22 million dwellings *(ABS)*. Of that figure, 1.46 million new dwellings were completed but 259, 000 old dwellings were demolished. Over the same period, the number of Australian households rose by 1.31 million (even more than the increase in population due to a trend toward falling average household size). There is a large and widening gap between the supply of new dwellings and underlying demand which continues to grow.

2. Underlying demand has steadily risen due to changing demographics and many other factors. In the ten years to 2005-06, the number of people living in private dwellings rose 13% *(ABS Housing Occupancy and Costs, Australia, 2005-06)*. At the same time there was an even larger increase in the number of households growing by 21% to 7.9 million nationally. This reflects a trend toward decreased average household size from 2.69 to 2.51 persons. The number of lone person households is also growing. This trend is influenced by a number of factors including the aging of the population and higher rates of divorce. Demand has also been fueled by lower interest rates, growing income, the availability of finance, tax concessions, the First Home Buyers Grant and immigration.

3. An adequate number of new dwelling completions is not being achieved to keep pace with demand from migrants and smaller households. The supply side problem continues. The ABS release of Building Activity for the September 2007 quarter shows that the trend estimate of the value of new residential building fell 1.1%. New houses and new other residential building fell 1.1%. Alterations and additions to residential building fell 1.0%. Saul Eslake, Chief Economist at the ANZ bank estimates that, on current trends, by 2010 underlying demand for new dwellings will be just above 180,000 while actual completions will be just below 150,000.

4. Land release is another component of the supply side problem. Modelling produced by the Property Council of Australia estimates that the shortfall in land planned for release on the east coast is currently 12,000. It projects, on current trends, that shortfall to be 50,000 lots by 2016 and 127,000 by 2026. The shortfall Australia wide by 2026 is suggested to be as high as 180,000 lots. *(Summary Report: Australian Broad Hectare Land Supply Study, Property Council 2007).*

5. Following from the above, the value of land is an increasingly important part of the housing affordability problem. As a proportion of the total housing package, the cost of land has increased rapidly since 2001; from 24% to 37% in Melbourne, 21% to 49% in Brisbane and most notably from 32% to 60% in Sydney.

6. The Property Council modelling suggests that failure of planning adequate supply to meet underlying demand has had an economic impact of $384 million (or $28,900 per dwelling), increasing house prices by 9% since 2001.

7. However, there is also another side to any analysis of the land supply issue. According to the NSW Government, in 2007 there were 33,000 lots in NSW zoned and serviced but yet to be developed. This is because, in the current market, with prices falling in outer Sydney, houses are not being built. It is therefore an over simplification to say that land supply alone is the issue. The problem is a combination of inadequate land supply and what the currently inefficient housing market produces by way of completed dwellings.

1.2 Income/house price ratio

8. At the same time as supply has been constrained and demand remains strong, wages have failed to keep pace with house prices. This has been the case since the early 1960s. There is strong evidence to suggest an underlying structural affordability problem. Between 1960 and 2006, real house prices increased at an average of 2.7% per annum. Per household real incomes for the same period rose 1.9% per annum. The problem was made worse in the late 1980s property bubble and particularly since the 2000-2003 housing boom. Between 1986 and 2007, earnings doubled but house prices increased five times *(NATSEM Income and Wealth Report 2008)*.

9. The NATSEM data shows prices to incomes in macro terms but there is also much variation between income groups; the distributional effects of housing costs are also of concern. Spending on housing costs across all tenure types has steadily increased from 11% in 1970 to just over 15% in 2003-04. In that year, spending by lower income households was almost double the national average at 28%. According to Yates et al, this shows that the proportion of households with high housing costs in relation to their income is “polarized and polarizing” *(Yates, Housing affordability: a 21st century problem, AHURI 2007).*

10. The most critical factor in housing affordability is, unsurprisingly, household income. The nexus between the housing and labour market is of critical importance. Professor Judith Yates et al *(AHURI Final Report No. 105, 2007)* highlights future risk factors in the income/housing relationship. The observation is particularly timely given the progress currently being made toward a new national system of labour market regulation and the insecurity of global financial markets:

