Submission to the
Senate Select Committee on
Housing Affordability in Australia

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INTRODUCTION

This submission attempts to distil a long, complex and fraught issue into a short and pithy presentation. Should the Senate Committee wish to interrogate me further on the themes I develop, I am willing to submit to detailed cross examination.

Once in every 10 to 15 years housing affordability becomes a hot political issue. This, in turn, generates a variety of 'solutions' that are often worse than the disease and which fade into obscurity after inflicting wasted resources and ineffective digressions on to the community. Severe housing affordability issues particularly afflicted the Whitlam, Hawke and Howard governments over the years 1972-75, 1988-91, and 2002-2007 respectively before fading – in the first two cases – from society's radar.

Focusing particularly on current circumstances, this submission explores serially:

i. the reasons why housing affordability issues emerge at medium term intervals
ii. the sections of the community adversely affected by housing issues
iii. policy responses on the part of governments and regulators, and
iv. the likely impact of those responses.

From this, I will comment on the likely future trajectory of the current 'crisis' and focus on the potential flaws in policy responses.

THE EMERGENCE PROCESS

Declines in housing affordability follow booms in housing prices, which in turn reflect lack of supply relative to demand. During the last five to six years especially, Australia has witnessed an almost perfect storm of soaring demand working against lagging supply of subdivided land and house construction. These two components of affordability have in many respects different dynamics and will often be treated separately in this submission.

Table 1 shows the principal factors at work shaping housing demand and estimates the extent to which governments can control or influence them. Table 2 contains similar information for the supply of land. One could present a third table explaining the rising cost of house construction, but this is not such an important issue because it is little faster than the pace of inflation and reflects mainly quality and appointments issues rather than runaway costs of construction. Most of the rising price of housing stems from land price inflation and that, in turn, reflects lack of supply in relation to demand. Lack of supply has two main components: insufficient new housing lots; and slow conversion of land with single housing units to medium and high density

Table 1 Factors Influencing Rising Demand for Housing (nationally or regionally)

Type	#	Factor	Importance: 2002 - 2007 [1]	Extent of Public Control or Influence [2]
Demographic		*Falling Average Household Sizes*		
	1	later marriage	L	W
	2	fewer children per family	L	P
	3	rising number of single/couple retirees (longer life expectancy)	L	W
		Internal Migration		
	4	to Capital City Regions	M	W
	5	inter-state	M	W
		Net International In-migration		
	6	long-term / permanent	M	P
	7	457 Visa (or similar)	M	S
	8	rotation into Australia of corporate executives	L	W
Wealth	9	Rise of Two-income Households	M	W
		Sharply Rising Real Wages and Salaries		
	10	productivity spurt in 1990s	H	P
	11	growth in professional, skilled, creative employment	H	W
	12	emerging skilled/professional labour shortages	M	W
	13	rising international competition for skilled/professional workers	M	W
		Emergence of Wealthy Retiree Class		
	14	based on earlier superannuation reforms	M	P
	15	Rising Levels of Inheritance and Other Intergenerational Transfers	H	W
	16	Decline in Unemployment (from 7 to 4 percent)	H	S
	17	Increased LF Participation Rate (from 63 to 67 percent)	H	P
Macro-Economy	18	Falling Marginal Taxation Rates	M	S
	19	Increased Private Share of GDP (cf Government/Public)	M	P
	20	Persistently High GDP Growth	H	P
	21	Low Reserve Bank Discount Rates (especially after the tech-wreck)	H	S
	22	Competitive Capital Markets - low cost home loans	H	P
	23	Changed Lending Habits by Financial Institutions (e.g.high LVRs)	H	W
	24	Commercial Investment Boom	H	W/P
		Rapidly Falling Price of Consumer Goods		
	25	globalisation of supply	M	W
	26	rise of China and other low-cost suppliers	M	W
	27	growing efficiency in retail / service distribution	M	W
Lifestyle	28	Rising Two-home Ownership	L	W
	29	Growth in Size of Homes (e.g. McMansions)	L	W
	30	Tree- and Sea-change preferences	M	W
	31	Rising Preference for Personal Independence	L	W
	32	Rise of Fly-In Fly-Out Living Arrangements in Mining etc.	L	W
Alternative Investments	33	Stock Market Slump of 2001-02 (made property look a good investment)	H	W
	34	Wealth Effects of 2003+ Financial Boom	H	W
Psychology	35	Herd Mentality of Housing Markets	H	W
	36	False / Distorted Understanding of Housing Markets	H	W
	37	Fear (e.g. of missing out on home ownership)	H	W

[1] High (H), Moderate (M), Low (L) **[2] Strong (S), Partial (P), Weak (W)**

Table 2 Factors Influencing Low Availability and High Cost of Urban Land (nationally or regionally)

