TRANSCRIPT
OF PROCEEDINGS

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PRODUCTIVITY COMMISSION

INQUIRY INTO FIRST HOME OWNERSHIP

MR G. BANKS, Chairman
DR D. ROBERTSON, Associate Commissioner
DR E. SHANN, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

AT MELBOURNE ON TUESDAY, 10 FEBRUARY 2004, AT 9.35 AM

Continued from 9/2/04

MR BANKS: Welcome to what is I think the last day of this round of hearings on the commission's discussion draft on first home ownership. Our first participant this morning is the Real Estate Institute of Australia. Welcome to the hearings. Could I ask you, please, to give your name and your position.

MR STEVENS: Bryan Stevens, chief executive officer, Real Estate Institute of Australia.

MR BANKS: Good, thank you. Thanks very much for taking the time to attend this morning, also for the submission that you've provided on the discussion draft and an earlier substantial submission that we benefited from in preparing that draft, and also of course you participated at a roundtable that we had early in the proceedings. So I'll hand over to you to make the main points and we can have some discussion about that.

MR STEVENS: Okay, thanks very much. I might make some comments for about 15 minutes or so and then open for questions if that suits.

MR BANKS: Good. Thank you.

MR STEVENS: Chair of the commission and the inquiry, Gary Banks, members of the inquiry, ladies and gentlemen, as I've already stated, my name is Brian Stevens and I'm the CEO with the Real Estate Institute of Australia. We represent all the state and territory institutes across Australia and collectively they represent about 75 per cent of all real estate agencies across Australia. In addition to that, we've recently signed strategic alliances with both the National Real Estate Franchisors Association, which represents all the major franchisors across Australia, We've also signed an alliance with a group collectively known by their web site as PropertyLook, which is all the commercial large companies across Australia and of course they have international commitments as well, and on that basis I'm delighted to say that on behalf of the REIA and our partners I thank you for the opportunity to address the inquiry today.

We've separately made two submissions to the inquiry. The first submission was in response to the Productivity Commission issues paper of September last year, and the second was one that we gave you last week in response to the Productivity Commission draft discussion paper of December of last year, and that's obviously the subject of the hearing today, and my remarks are confined to our latter submission.

Let me say at the outset that we believe the Productivity Commission has provided a comprehensive draft which covers a number of issues on what we think is the very complex subject of home affordability. There are some issues which we believe warrant further consideration. Firstly, with respect to home affordability, I think there's little doubt that house prices have risen as a result of a number of reasons, including historically low interest rates, high consumer and business confidence, relatively poor performance of alternative investments, including the share market, implications for the ageing baby boomers, low unemployment rate and, of course, relatively ready access to finance.

In the context of the latter, that is availability of finance and investment advice, in its draft report the commission has suggested further regulation of lending practices and property investment advice. Regarding property investment advice, in August last year the Ministerial Council on Consumer Affairs agreed to form a national working party to examine national regulation of property investment advice. This came about as a result of government concerns at the operations of marketeers and property investment advisers and the detrimental impact that they may have on unwary consumers.

The REIA is on public record supporting government initiatives to stop deceptive and misleading conduct of marketeers. Moreover, real estate practice is already highly regulated by state and territory governments and also must comply with Commonwealth legislation, including the Financial Services Reform Act. We believe this act clearly outlines the limits of advice that can be provided by real estate agents, and we've had that formally confirmed by ASIC, and that decision has been relayed to agents and the institutes across Australia.

The REIA proposes that the commission make a clearer distinction in its report of the problem regarding the objectives of a national working party, that is, targeting marketeers and seminar spruikers so that the high street real estate agents who we represent are not inadvertently and unnecessarily further regulated as a result of general views which may be expressed by the commission in the draft discussion paper. Whilst still on affordability, the commission made the point that affordability is cyclical and may be at its lowest level of the cycle. The REIA analysis suggests that whilst economic fundamentals remain in place in the foreseeable future, then affordability is generally not expected to change significantly.

The next issue is the social benefits of home ownership and implications for government. The REIA supports the commission's findings that home ownership enhances both social and economic performance and social capital. The socioeconomic benefits of home ownership are extremely well documented and I think are indisputable. We have a very high rate of home ownership in Australia and rental property is a part of the important balance, but we should not stop there. Indeed, home ownership has fallen across Australia from 69 to 67 per cent, and in the age group of 25 to 34 years old, it has fallen by 10 per cent over 10 years. There are a number of reasons behind that which I won't go into at this stage.