    “Labour markets are less regulated than they were in the past. There is greater reliance on fixed term contracts, part-time work and a casualised workforce, all of which put incomes of the working poor at risk. The steady growth experienced over the past decade has provided a strong

element of protection against the risks that such changes impose on individual workers but there is no guarantee that the economic boom will continue to benefit all workers including the low skilled. A downturn will affect purchasers who depend on overtime or additional part-time work to pay their mortgage and aspirant purchasers who rely on this to help save a deposit."

A key ingredient to housing affordability is a decent, predictable income. In the context of a tight labour market and low unemployment, adequate wages growth is part of the solution to housing affordability

1.3 Trends in affordability/demography

11. Housing affordability is a deep and deteriorating problem. This is evidenced by a number of trends. Over the past decade, outright home ownership has declined by 9 percentage points to 34.3% (NATSEM Income and Wealth Report 2008). There has been a corresponding increase in the number of households paying off a mortgage, from 30% in 1995-96 to 35% in 2005-06.

12. Further, the number of households renting privately has grown from 18% in 1995-96 to 22% in 2005-06.

13. In 2004-05, the average household needed 7.5 times its annual disposable income to purchase a house. In NSW, the situation is even more dire where the ratio is now 8.3 (up 40% since 1995-96). In the same time period, owners with a mortgage experienced a 32% increase in weekly housing costs (after adjustment for inflation). Private renters experienced a 19% increase (new CPI data shows this number in particular has risen dramatically since then).

14. Low income households experience a higher incidence of housing stress. The average housing costs paid by low income renters in 2005-06 was 29% of disposable income; just slightly below the commonly accepted housing stress standard (a similar proportion of disposable income is spent by lower income households with a mortgage who paid on average 28% of disposable income on housing costs in 2005-06).

15. Across the whole private rental market, that figure was on average, 19%. This means that there is a large gap between what proportion of earnings low income earners pay and the average for the whole rental market; a further demonstration of polarisation in the market.

16. Housing costs in the private rental market are likely to increase sharply in the period ahead *(Rising rents will fuel investors' returns, Australian Financial Review 20/03/08 p32)*. In this section of the housing market there too is a sharp misalignment of supply and demand. Nationally, the vacancy rate is about 1%, approaching an historic low. In some capital cities, that rate now sits below 1%. A recent forecast by BIS Shrapnel predicts sharp rent rises in the period 2008-11. It predicts rent rises of 11% (Sydney), 8% (Melbourne), 7% (Brisbane) and 6% (Adelaide and Perth).

17. This will compound an already difficult period for private renters with CPI figures showing a 6.4% increase in rents nationally in the year to December 2007.

18. Across all income groups and forms of tenure, 23% of households spend more than 30% of their disposable income on housing costs. This figure rises significantly for one of two groups disproportionately represented in the housing stress figures – first home buyers. In this group, 62% spend more than 30% of their income on housing costs. In particular, it is recent first home buyers

who are vulnerable to upward movements in interest rates. They have bought at high prices but have comparatively low income (and low equity levels) compared with other home purchasers.

19. Predominately, recent first home buyers are members of the so-called Generations “X” and “Y”. Only 3% of lone person and couple only households under 35 owned their home outright. By contrast, 74% of lone persons aged 65 and over and 86% of couples in this age bracket owned their house outright. As well, owners in the from the so-called “baby boomer” generation are less susceptible to housing stress. Less than 10% pay more than 30% of disposable income on housing costs. This imbalance clearly highlights a growing problem of intergenerational equity.

20. However, there are indications that higher house prices are starting to be felt across all age groups but in different proportions. In the age category 60 and over, 9.5% now still have a mortgage. In 1995-96 that figure was 4.2%. It has more than doubled.