Type	#	Factor	Importance: 2002 - 2007 for High Land Costs[1]	Extent of Public Control or Influence [2]
Goverments		***State Government***		
	1	Lack of Timely and Coordinated Infrastructure Provision (publicly of privately owned)	H	S
	2	User Pays Infrastructure Pricing Mechanisms (vs community rating)	H	S
	3	Insufficiency of Designated Urban Land in Metropolitan Planning Schemes	M	P
	4	Ineffectiveness of Protocols to Increase Residential Densities	H	P
		Lack of Willingness to Work Flexibly with Major Developers to Accelerate Production		
	5	site assembly	L	P
	6	coordinated servicing	M	
	7	acceptance of new design principles / construction standards	M	
	8	innovative funding arrangements	L	
	9	Insufficent Encouragement of / Engagement with Developers	L	W
	10	Inadequate Own Account Land Subdivision / Redevelopment of Existing Urban Land	L	W
	11	Where a State Responsibility, Failure to Determine Development Consent Speedily	M	W/P
	12	Insufficient Monitoring of Demand and Supply Balance of Residential Property	L	P
		Local Government		
	13	Effectiveness of Working with State Governments to Reinforce Items 1 - 10	M	P
	14	Failure to Ensure Timely and Speedy Development Consent	M	P/S
	15	Excessive Planning Gain Requirements / Developer Charges	H	S
	16	Lack of Can-Do Development Culture	M	P
	17	Insufficient Engagement with Communities to Reduce NIMBY sentiments	H	P
		Commonwealth Government		
	18	Insufficent Monitoring of State and Local Government Approaches to Land Dev't	L	W
	19	Insufficient Monitoring / Forecasting of Residential Property Supply and Demand	L/M	W
	20	Insufficent Research on / Disseminate of Best Practice Land Supply/Management	L	W
	21	Overly-Generous Fiscal Inducement for Land/Home Ownership	H	S
	22	Inadequate Supply of Skilled Trades Labour	L	W
Developer Operating Environment		Industry Conservatism on:		
	23	design concepts	M	W
	24	construction standards	L	W
	25	lifestyle options	L	W
	26	Inadequate Investment in Plant / Equipment / Skilled Labour	L	W
	27	Inadequate R & D Expenditure on Construction Technologies	L/M	W
	28	Failure to Adopt Best Practice Management Techniques (e.g. scale economies)	M	W
		Insufficient Work with Communities to:		
	29	reduce NIMBY sentiments	L	W
	30	explain / market development proposals	L	W

[1] High (H), Moderate (M), Low (L) [2] Strong (S), Partial (P), Weak (W)

Contingency Tables for Tables 1 and 2

Contingency Tables

A Table 1

Extent		Importance L	Importance M	Importance H	
	W	7	9	9	25
	P	1	3	4	8
	S	0	2	2	4
		8	14	15	37

26	9	2

B Table 2

Extent		Importance L	Importance M	Importance H	
	W	12	3	0	15
	P	3	6	2	11
	S	0	0	4	4
		15	9	6	30

18	8	4

housing. Thus these two tables summarise the principal factors at work and the extent of public control over them. The two contingency tables and the foot of Table 2 suggest that the room for public manoeuvring is limited because of the complexity of the problem, and minimal government control over many of the relevant contributing factors. However, some action is possible, and I will deal later with the appropriate form and scale of such mechanisms.

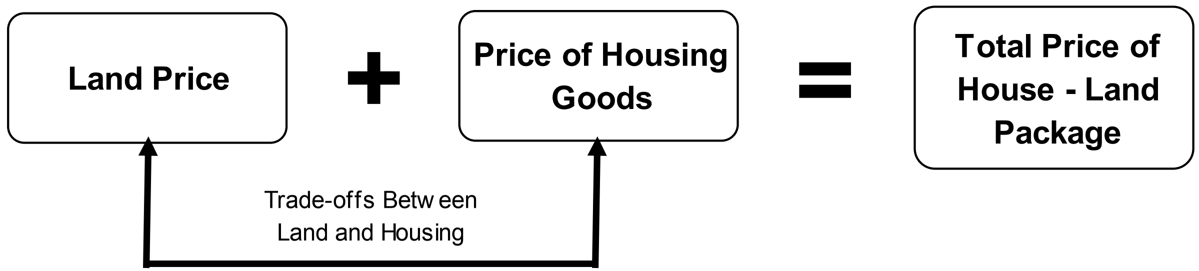
Before we go further, I will address the nature of housing markets. First, the amounts of money available for housing is, in some ways, a residual after households allocate money for a wide variety of goods and services. A feature of the 2000s was the sharp drop in prices for many items of expenditure, especially household appliances, electronic equipment, cars, clothing, and even some food. That liberated income for expenditure on housing and a range of emerging heads of expenditure, notably travel, personal care, dining out, and entertainment. It is difficult to assess the impact of shifting expenditure patterns on house prices, though I suspect that the period 2002-2005 saw a swing in the balance of expenditure towards housing, just as current rising fuel costs and food prices will drive house prices lower in real terms for some market segments. These balances are shown in Figure 1.