This concerns the REIA and we believe should be a major concern for all federal and state governments. The major political parties both advocate self-funded retirement and self-funded retirement implicitly assumes home ownership, so when you talk about self-funded retirement you are immediately talking about the fact that you assume that person owns his own home. If a retiree does not own their own home, they would need a dedicated superannuation fund of about $250,000 returning 5 per cent per annum to generate $250 per week for modest rental accommodation.

This figure does not allow for depreciation of the capital by inflation of subsequent rent increases over the life of that retiree, which could be 30, 40 years. Plus, in addition to that fund, the retiree would need a separate and substantial superannuation fund for normal living expenses. Such funding is beyond the means of many Australians. Therefore there is potentially a significant reduction in the lifestyle of the retiree and a significant added impost for governments in terms of pensions, health and welfare, as well as the lost investment in social capital that we all acknowledge is important in the very fabric of our society.

Next is the supply of land and houses. The REIA supports the commission's general finding that the processes for supply of land and homes should be reviewed to improve efficiencies in order to help home affordability. This, together with the social implications for governments, would cause the REIA to recommend that there should be a federal government housing minister to work with state and territory governments and industry to develop a nationwide approach to take account of the many issues in home affordability, including but not restricted to regional policy, demographic changes, public housing, taxation reform which affects housing, and sustainability.

The commission noted the inefficiency and inequity of stamp duty. The REIA agrees and is pleased to see that this issue is being picked up by some state and territory governments, if only regrettably at this stage for first home buyers. Reliance of state and territory governments on stamp duty can be described as unjustified and discriminatory, and some rely on up to 30 per cent of their state revenue generation from property taxes. Stamp duty should be abolished or, at the very least, indexed so that the thresholds keep pace with rising house prices to avoid early threshold creep.

Next, land tax: the REIA is concerned by the commission's suggestion that land tax, amongst other things, I hasten to add, is an alternative to stamp duty. Land tax is a disincentive to already diminishing yields on residential investment property which will affect residential property stock available for rent, keeping in mind the commission's very good points that there needs to be a balance between home ownership and rental availability. Land tax would be an unwelcome impost on the income of retirees and may force some retirees to relocate from their family home to more affordable and potentially less enjoyable areas.

The REIA agrees with the commission's view that an holistic review of taxes is required. For example, there is currently no asset holding tax on shares. Why should there be a significant holding tax or penalty tax on property which is particularly one of the fundamental requirements of life - that is, shelter - but shares go unmolested?

The next issue is taxation. The REIA agrees that tax on tax, that is, stamp duty on GST, is iniquitous and should cease. Overall, the REIA proposes that there should be a review of taxation to identify inefficient taxes and replace these with more efficient and more equitable arrangements. We suggest that government consider the proposals of the Business Coalition for Tax Reform, the BCTR, of which the REIA is a member, for government to initiate action to conduct a review of the intergovernment agreement, IGA, as part of the new tax system which was promised for review by 2005.

Despite representations by the BCTR and ourselves to governments over the last few months, I am not aware of any action that has started on this particular review - bearing in mind 2005 is not far away. Moreover, unless government accepts the broad terms of reference for that review, residential stamp duty and land tax will not be reviewed, because these taxes are actually not already included in intergovernment agreement. Only stamp duty on commercial conveyances is included in that agreement.

Next, negative gearing: the REIA concurs with the commission's view that changing negative gearing on housing investment would have a range of detrimental flow-on effects to renters and investment opportunities for individuals. Negative gearing assists individuals in all income levels and is a key instrument to assist the wealth creation process in a range of investments rather than only property. The REIA considers that there should not be any housing-specific changes to negative gearing, including depreciation. However, we note that the commission has recommended a broad review and if this occurs it should include the interaction with all taxes, including capital gains tax and general income tax across all - and I stress "all" - asset investment classes.

Next is the first home owners scheme. The REIA notes that the commission found that the scheme brought forward some housing demand and this has increased prices somewhat but its overall effect has been small. The REIA also notes that the federal government has indicated that the scheme has no sunset clause. The REIA does not support the commission's view that a deficiency in the present arrangement is the lack of targeting. The scheme is a fixed dollar grant that has not been adjusted as house prices have risen.