21. These market failures have also been compounded by poor or inadequate policy responses. Of particular importance was the 1999 decision of the Howard government to halve the rate of Capital Gains Tax. This policy setting diverted funds from the productive section of the economy – income derived from producing goods and services – to speculative real estate investment. This had an immediate effect. Australian Tax Office data shows that in 1998, interest paid by property investors was over $5 billion. In 2005 that figure was over $12 billion (partly explained by increasing interest rates – but still a very large movement), a massive increase which demonstrates a reallocation of economic resources. The increase in speculation and resulting increase in property demand for housing by investors very often simply increased house prices.

22. It is apparent that presently housing costs are inflationary. The December CPI figures demonstrate this clearly. Importantly, prices are rising with no productivity offset. Addressing housing affordability therefore becomes part of any strategy for addressing inflation.

1.4 Social and economic impact of unaffordable housing

23. The social impacts of unaffordable housing have been well documented *(3rd Annual Demographia International Housing Affordability Survey)*. With a homelessness rate surpassing 100,000 and an increasing number of families finding themselves in this situation the problem is large and growing. There is also a related growth in demand for emergency housing.

24. Similarly, housing in Aboriginal communities is in critical need of renewal. The recent announcement of a review of Aboriginal housing is timely and urgent.

25. Housing stress blocks engagement with and formation of local communities and disadvantages households in the labour market. Links to local communities take time to build, they also require security of tenure.

26. There is also new evidence of negative economic impacts that unaffordable housing may be causing. In the December CPI numbers, housing clearly shows up as driving up prices. In particular, after a long period of constrained growth, rents are up significantly. This issue was touched on above in the context of the private rental market. However, in broader terms and with much discussion now focused on inflation, it’s important to see this trend in the

broader economic context of price pressures. Similarly, the impact of the recent interest rate hikes is now pressing on mortgagees pushing up their housing costs significantly.

27. There is emerging evidence that unaffordable housing is beginning to impact on the proper functioning of the labour market. Berry *(Housing affordability and the economy: A review of labour market impacts on policy issues. AHURI Research Paper 2006)* has found that, particularly urban labour markets (where 80% of the population is concentrated) may be artificially constrained as workers are forced to the periphery of major cities. There is little Australian research on this issue to date however, as Berry points out, in the United Kingdom a clear trend has emerged. The UK Government has set up a program aimed at subsidising housing for so called "Key Workers," teachers, nurses and police amongst others. The program has not yet been expanded to the private sector. In Australia in the context of almost full employment, an economy operating at near full capacity and skills shortages in many industries, it is likely our housing problems are impacting on the efficiency of the labour market.

Current federal government announcements on housing affordability

28. The CFMEU welcomes the active approach of the Federal Government on the issue of housing affordability.

29. We endorse the view that the private rental market is a key area of housing stress, and therefore regard the expanded National Rental Affordability Scheme as timely and well targeted.

30. The CFMEU supports the tax incentives for development of 100,000 new affordable rental properties. Close attention will have to be paid however to whether the level of subsidy is sufficient to attract the large amount of investment required to make the scheme work.

31. The CFMEU believes that Industry Superannuation Funds have an important role to play as investors in housing. The union will work with government and employers to examine the viability of providing funds toward this new asset class. As always, these decisions will be informed by prudent financial decisions at the Industry Super Fund board level.

32. In particular, we welcome the Housing Affordability Fund of $500 million. There is a critical need both for investment in housing associated infrastructure and coordination of the various levels of government to facilitate its provision. As a policy position, the CFMEU also takes the view that developers have an obligation to contribute to the costs of infrastructure. We believe the Federal Government should closely monitor the implementation of policy in this area to ensure that savings to developers are passed on to consumers and not simply translated into increased profits.

33. Similarly, the First Home Saver Account, enjoying favorable tax treatment is an appropriate policy response to the growing deposit gap – particularly with respect to lower income renters saving to enter the home ownership market. The CFMEU supports this policy as one means of addressing intergenerational equity issues arising out of housing market failure.