Secondly, housing markets work very badly at pitching fair value compared with, say, stocks and shares. Both are subject to excessive booms and busts, the former stemming from what Robert Shiller has termed irrational exuberance, and the latter reflecting the fear of bear markets and household over-extension. The similarities end there, because stock markets can quickly retrace their steps as we have seen in the 25% correction between November 2007 and the end of March 2008. They are helped by short-selling, calls on margin loans, the sheer skill of investors, extensive trading disclosure rules, the generally massive about of reasonable quality information brought to the market, and a wide array of expert analysts.

In contrast, housing markets are simply appalling. Most households are amateurs using rough rules of thumb; many owners are resistant to taking losses; there are huge entry and exit costs compared to the 1% or less brokerage on shares; markets are illiquid for property and buying or selling times can be measured in months; people are much more emotionally attached to their property than computerised CHESS records for shares; and home-owners rarely downsize their accommodation to meet their changing needs. One consequence of these considerations is that housing markets are very slow to get up a head of steam on the rise and even slower to fall, a feature common to many countries around the world. Average Japanese house prices recorded 16 consecutive years of falls (from 1990 to 2006) before bottoming, after the property boom of the 1980s. Australia's housing prices were flat in nominal terms (falling in real terms) during the first half of the 1990s. Current US house prices are falling much more steeply, but for the fact that the sub-prime driven boom lost complete touch with fair value and because of certain institutional and legal factors working in the US housing market. The difference in price performance over time for shares and houses is shown schematically in Figure 2.