There is certainly a deficiency in the scheme which is that its value has declined markedly, such that the grant should actually now be no less than about $11,000 instead of 7000 to maintain relative value. The scheme should continue, as far as the REIA is concerned, to apply equally both to new and established homes, in order to provide choice to first home buyers, ensure an equitable approach to home ownership and not unduly skew one part of the marketplace.

The commission has suggested means or asset testing for the scheme. We believe any government proposal would need to account for potentially - and I stress only potentially - insurmountable practicalities. For example, there would be significant administrative overheads which would reduce the amount of funding that's available for what it was intended.

Secondly, people who have accumulated some other assets: for example, a small parcel of shares through prudent investment may be forced to sell at a time not of their choosing when the market is bad. It will be difficult to decide an equitable income threshold because house prices vary so much across Australia. Similarly, we believe that a cap on the value of the home would not be consistent, even within each state, let alone across states across Australia. A straightforward, consistent and relatively simple approach is to index the scheme so that it remains useful, as the government intended.

So, overall, the REIA considers that the Productivity Commission has provided a comprehensive report on a very important and complex problem. Clearly the bottom line of the report is that homes are less affordable and this will probably not change whilst the socioeconomic fundamentals remain for the foreseeable future. The REIA broadly endorses the draft discussion paper.

Now, Australians know property. You can't go to a dinner party, a lunch, a cup of coffee without someone talking about property. They know property. Whilst affordability is a complex issue, Australians understand that demand has pushed up property prices for a number of reasons. Notwithstanding this demand, the major reasons for reduced affordability include inefficient and inequitable taxation arrangements including stamp duty and the fact that the First Home Owner Grant scheme is simply not keeping value against relative rising house prices. There are significant implications for young Australians and we have a responsibility to address that, but also potentially costly implications for governments in the context of declining home ownership and self-funded retirement.

In summary, the REIA proposes five broad initiatives: first, taxation reform in the context of a review of the intergovernment agreement on the new tax system by 2005, to reduce if not abolish stamp duty on residential property; second, establish a minister for housing in the federal government to develop a nationwide approach to housing including comprehension of implications for government of declining home ownership; third, establish a national housing forum of governments and industry to progress the commission's report and actually do something about home affordability; we can't let the good work the commission has done thus far sit on a shelf collecting dust. It needs to be progressed in conjunction with industry. Fourthly, review the land and housing supply process and finally, the First Home Owner Grant should be indexed to changing house prices.

Gentlemen, on behalf of the REIA, thank you for the opportunity to address the commission, and we look forward to working with the commission and government to help develop solutions to the problems of home affordability, particularly for first home owners.

MR BANKS: Good. Thank you very much for that. You've ranged over a variety of areas, some of which we could explore in a bit more detail. One of the earlier points you made was in relation to trends in affordability and whether affordability was likely to improve and I guess to what extent we're observing cyclical versus more secular influences at work. I thought I might just get you to elaborate a little bit on that and in particular maybe comment on what has been happening in the high-rise or multi-unit inner-city segment of the market; whether we are seeing that come off the boil.

We know that rental yields are pretty low - they're some of the indicators that we referred to in our report - just whether you place any significance on those and perhaps a related question as to what extent different segments of the housing market are related, so that if you had a significant downturn in that component of the market, whether that could relay itself more broadly to the housing market, or would be likely to be confined within that sort of multi-unit segment.

MR STEVENS: Okay. Just on the cyclical nature of it, certainly our data is showing, and anecdotal evidence in the last three or four months - ie, before the December quarter figures are known - it's basically showing that things have stabilised, if you like, but overall there is still a strong market. We believe that whilstever the fundamentals stay in place - for example, low interest rates, low unemployment rate, easy access to finance, high business confidence, high consumer confidence and all those things remain in place - that you will sustain a strong market. That's across the board.

Obviously in the marketplace there are different segments of the market. There's inner city, there's houses, there's apartments, there's townhouses, freestanding, city fringe, rural and what have you. A lot of that is driven by people's family circumstances, married/no children, single, married/children/dog, access to schools, access to work, access to recreational facilities - driven by a whole bunch of individual circumstances. So we're simply saying that across the board we believe it's still a sound market, but there is no doubt that some segments of the market are showing cracks - like, you know, the flat market, apartment markets.

