Submission on the Housing Supply Regulation Interim Report

Dr Robert Sobyra
[Redacted]

Thank you for the opportunity to comment on the PC's interim report. The report is, in broad terms, economically sound and correctly identifies the central role of commercial feasibility in determining whether housing is built.

My main concern is that the PC's policy conclusions run ahead of the analysis in one important respect. It has established a plausible mechanism through which upzoning can improve development feasibility. It has not yet established how much additional housing broad-based upzoning would produce over and above the housing that would emerge as feasibility conditions adjust through normal market processes.

This is the most important question for policy because the PC is contemplating a permanent structural change to the planning system in response to a temporary cyclical dislocation in development feasibility. The burden of proof is therefore higher than simply showing that upzoning can improve project economics in the short run. It needs to show that any acceleration in restoring normal rates of housing supply is enough to justify the enduring consequences for urban form, amenity and other planning objectives.

My submission develops three broad points:

1. **Separate the shelter problem from the ownership problem**—housing availability, rental affordability and access to home ownership are distinct policy outcomes and should not be treated as interchangeable measures of "housing affordability."
2. **Upzoning can increase supply, but the effect will be transitional**—in current conditions, broad upzoning may provide a one-off feasibility reset by helping development revenues catch up with the post-pandemic cost structure, but that does not imply a permanently higher rate of aggregate housing production.

3. **Test policy against the no-reform counterfactual**—the PC should compare the path of housing production under broad upzoning with the path that would emerge as land values and dwelling prices adjust anyway.

Separate the shelter problem from the ownership problem

The inquiry's Terms of Reference blend several separate conceptions of Australia's housing 'crisis'. The two key concepts involve access to housing as shelter and access to housing as an asset. These are different problems, governed by different price-formation mechanisms.

Housing performs two economically distinct functions. It provides a flow of shelter services, and an owned dwelling is also a financial asset. Policy should not treat access to those two things as synonymous.

For housing as shelter, the question is whether the housing stock is sufficient to the number and location of households seeking accommodation. The vacancy rate is the clearest market-wide indicator of that balance. Housing as shelter is recognised by the United Nations as a universal human right.

For housing as an asset, the question is what determines the price at which households can acquire claims over the existing housing stock? That market is heavily influenced by financing conditions because most purchases are leveraged. While unequal access to the privilege of property ownership may raise some wealth equity considerations, it is not existential in the same sense as access to housing as shelter.

It is unfortunate that this conflation in the Terms of Reference has been carried forward into the PC's interim report, which moves too freely between three policy outcomes: whether there are enough dwellings, what shelter costs, and whether households can afford to purchase housing assets.

This weakness is visible in Box 1 of the interim report, which begins with the textbook proposition that, holding demand constant, greater supply lowers housing prices. The report then cites empirical studies finding lower city-wide dwelling prices and rents relative to the counterfactual and treats both as evidence of improved "affordability".

But these are not economically equivalent welfare outcomes.

Suppose a demand-side stimulus increases household borrowing capacity and drives up dwelling prices. Higher prices trigger a construction response that ultimately lifts rental vacancies and restrains rent growth. Access to shelter improves while access to the housing asset market deteriorates. A combined measure of "affordability" obscures that distinction.

Conversely, suppose a tax reform materially reduces investor demand for new dwellings. House prices fall, improving home-purchase affordability. But weaker presales and lower project revenues reduce development feasibility, causing fewer homes to be built and eventually tightening the rental market. Ownership affordability has improved while access to shelter has deteriorated.

This illustrates that housing policies are often pulling in different directions. Whether a measure is good policy cannot be answered without first specifying the housing outcome it is intended to improve. To avoid further confusion in housing policy, the Commission should draw a clearer distinction between access to housing as shelter and access to housing as an asset.

Upzoning can increase supply, but not permanently

The PC is right to place commercial feasibility at the centre of the housing supply question. As the interim report notes, the market is currently plagued by a feasibility crisis resulting from a one-off cost shock that drove down residual land values, while prevailing land prices proved inelastic. This dampened the investment signal for new development and is the root cause of the current low rates of housing supply.

The burden on any reform is therefore to demonstrate how it can help rebalance the prevailing revenue–cost structure for new development and restore that investment signal.

Under normal circumstances where supply is broadly aligned with household formation—something that should be reflected in a relatively stable rental vacancy rate—upzoning should not be expected to have a significant impact. That is because zoning determines what gets built and where, but it cannot manufacture the purchasing power required to sustain new development above the rate supported by the market.

However, where feasibilities are systematically depressed—as in the current market—broad upzoning could provide a one-off "feasibility reset." By allowing developers to extract more value from prevailing land prices, revenues can be brought into a better alignment with the new higher cost base. Note that any uplift beyond the feasibility gap would be quickly capitalised into land prices.

The key point is that the opportunity for a large catch-up response is unusually strong because the market is currently experiencing a widespread feasibility problem. Once feasibilities have normalised and supply has returned to a rate consistent with underlying household demand, the one-off reset has been exhausted. The more permissive zoning regime will continue to affect what gets built and where, but it should not be expected to sustain housing production permanently above the rate the market can absorb.

Upzoning is a permanent, structural solution to a temporary, cyclical problem – but is it worth it?

It is rarely acknowledged that the current feasibility crisis is not fixed and will resolve itself over time without intervention. Some combination of lower land values and higher dwelling prices will restore feasibility to the market. Even without planning reform, many of today's unviable projects will be viable later.

Clearly, this 'natural' adjustment is taking longer than we would prefer.

The promise of upzoning is to accelerate this process. That could still be a substantial benefit. Housing delivered several years earlier can materially ease shortages. But it is different from claiming that upzoning permanently lifts the aggregate rate of housing production.

The most important analytical question, then, is how much additional housing upzoning would cause to be built *relative to what the market would produce anyway*.

The interim report recognises the first part of this problem and has indicated the PC would make it a focus in its next phase of work. However, it is just as important to model the 'do nothing' counterfactual. Upzoning is a card that can only be played once, and it carries permanent consequences for the form and character of our built environment.

The comparison that should be made is therefore not between an upzoned market and a world in which today's economics are frozen in place. The choice is between two adjustment paths – a gradual free market adjustment, or a potentially quicker adjustment via a broad-based regulatory intervention.

The most important policy question is whether the temporary acceleration in housing production generated by upzoning is large enough to justify its permanent effects on urban form, amenity and other planning objectives. Only by modelling both adjustment paths can governments and communities make that judgement.