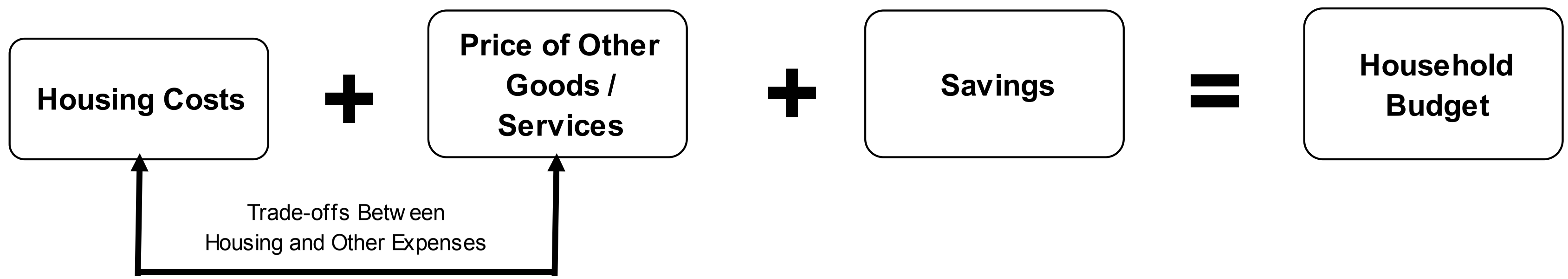
Figure 1: Some Basic Equations

Land Housing Interaction



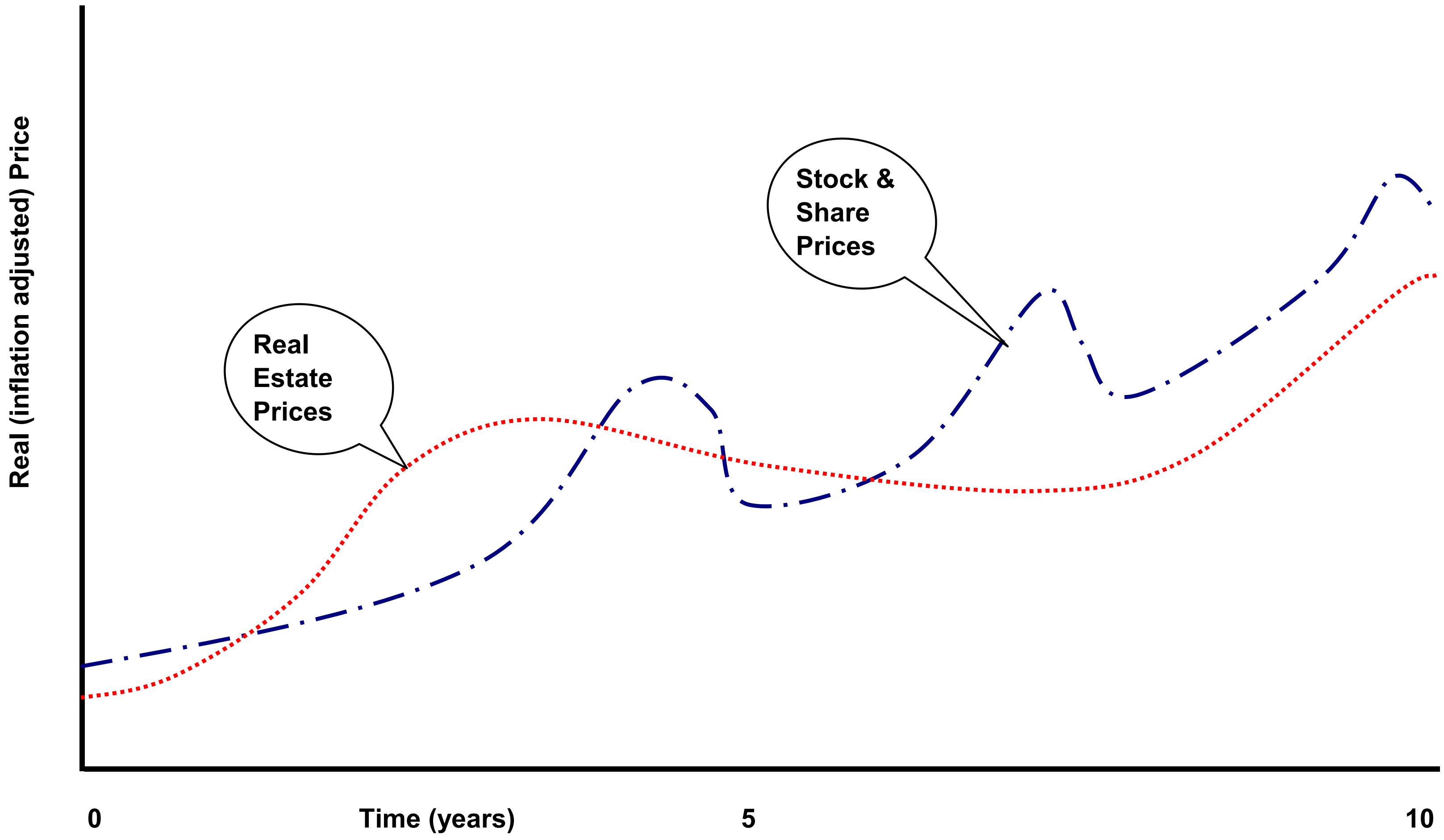
Source: the author

Housing Outlays to Total Budget



Source: the author

Figure 2: Cyclical Price Fluctuations in Housing and Shares



A PERFECT STORM

Given this background we can summarise the house price boom in Australia during 2002 to 2005 (in Sydney) and later in other major cities as follows. After the Dot.Com share market crash of 2000, ASX share indices had a rough two years and investors turned their attention to property as a safer haven and this helped trigger rising prices for investment property. The owner occupied housing market had also been given a boost by the First Homeowner's $7,000 subsidy (raised temporarily in about 2000 to $14,000) and this, as theory suggests, was capitalised in house prices for this buyer category. A substantial rise in prices therefore became apparent in about 2002 and was given a sharp boost by several more or less co-incidental events. Reserve Banks in Australia and elsewhere lowered their discount rates sharply in 2000/2001 to counter the financial effects of the Dot.Com frenzy. This meant that households could borrow a lot more money and still maintain repayments. In my view the corresponding mortgage interest rates were held low for much too long, and the processes was given a sharp nudge by the emergence of fringe mortgage lenders (e.g. Aussie, RAMS) which forced the main retail banks to trim their interest rates further. Once stories gained ground of large profits to be made from buying and selling property, a typical buying frenzy emerged as lots of people wanted a slice of the action. This was ably abetted by TV lifestyle programs explaining how to make money from property.

At this point, several other factors crept in. The share market recovered markedly and money made from that had a 'wealth' effect encouraging people to borrow more for real estate, which for a while was self-sustaining. Share price rises reflected initially the fundamentals of the mining boom and generally rising consumer sentiment, both of which led to (a) a sustained fall in unemployment and (b) rising workforce participation. Both these increased the amount of cash in the economy chasing housing. At this point immigration levels rose sharply, doubling between 2000 and current targets for 2008 fuelling demand for accommodation.

These events impacted on housing markets differentially across Australia, with Sydney being the first cab off the rank, but rapidly joined by the mining states of WA and Queensland with their large inflows of labour. Victoria's residential property markets responded a little later as the national boom gathered strength, followed by Adelaide and Hobart. The latter saw huge prices rises off a relatively low base.

In ALL cases rapidly rising demand hit sluggish supply created by lack of state investment in infrastructure, ponderous regulatory controls, constraints in the building sector which also faced high demand for commercial property developments (office, retail and industrial), and insufficient supplies of building materials and tradesmen – many of the latter lured more recently to high paying jobs in the mining sector. As in any other boom, failure of supply to match demand caused rapidly escalating prices aided an abetted by the animal spirits of the housing sector alluded to earlier.

THE CONSEQUENCES

As in most markets, house prices badly over-shot. The extent is debateable, but several indices – including the annual Demographia Survey, data from the Reserve

Bank and the Housing Industry Association – Commonwealth Bank (HIACBA) – suggest that there is great separation between current prices and fair value. For example, the Demographia Survey puts Sydney's median house prices at 8.6 times median household income when a ratio of >5 is severely unaffordable and ≤ 3 is affordable. In contrast, such important and comparable cities of North America as Dallas – Ft Worth and Montreal have indices of around 2.5. To put things in perspective, Sydney's house prices would have to fall over 70% from their current level to represent comparable value! Let's make that closer to 50% if we take into account Sydney's superior living environment and public services, but that is a massive fall from current levels. And nearly all the difference is in land prices. In the March Quarter of 2007, the HIACBA report noted that, Australia-wide, the average annual household disposable income had fallen substantially below the annual qualifying income to support a mortgage to purchase a median first home. Such figures are alarming and unsustainable