That said, in Sydney the vacancy rate is still quite low - still quite low - so all the prophets of doom two years ago - that hasn't come through on the data. It varies around the country. I do stress that. It varies within segments of the market, so we'll wait and see what the so-called glut of apartments, particularly here in Melbourne - what effect that does have and how that might affect other segments of the market, because I think a lot of it is driven by family circumstances, access to jobs, access to schools, how far they're prepared to travel, whether they need a yard, whether they don't - those sorts of things.

MR BANKS: What you've said - you mentioned that there had been some sort of levelling out and I guess the question for us is to what extent we'd see the kind of cyclical behaviour continuing that we've observed in the past. Others have rightly pointed out that it has involved rises and falls above what has been a rising trend in real house prices over time. But I mean, are you saying in a sense that you'd see a levelling out rather than a decline?

MR STEVENS: Our data is showing that. Anecdotal evidence is showing, for example, open for inspections around various capital cities are dropping off - you know, the attendance at those. Auction rate clearances have fallen. We think that the rise in interest rates, two rises last year, had an effect on that, and we've had discussions with the RBA to that effect. We basically suggested to the RBA a few weeks ago - before the board sat last week - that we felt they should wait until the December quarter figures were available for analysis, in order to be able to comprehend what's actually happening in the marketplace. So we have anecdotal evidence, but we like to work off facts. Anecdotal evidence is showing it is stabilising and we wait and see in the March time what the December quarter figures show.

MR BANKS: Okay.

DR SHANN: Do you attribute what you see as that stabilisation, too, I suppose, the interest rate rises and how significant do you think the Kaye events were in influencing views about the real estate market?

MR STEVENS: I wouldn't like to comment on Mr Kaye at a public hearing. I don't think it's appropriate for me to do that. I would say that I think the interest rate rises have had an impact. I don't think there's much doubt about that. I think, though, that they are still relatively low historically and we need to keep that in mind. We don't believe that the drop-off, if that has been the case, is directly as a result of that. We think that the home affordability is really about a number of other issues, not just interest rates, and I've covered those.

We think that stamp duty in particular is absolutely horrendous and no real concern has been expressed by governments that they are helping to cause that problem. So we think government should look at that first home owner's scheme as targeting that deposit gap. Now, certainly the first home owner's scheme was introduced to offset GST, that's what government introduced it for. It wasn't there to help deposits, in that sense, but I think the government has a philosophical commitment towards helping first home owners. Now, whilst that philosophical commitment is there, and they are prepared to put a grant scheme together, it should be valued at current prices. It's way below it's market value at the moment.

So we believe that really home affordability is not just about interest rates; it's about all the measures that are in the marketplace that make it difficult for a young couple or single person to get into a home for the first time.

DR SHANN: I guess - as you say, as we argued, the surge in demand has been a major factor in pushing up house prices and therefore affecting the affordability of first home buyers. The solutions you're suggesting in terms of increasing the First Home Owner Grant and abolishing stamp duty, and I'd assume replacing it using GST receipts or payroll tax rather than land tax - in brackets. I mean, it would all have the effect of boosting demand further - ie, they'd all be adding to demand for housing. You are also suggesting the federal tax treatment of negative gearing shouldn't be changed, so I guess the question would be: isn't the problem with the set of proposals you're putting forward, that it would lead to further increase in demand and further rise in house prices?

MR STEVENS: There are some very good points in there. I think there are three aspects to it. Let me just take them along the lines of how you've posed them. Firstly, with respect to alternatives: I've clearly said in the opening statement there I think that land tax would be iniquitous. Already it's becoming a disincentive for investors in residential with low yields. If you broaden it in a general term so that it would hit any home occupier, the retiree would really feel it. He would really feel it. If you gear it against unimproved value of land, some retirees who bought their home on the North Shore of Sydney, when you could buy a place for sort of $40,000 or $50,000 and it's now worth $2 million - he couldn't afford to live there. That's a family home. I mean, you'd be evicting him by any other means, and I think that would be a great tragedy. I don't think the retiree would feel that, you know, he'd been done rightly about that.