34. The transition toward a viable National Affordable Housing Agreement will be a difficult process. Previous policy failure and general neglect of the nation's housing needs means we are starting from a weak institutional base. With the renewed attention of the federal government in this vital area, the CFMEU is determined to play an active policy role.

Recommendations by terms of reference

Barriers to home ownership in Australia, including:

a) Taxes and levies imposed by state and territory governments

35. The CFMEU recognises that the cost of provision of infrastructure to local communities requires a revenue base through appropriate taxation. In our view there is little evidence to support the proposition that state and territory taxes are excessive and therefore the CFMEU supports the current settings. Special pleadings by property developers should be seen for what they are. Similarly, land release should be sensitive to employment, environmental and community considerations.

Recommendation: Maintain existing policy settings

b) The rate of release of new land by state and territory governments.

36. It is vital that land supply is more closely aligned to underlying demand. The CFMEU supports the release of land by state governments in a more timely manner. However, we also recognise the critical need for the construction of infrastructure associated with new housing projects. Land release and development without appropriate attention to infrastructure investment is not sustainable.

Recommendation: Pending the review of housing supply by the recently announced National Housing Supply Research Council, policy settings should aim at increased land release. Land release should be tied to infrastructure development and broad community considerations.

c) Proposed assistance for first home buyers by state, territory and the Commonwealth governments and their effectiveness in the absence of increased supply.

37. The CFMEU recognises that increased supply of new housing must be a priority area for policy settings. However, the proposed measures to aid first home buyers are appropriate where supply can be increased. Given the fact that the deposit gap and housing stress are disproportionately felt by lower-income households, targeted measures are necessary to aid affordability outcomes.

Recommendation: That the Commonwealth appropriately means test the First Home Buyers Grant. That the savings be re-directected to lower income households operating in conjunction with the First Home Buyers Savings Account to facilitate a more targeted program assisting low-income households in purchasing a first home.

d) The role of all levels of government in facilitating affordable home ownership.

38. The CFMEU holds the view that housing affordability is a deep and worsening problem with serious social impacts. From this it follows that it must be a priority area for all levels of government. The new institutional arrangements at the Commonwealth level, particularly the establishment of a Ministry, will aid the process.

Recommendation: The negotiation of a new National Affordable Housing Agreement be a matter of priority for all levels of government.

e) The effect on the market of government intervention in the housing sector including planning and industrial relations laws.

39. The CFMEU believes there is market failure in housing. There is now broad consensus, even amongst conservative economists that when markets fail governments should intervene. There is both a strong social and economic case for the Commonwealth to address the housing affordability crisis. The focus on supply side measures with the aim of injecting new private sector capital is an appropriate response along with a suite of other measures.

40. The question of industrial relations laws is also important. As discussed, the factor of household income is a key determinant of housing affordability. It is important that wages keep pace with prices. The new more balanced system of workplace relations to be introduced by the Labor government will aid housing affordability to the extent that it allows greater security of employment and a more responsive relationship between prices and wages.

Recommendation: That the Commonwealth proceed with urgency to legislate its commitments both in housing affordability and workplace relations.

f) The role of financial institutions in home lending.

41. The CFMEU recognises that, particularly since the advent of financial deregulation, financial institutions have played an active role in increasing demand for housing. Lending criteria has loosened. There is also recent evidence to suggest profit taking by banks at the expense of borrowers. Mortgage interest rate rises above the official interest rate continue to be the norm for the big banks.

42. A recent report from the Melbourne Business School *(Joye and Gans 2008)* puts forward a useful policy proposal. It calls for the establishment of a government agency "AussieMac" similar to models in the US. The proposal would aid non-bank lenders and preserve competition in the home mortgage market (a critical element in any affordability solution).

Recommendation: That the Commonwealth and the Reserve Bank of Australia actively monitor financial institutions to ensure appropriate lending standards are upheld and customers are protected from inappropriate price gouging. Further, the Commonwealth should consider creating a government agency capable of borrowing at government rates to underwrite non-bank lenders and ensure continued competition amongst housing finance providers.