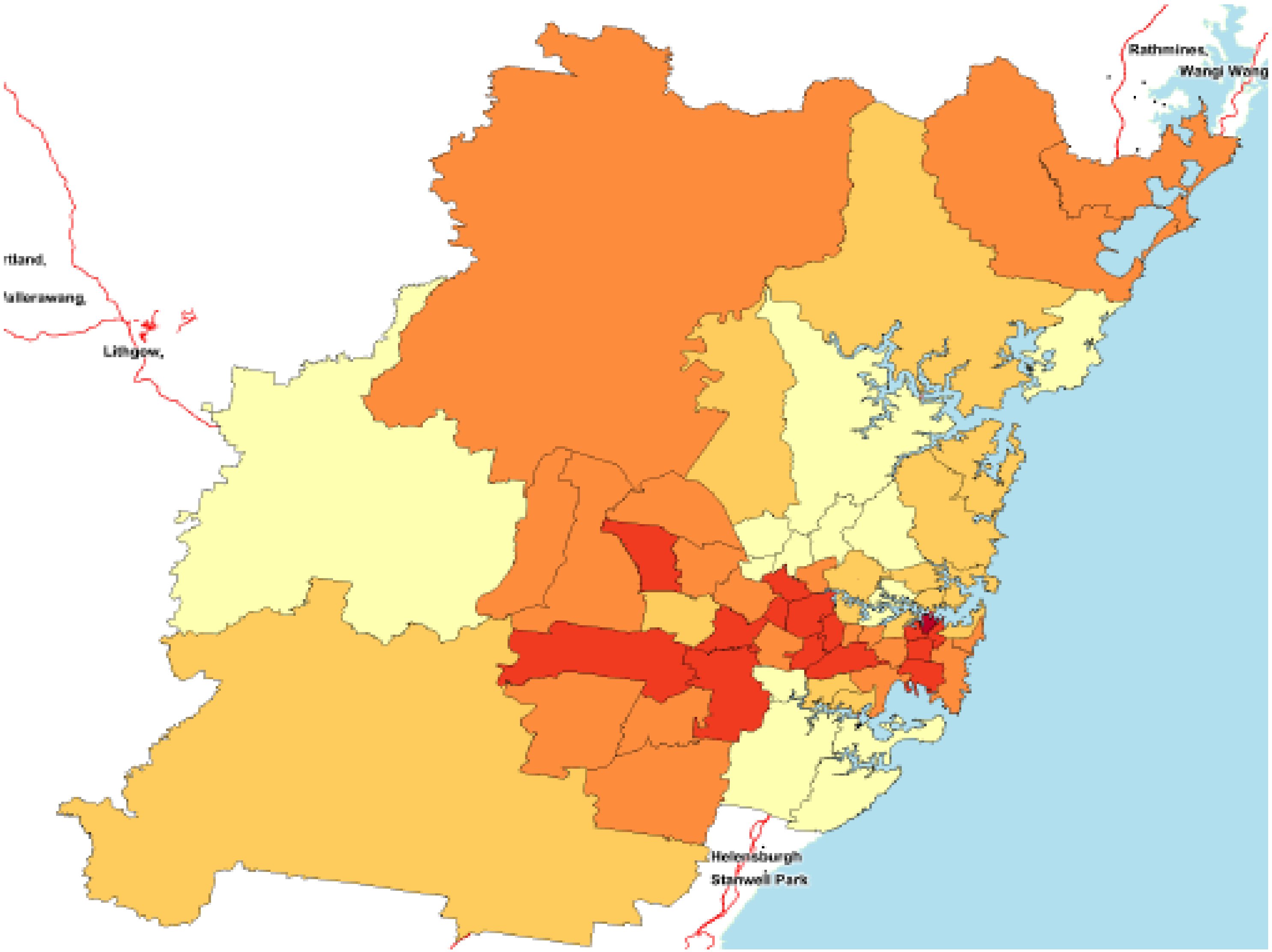
These figures just presented are Australia or city-wide, but the incidence of housing stress varies spatially within our cities. The highest stress locations are those with high proportions of households in the bottom 40% of household incomes and with housing costs > 30% of income. In the case of Sydney, these two indicators coincide in belt running south of the harbour through such suburbs as Canterbury and Bankstown and on west and southwest (see Figure 3 for a sample map of places where housing outlays exceed 30% of gross income). This is important because it suggests that high housing prices can be handled much better by the residents of some areas compared with others. The worst affected localities will be those with large numbers of households with first home mortgages taken out relatively late in the boom-bust cycle and relatively low incomes reflecting some combination of young age or low skills. Such areas are doubly at risk from the inevitable sharp reduction in house prices and potentially rising unemployment as the economy slows under the weight of adverse consumer sentiment and high interest rates. Both will feed an accelerating house price reduction, especially in such stressed locations.