With respect to real alternatives we do believe - and it's in our first submission - payroll tax is an alternative. Access Economics did a report in year 2000 which the

REIA commissioned, which has an economic model which compares property taxes and payroll tax, amongst other things. I won't go into the model because it's actually quite complicated, but we have the report and we can make it available to you. We believe the bottom line of that report is that there are far more robust, stable taxes available and equitable taxes available than property tax - particularly stamp duty and land tax.

So the bottom line of that very lengthy and complex, thorough report is that you should be looking at other taxes. We think that you could roll that into the intergovernment agreement review, to show where the inefficient taxes are. A second report that was done by Access Economics, commissioned by BCTR, basically showed that payroll tax of all of those taxes, is the most efficient tax, and we can make that available to you as well, if you would like it. I hasten to add that when you talk about payroll tax, you know, people start to wince in their business pocket. Far and away of the 1.3 million small businesses in Australia who are the main employers in Australia, most of them would not pay payroll tax. So that needs to be clear.

I think the second point you made was about adding to demand. I think there are two points to be made there. The first is, philosophically, the government has made a commitment to help first home buyers. We think that's most laudable and I daresay that most Australians would agree with that; their sons, daughters, relatives should have an opportunity to get into the market - or themselves. So philosophically if the government accepts that they've made that commitment, then we believe that they should stand by that commitment, so its value is retained. So they have made it at $7000, that's way below what it was intended to be and we think it should be at least $11,000 according to the model we've got.

The second point, with respect to: will it push up demand? Your report in here concluded that the first home owner's scheme, whilst it did have an effect, overall it was a small effect. To answer your own question, I think your own report shows that it had a small effect. Aligned with that is that the first home owners historically run at about 20 or 25 per cent of the marketplace. They're down to 14 per cent at the moment. They're down to 14 per cent at the moment; it's horrendous. So you could argue that if that goes up it will have an effect on the marketplace - well, it will, but your report says it won't have much effect.

My argument would be, well, if it does have an effect, isn't that great, because you've got people getting into the market for the first time and they're getting homes, which is what this inquiry is about. So it will have some effect, but your own report is saying it doesn't have a great deal. The third point you made about negative gearing I think is that your report clearly shows and the REIA believes that at the moment public housing runs at about 5 per cent, renters run at about 28 per cent and home owners run at about 65, 67 per cent. We think that there has to be a balance between rent and home ownership and public housing. That balance is very important. It is very complex, and the extent to which you tinker with that is something that needs to be looked at.

But negative gearing is a key instrument in providing that rental housing - a key instrument. If you take that instrument away, it will affect the rental market, no question about it. The amount of rental properties that are available dry up, rents will go up and you'll force people into the public housing sector, because we know - we've got the inquiry here - they can't afford to get into their own homes; they're going to have to rent some way. So you're pushing people to the right rather than the left, and I think that would be a tragedy.

The other aspect I would say with respect to negative gearing is, look, it's not something special for property and we need to dispel this, I think, very clearly. Negative gearing applies to any business, any form of wealth creation, and wealth creation is very important from the point of view of lifestyle. It's very important from the point of view of self-funded retirement and provision for all of that. And negative gearing is a part of it. It's very simple. If you make an investment and you negative gear it, if you don't have enough cash flow to cover the negative gearing, then that investment becomes null and void. So it's not as if you're giving something away for nothing. You're not. So I think negative gearing is a very key part of the balance between home ownership, rental and public housing. I hope that covers those points, Ed.

DR SHANN: Yes, I guess I'd note that effectively what you're suggesting would increase the cost of the first home owners scheme by probably about half a billion and you'd be removing stamp duties and replacing them with taxes which weren't on property, and stamp duty is currently raising 7 or 8 billion, so you are talking about a substantial potential boost to demand, it would seem to me, for housing.

MR STEVENS: I guess what I'm talking about is if you increase the first home owners scheme by half a billion, I think your report says that the government outlaid about 3.8 over three years. Another half billion I think over three years is not a lot.

DR SHANN: That would be per year.

MR STEVENS: Yes. Now, with respect to stamp duty, what we're simply saying is that you need to look at other ways to do that, so I'm not for a minute suggesting that state governments could do without that money. What I'm simply saying is that we think there are more efficient and equitable ways in which the state governments can raise the revenue.

MR BANKS: We've had a number of participants tell us that the tax arrangements - and we're going to discuss this in a bit more detail with the next participant - but tax arrangements, including negative gearing, have really only favoured the top end of the rental market, so your point about those on lower incomes - what we're hearing from the ACTU, from ACOSS and from others is that in fact things are getting worse and worse for those in the lower quintiles and that most of the investment has flowed through into the top end. I'm just wondering whether you have any comment on that.

MR STEVENS: My comment would be this: I'd like to see their data rather than - - -

MR BANKS: We've seen no data. This is largely anecdotal.

MR STEVENS: I think it's important that you do see some data. I mean, you can't take that on face value. I'm just asking what the data is. It's just a simple request, that's all. I haven't seen the data. You've got to look at negative gearing as being across the board. I'm aware anecdotally that people do get into the lower end of the market in terms of investment, not just the high end of the market. And, indeed, from an investment point of view, if you have a look at the return that you would get on a $1 million property for the rent that it would generate, compared to a $400,000 property with the rent that it would generate, your rental yield on that million dollar is not nearly as good. I mean, you just have to do your numbers there, Gary.

MR BANKS: Yes, but the capital gain might outweigh that, and a lot of that investment is driven more by the capital gain than the rent perhaps - - -

MR STEVENS: And then it comes into capital gains tax, and it's the point we were making before, the interconnection of all those taxes; you can't just look at taking the housing negative gearing away; you've got to look at it in the context of all of the taxes because it does flow into capital gains and all those other things. So we're advocating a holistic view, and part of that intergovernment agreement, Gary, I think would be the way to do that.

DR ROBERTSON: I think one of the key points that's being made by these social groups is that in fact the rental properties that might be available at reasonable rents are being pushed further and further out. A lot of people that lived and worked in city centres lived in quite poor housing that's now been taken over in tower blocks, and they're out of reach. So I think part of the problem is the distribution of rental properties that are suitable for people who are not high fliers. It does seem as if the high end of the market has taken a lot of the capital.

I agree with you that we've also heard of quite modest households that have taken on an investment property by remortgaging their first house and what have you, and so there must be something there. I think you're right; the statistics are difficult to get at because it's not just a question of numbers. It's distribution as well. One of the things that I think we have to take into account as well is if we've got so many people investing in property now, then the house ownership figures are bound to fall, right, because the owner-occupiers are not there. I mean, the rental properties, in terms of the total stock of housing - the investment chunk is getting bigger, by definition, as the growth occurs - is going to reduce the number who are owning the house they live in. Have you got any indicators of the shift from ownership to rental in city centres and things, and how that's affected the total numbers?

MR STEVENS: There's a couple of questions in there, if I could just address those. You're talking about the city centres. There used to be affordable low-end rentals in the city centres because it's close to work, and I think it's very true, and some of those areas have been taken over by large apartment blocks and what have you, which has gone to another level in the marketplace - not all of it, but some of it has. There's no question about that. I think the inquiry should have a look at things like the Australian Housing National Research Consortium model, which I mentioned at the roundtable.

I think that's a very worthwhile model to have a look at. It combines private industry money with public money to put forward public housing which is available for rent at very reasonable prices, basically subsidised on a bond yield guarantee from state governments. The REIA believes that that is a worthwhile model to have a look at, and we think that would go a long way towards servicing that part of the marketplace that you pointed out you feel has possibly missed out.

I think the next point to be made is that when we're talking about first home owners, we're not just talking about those who are on the fringe of public housing. We're talking about people who are coming out of university or otherwise who might have a HECS debt, who are getting their first job, who have very promising prospects, but haven't been able obviously, without servicing their HECS debt, to save a lot of money to put down to a deposit. They've got no equity in anything to be able to fall back on to help them with that.

So I think we're not just talking about that sort of public housing end; we're talking about people who have good prospects, secure jobs, who simply can't afford to get into the marketplace. And I think that's a very important point, that we don't get too skewed at the public housing end. The REIA still very closely supports the need for public housing. We think it's absolutely critical, and hence we were part of that consortium that I mentioned earlier that developed that model for public housing. Does that address your questions?

DR ROBERTSON: It's helpful, thank you.

MR BANKS: Your comments on the first home buyers scheme - I just want to get you to elaborate a little bit on your position there. You've strongly argued for indexing the scheme and one can see the arguments there, but you've disagreed with targeting the scheme.

MR STEVENS: Yes.