PROGNOSIS

The reduction in house prices and its collateral damage appears to be beyond any government control, even at the margin. Every housing bust – in Australia and elsewhere – has had similar consequences and this occasion looks to be no different. One can expect flat to slightly declining nominal property prices over an extended period of several years over Australia as a whole, with much worse or better performance in specific sub-markets. Expensive real estate and regions experiencing strong net in-migration are likely to fare much better than their low priced or low population growth counterparts.

Market corrections to residential property generally take several years to unfold, despite the perception on this occasion that there is a large overhang of pent up demand. It is true that Australia's annual population growth figures have risen on the back of rapidly rising net immigration, a rebounding birth coincident with the baby bonus, and large gains in life expectancy. The rate reached 1.5% in 2007 (ABS 3101.0). That is allied to continued declines in household size (falling from 2.7 to 2.6 over the decade to 2006). The tightness of the housing situation is revealed by rapidly

Figure 3: Households with Housing Costs 30% or more of Gross Income
percentages of households shown by SLA
Source: ABS Census Statistics



rising rental outlays for those households unable to afford entry into the owner-occupied market. We know, too, that existing mortgagees will be reluctant to let go of their properties despite increasing mortgage interest rates and will forego consumer goods, holidays, and even food to do so. The iconic nature of home ownership in Australian society ensures that, along with the personal shame of loosing one's home.

On the opposite side of the coin, several factors will continue to act as severely depressing influences on house prices:

- the Reserve Bank's primary aim of curbing inflation by raising its discount rate to a sufficiently high level;
- the response by major lending institutions of raising their mortgage interest rates even higher to reflect the tight supply of money and to regain traditional margins eroded by non-bank competition;
- a general tightening of lending standards by financial institutions to eliminate loans to risky customers;
- the risk of rising unemployment, which, if it occurs, will severely damage consumer sentiment among would-be first home owners. Such rising unemployment is likely despite current historically strong demand for labour;
- consumer sentiment is falling anyway and that probably has some way to run;
- the abating of consumer faith in ever rising property prices;
- indeed, the realisation that, in a falling market, the 'entry imperative' no longer operates. Simply sitting on the side-lines will ensure cheaper homes in the longer run;
- the slowly dawning realisation that inflation is accelerating the fall in real prices of homes. Suppose that Australia averages 3% inflation a year over six years, and that nominal prices remain static. The average hone-owner will lose 20% of their property's real price over that time frame;
- high (and probably rising) petrol and food prices will directly erode the price of land, which is a residual; and
- even a resurgent stock market could attract funds away from housing.

My best guess is that Australian house prices will decline on average about 25 to 30% in real terms over the next 5-6 years for these reasons.

POLICY CONSEQUENCES

The extent of the decline over that time (say, 6 years) and thereafter could be affected in either direction by policy settings. It is conceivable that some measures would mitigate the extent of decline (but not avoid it). On the contrary, all the sensible policy responses would tend to accelerate it!

Mitigating a Declining Market

Numerous policy suggestions have made to reduce the impact of declining house prices, while at the same time hopefully improving affordability. Let us be absolutely clear, however, that the essential way of improving affordability is to reduce prices drastically, and discussion of how to do that follows later. In the meantime we can only help people to get into the housing market or prevent the loss of their homes through subsidies of one kind or another. Ideas that have been floated include:

A First Home Owner Grants

Governments might raise such grants to the sum of, say, $15,000 to help would-be owners to bridge the deposit gap and reduce their future mortgage outlays. Such schemes are entirely without merit because there is clear evidence in support of theoretical suppositions that such grants are soon capitalised in house prices as demand is raised. Early entrants get a slight advantage and later grant winners none at all as they now confront higher house prices to roughly the extent of the subsidy.

B Special Savings Deposits for First Home Owners

This notion (as outlined by the new Commonwealth Government) has a few merits, but also some of the demerits of the FHOGs above. Insofar as they raise the amount of money available for deposits, they will also raise prices (or, in the current market, cushion declines), making entry in home ownership more difficult for those not needing special assistance to raise a deposit. The merit lies in encouraging would-be home-purchasers to save for their future and, hopefully, develop a life-long habit.

C Accessing Accumulated Superannuation Savings

I cannot think of a worse use of superannuation moneys, which supposedly designed to improve the life of retirees and remove them from dependence on the state. The use of such moneys for immediate consumption comes with the moral hazard of favourable tax treatment and the need therefore, on equity grounds, to tax recipients for the benefits they have received and betrayed. The squandering of such savings in a falling market to keep people in homes they have mistakenly brought at excessive prices is stomach churning.

D Establishing the Australian Equivalents of Freddy Mac and Fannie Mae

These long-standing home lending institutions in the US are busy trying to quarantine the fall-out from the sub-prime disaster and protect over-extended households and it has been suggested that similar institutions be set up here. Certainly they are the kind of channel through which the Commonwealth could channel funds to prop up stressed households. However, it appears too late to launch these kinds of organisation to deal with the current crisis and their roles were partly covered by our non-bank home loan institutions like *Aussie*. I wonder if this approach is needed with better regulated home lending procedures of the kind advocated later and more timely home construction to meet spiked demand. Incidentally, neither Freddy Mac nor Fanny Mae succeeding in dampening the animal spirits of the US housing market over the period 2003-2006.