MR BANKS: As you know, we discussed in the discussion draft that the effectiveness of the scheme was obviously much less at the higher end and if the goal was to get more people into home ownership then some form of targeting seemed appropriate. Is your objection to that primarily administrative or is it broader than that?

MR STEVENS: I think it's broader than that. It's two things. We would be very happy to look at any detailed proposal, and I think a lot of the devil is in the detail there. What we're simply saying is that there are practicalities that would need to be addressed. For example, do you put a cap on housing? How do you settle on a cap? Do you have a cap for houses, apartments, town houses, semidetached, rural, fringe CBD, CBD, middle CBD? Where do you put your cap? Do you use Sydney, do you use Tasmania? Prices are so disparate that it would be very difficult to settle on a price cap.

Secondly, in terms of targeting income thresholds or circumstances, how do you do that? You've got some single person who wants to get into his own home who has a particular income that you might set a level as a threshold. Does that apply equally to someone with three children who is trying to go to a house rather than an apartment. It's very difficult. So our objection is not a philosophical one. It's more on the basis of the practicalities of being able to actually implement that in an equitable way that would apply equally across Australia for all first home owners, and that's our real difficulty with it.

As I've said in there, there are potentially insurmountable practicalities. And whilst you invest a lot of infrastructure in developing ways to overcome that, all that administration cost takes away from the base which is being allocated to people. So what we're simply saying is, look, keep it simple, equitable, across the board and you'll find it goes a bit further.

DR SHANN: Haven't you, in a sense, got some of the same problems with the first home owners grant?

MR STEVENS: Yes.

DR SHANN: I mean, it's a flat amount but its significance varies depending on whether you're buying a house in Hobart, Sydney or regional Queensland, doesn't it?

MR STEVENS: It does, and we're saying that it's lost its value, Ed. We're saying $7000 - - -

DR SHANN: Yes, but even if you increased its value, it's still going to be a set amount and so its worth is going to vary, depending on the area in which you're buying a house.

MR STEVENS: Bearing in mind the basis on which it was introduced, we think it's about right. In other words, it was introduced to offset GST, so it wasn't introduced originally as part of a deposit, so I think there's some history there, Ed. You're not starting with a clean sheet of paper, okay? We acknowledge that it was introduced to offset GST. Now it's there. The government has a commitment philosophically to it. We've got to work with what we've got rather than start again, and we're simply saying it's not retained its value.

DR SHANN: Well, even then it's arbitrary because the amount of GST paid will vary with the price of the house.

MR STEVENS: Ed, we're not starting with a clean sheet of paper there. We're trying to work with what we've got there.

MR BANKS: About the philosophical commitment, you said earlier I think that there had been some kind of commitment to it being an open-ended ongoing scheme. What are you referring to there? Is there some documentation?

MR STEVENS: Yes. The treasurer made that commitment about 18 months ago, publicly.

MR BANKS: In what context?

MR STEVENS: In an interview.

MR BANKS: Okay.

MR STEVENS: And, if you like, I can check that, just to make - I can actually give you a date, I hope, but we're aware that that is the case, and we've certainly spoken with his office on that some time ago.

MR BANKS: All right. One question just occurred to me. We had an organisation yesterday called, I think, the Currency Task Force.

MR STEVENS: Sorry, I didn't get that.

MR BANKS: I think it was called the Currency Task Force. Mr Sherman came along and talked to us. He was arguing that regulation had to play a bigger role in controlling property markets, but he made the particular point that I thought I'd just raise with you. He saw this whole question of dummy bidding being a major inflammatory factor in price escalation throughout Australia. It's a legitimate point to raise because, as you know, some jurisdictions have moved against it. But I just thought I'd give you the opportunity to comment on that, since he's raised it as what he sees as a significant factor in the price escalation.

MR STEVENS: So you're asking me to comment on dummy bidding as a way of conducting auctions or that it might have had an effect on the increase in prices?

MR BANKS: Both, yes. Any comment you'd like to offer on it.

MR STEVENS: I think in the broad, the REIA has publicly said it's not in favour of dummy bidding, and in fact we've put out guidelines. We're working with the ACCC to stop that taking effect, and some state governments have already introduced legislation basically saying it's outlawed. So the REIA's position has been for some months, and will continue to be, that we don't support it. It's as simple as that. And I know here in Victoria legislation has just come into effect to outlaw dummy bidding.