I find it difficult to think of any action to rescue the current over-bought and faltering market in any substantial degree from its inevitable nemesis or nadir. All such potential ‘solutions’ tinker at the edge of a large abyss brought about negligence, stupidity and bad luck of a large cast of players. They represent an attempt to shut the stable door after the horse has bolted. None are directed at the nub of the affordability problem: excessive prices brought about by sticky supply in response to unanticipated demand.

Anticipating Uneven (Spiked) Demand

In its simplest terms, our property market experiences over the last five or six years, reflect the inability of the land supply and construction sectors to deliver a timely product. Put another way, were supply perfectly elastic, we would not have had an explosion in the price of homes, though they would have risen because of excessively low (in retrospect) mortgage interest rates and aggressive lending by financial institutions. We therefore focus here on a range of supply side issues.

E Infrastructure Supply

For me, one of the key supply bottlenecks lies with infrastructure supply and pricing, largely a state government responsibility. It has been remarked widely that state governments have failed in the timely, integrated (or coordinated), and cost-effective supply of essential urban infrastructure. We are talking here of water and sewerage works, electricity supply, roads and freeways, railways, a range of public transport services, and schools and hospitals. A key word above is timely. Painful as it might seem to the budget, many – if not all – of these facilities are needed **in advance** of development to permit the instant expansion of housing supply in the face of surging demand. This raises the issue of whom or what will fund this advance infrastructure. At first sight, it seems to place primary responsibility in mainly public hands because it is difficult to see the private sector constructing infrastructure in advance of urban expansion without knowing its take-up speed. On further reflection, this need not be a bar and urgent discussions are needed between government and private suppliers to assess the conditions under which the private sector might engage in anticipatory infrastructure provision.

The funding of infrastructure is also fraught, though not insoluble. Up until almost 30 years ago, much was community rated in the sense that recurrent income from user charges was used to fund capital works. In the interim, state governments have moved heavily towards the user pays principle, where facilities are charged substantially to new residents seeking to live at the urban fringe. This, in retrospect, is a mistake and a return to community rating is overdue. User pays, in the case of Sydney, adds up to $150,000 to the cost of newly subdivided land. Its removal could chop nearly 25% off the price of a house and land package (everything else being equal). Of course, users of these services would pay a higher price, but over a life-time and at mostly at times when they could afford to pay extra. Secondly, the return to community rating would more or less end (after a generation or so) the massive free benefits handed gratuitously to the residents of pre-1980s housing stock. In essence, high up-front charges for new subdivisions were capitalised by all existing owners, as one would expect in a competitive market. The high cost of new land bid up the price of existing land.

Of course, we need comprehensive metropolitan planning (which has gone in and out of favour over the years) to know where in advance the infrastructure will be needed and the likely development schedule for different locations. This will enable relevant authorities to development long range and timely works programs that will catch them short through unanticipated population growth. Metropolitan planning also needs to pay much more attention to the redevelopment of existing facilities and regions to accommodate many more households – in effect to come up with large scale and imaginative urban renewal schemes and the planning mechanisms to make them happen. This is essential to avoid protracted NIMBY campaigns to protect the benefits and lifestyles of existing residents as the expense of the urban whole, and deter unknown would-be residents who have little voice in the issue – except where represented by some combination of developers or planners. As an aside, public particpation processes in planning (which have a surface appearance of democracy) slow down the potentially beneficial redevelopment of whole swathes of existing suburbia. Metropolitan Planning schemes need to be under constant reappraisal and revision and capable of long range action.

F Innovative and Timely Housing Forms

If proactive metropolitan planning and infrastructure development are essential to more closely match demand for housing goods, so are proactive land subdivision (or redevelopment) and house construction. There have been several difficulties in this respect, including:

- the natural unwillingness of developers to produce lots much ahead of revealed demand;
- bottlenecks in home construction;
- lack of imagination in home design so that different market segments are well catered for;
- extensive community conservatism over what constitute acceptable housing designs (it's doubtful if we'll go as far some Dutch developers and create homes out of shipping containers). Conservatism exists in both the wider community and among house purchasers; and
- sometimes important delays by consent agencies (not just, though mainly, local government) in respect of subdivisions, redevelopments, and housing proposals.

All these problems could benefit from constructive and on-going discussion by the parties involved, with the idea of developing speedy, imaginative, early and timely, and environmentally sound house construction. These discussions will involve not just developers, communities, and regulators, but also architects, building materials suppliers, environmental scientists, and infrastructure or building materials suppliers. This is a whole of community issue.

G The Role of Public Housing / Land Commissions

Public housing accounts for a small portion of the housing market (about 5%) and has little part to play in providing a solution to massive imbalances in supply and demand in the remaining 95% of the market. The current unaffordability problem owes virtually nothing to the role of public housing, and it would have occurred in more or less its observed form were the public sector 10% or 20% of the total. In the long term, after the price of housing has sunk substantially in real terms, there will be few calls for or need for the expansion of the public sector.

Under current price conditions, the demand for rental housing has soared along with the price. A sharp drop in house prices will serve (a) to reduce demand for rental accommodation, but (b) balance that effect with rising yields, probably making private investment in rental housing more attractive. Of course owners of rental properties will suffer capital losses in this process, but they above all should have been prepared for a large market correction.

Land commissions were the 1970s solution to soaring land prices, but they have never realised their potential and were conspicuously absent during the current crisis in shovelling large lots of subdivided land at low prices into the booming market. Of course, Land Commissions would have been hobbled like private developers by excessive infrastructure pricing issues, and the hazards of land regulation. I cannot see any continued role for such Commissions in taking the stick to private developers with low cost subdivisions. Rather, the various measures advocated here collectively will serve to reduce land prices.

ENTHUSIASM FOR RESIDENTIAL REAL ESTATE

Owner-occupied or rental housing has iconic status for its owners. It is regarded as an undemanding and understandable store of wealth with excellent prospects for capital gain. It is attended by tax breaks which make investing in residential property financially attractive. It is also enmeshed in a set of beliefs and myths, some untrue, which make it appear better than it is in practice as an investment vehicle. As always, property investment is like share-market investment. The biggest gains are received by those who buy quality property early in the upswing of the property cycle; those who catch the train late in less desirable locations are probably en route to struggle street. Yet few of the precautions attending share-market investment are voiced property spruikers.

Perhaps it is time to remove some of house investment's gloss in the interest of making good quality housing accessible to all. Among the possible steps are these:

- removing the capital gains tax exemption for owner-occupied housing. This is, by the way, a hugely regressive tax treatment with nearly all the gain attaching to the top one third of households by income. For simplicity, capital gains taxes could be installed for housing with a market value approximately > $750,000.
- removing negative gearing for rental properties. The key to encouraging investment in rental properties is to raise yields and that can be done by reducing the price of residential property. Rents would fall, but not as fast, thereby driving up yield.
- imposing stricter loan protocols on financial institutions to provide borrowers with a buffer. Aggressive lending practices over the last few years have encouraged households to over-borrow to the extent that they are hugely exposed should unemployment rise, one or more members leave the workforce through illness or parenting.
- revising the real estate industry's responsibilities in selling properties to include similar restrictions to the financial planning sector. At the moment, real estate is sold much like furniture, despite property being the largest investment ever made by most households. *Caveat Emptor* is not an appropriate strategy for most households unschooled in the realities of property ownership – which are almost always less rosy than many suppose. Failure, to advise households of the risks involved in high home loan debt could lay the real estate sector open to legal action by financially stricken households.

None of these approaches will operate rapidly to depress house prices. Instead, they would operate over a generation to dampen the historic boom-bust cycles experienced in house prices. The principal levers to reduce house prices and therefore raise affordability lie principally in the supply side approaches outlined earlier.

MACRO-ECONOMIC MANAGEMENT

The Commonwealth Government has a prime responsibility of engineering a prosperous and expanding economy where growth is maintained in a stable way. It so happens that these responsibilities are also central to the maintenance of housing affordability. Crises in affordability, as we currently have, are exacerbated when macro-economic settings are pitched inappropriately. The single most unfortunate event was the failure to raise interest rates during 2002-2003 after the Reserve Bank had engineered their fall as an antidote to the Dot.Com crash two years earlier. Artificially low rates triggered a frenzy of rising house prices. This was no isolated event because the US Federal Reserve and the Bank of England did exactly the same and the outcomes were also similar – unsustainable housing booms. Recent rises in interest rates, which have thrown Australia's property markets into reverse are the unfortunate consequence, and, in my view, the rises have been sharper than they would have been otherwise had rates been raised concurrently with booming prices.

Of course, the US Fed has had to lower its discount rate dramatically because of much worse financial conditions than our own triggered by the sub-prime mortgage crisis and the drying up of business liquidity. They will soon discover, however, that rises in interest rates will be needed to head off inflation and another asset price boom. The necessary macro-economic trick is to keep interest rate settings as stable as possible and move immediately to choke off emerging price bubbles before they cause rampaging damage. Part of that task, in respect of real estate, is to expand the Reserve Bank's watching and regulatory briefs over innovative financial instruments – such as the securitisation of dubious mortgages with unwarranted AAA ratings. I have no problem with financial innovation designed to improve the velocity of the circulation of capital and its direction to high yielding and sustainable investments. However, the Australia's recent housing boom did not have those effects. Capital was diverted from productive investments into rapacious consumption and ultimately much higher interest rates likely to cause economic loss.

I have noted that rising house prices – and consequent lack of affordability – were triggered in part by rising immigration, rapid growth in the mining sector, and globalisation among others. These are desirable developments of considerable national benefit and are matters to be accommodated in housing policy, not choked off for fear of their inflationary consequences. Once again, I will reiterate that the path to avoiding booms in house prices and their malign consequences is to engineer conditions of rapidly flexible supply. This is a task requiring accurate forward planning, up-front infrastructure investment, and streamlined regulatory procedures.

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