MR BANKS: What about on the second point, his point that it's been a factor in the boom in property prices?

MR STEVENS: Well, I have to say I'd be interested to see what his basis for that assessment is.

MR BANKS: I think it's largely an assertion.

MR STEVENS: Well, there you go. Largely an assertion: an assertion not substantiated by any sort of facts. Look, not all properties go to auction. Even those that go to auction will only take a price that someone is prepared to pay. It's as simple as that, and market forces will prevail, whatever that might be. Now, I don't think you could justify that that's actually had an effect on pushing prices up. I think your report covers fairly comprehensively the reasons behind the house price increases, demand, and all the things that go inside demand, and I didn't detect anywhere in your report that referred to dummy bidding, unless I missed it. I read it very carefully, Gary.

MR BANKS: This is a new ingredient that's been introduced through the hearings that we have to think about.

MR STEVENS: I have to say we didn't see anything in that regard.

MR BANKS: Thanks very much for that.

MR STEVENS: Okay.

MR BANKS: We'll break now for a moment, please.

MR BANKS: Our next participant is Prof Cameron Rider from the Melbourne Law School. Welcome to the hearings.

PROF RIDER: Thank you.

MR BANKS: I should say at the outset that we greatly appreciate the two submissions that you have provided as having more analytical content on tax than many other submissions, if I put it that way. They have really been valuable to us and, indeed, the one you provided in response to the discussion draft takes things a bit further and has some interesting ideas that we would like to discuss with you. Why don't you provide an outline of your argument and your case and then we'll proceed from there.

PROF RIDER: Okay. Thank you for the opportunity to speak today. My area of interest was the influence of income tax factors on the demand for housing and, in particular, the interaction of negative gearing, depreciation and the capital gains tax discount. There are two issues at stake. One, for want of a better word, I'll call the macro issue, which is the general feature of our tax law that permits negative gearing of capital gains tax assets so that you get the benefit of a full deduction for interest expense and then when you sell the property, be it a housing property or be it shares, only half of any gain is brought to tax. It's a fairly attractive proposition; you get your full deduction on the one hand and only return half the gain on the other.

There is a suggestion that the housing price increases some kind of, to use someone else's words, irrational exuberance, but when you look at the tax advantages here you might say people are being exuberantly rational because it's a good deal. That's the macro issue. The second issue which, for want of a better word, I'll call the micro issue is the relative treatment of property on the one hand and equities or shares on the other hand under this regime. I think we've heard a number of people suggest that the negative gearing of rental properties is exactly the same in tax terms as the negative gearing of shares or other investments.

It's my submission that that's not true in all respects and the reason is this: when you negatively gear shares you get an interest deduction for the interest expense and then if you sell the shares at a gain you get the capital gains tax discount on the gain. When you negatively gear a property investment it's different. When you negatively gear a property investment you get not just the interest deduction but in addition you get a capital allowance deduction for the cost of the building plus depreciation deductions for the plant and equipment in the building. The capital allowance deduction is typically 2.5 per cent of the construction cost of the building.

Depreciation rates vary according to which particular item you're talking about. I notice that the Reserve Bank's submission is talking of ranges of 5 per cent per annum, I think, to 20 per cent. The rate doesn't matter. The important thing is when you invest in property you get something you don't get with shares. You get a capital write-off for part of your capital investment. Then when you sell the property only half that capital write-off is recovered under the capital gains tax discount regime. I have handed up to the inquiry today a simple example to try and demonstrate the point. As I was mentioning beforehand, and I am somewhat embarrassed about this, my actual formal submission had an arithmetic error. Those who know me will not be in the least bit surprised by that; lawyers should never be permitted to dabble in numbers. Fortunately, the arithmetic error doesn't detract from the main point.

I have taken as an example investing in property with a cost of 100 with a rental yield of 3.5 per cent and an interest expense of 7 per cent. I have taken 7 per cent because it made the numbers easy but, also, it corresponds to where I think interest rates are going. The annual rental yield of 3.5 per cent, I think your report suggests that's where the average yield is tending. I have compared that to purchasing shares on the same terms; purchasing shares with a cost of 100, interest expense of 7 and a dividend yield of 3.5. When you purchase the property, as I say, you get in addition a capital works deduction and a depreciation deduction.

What I have, in this example, sought to show is that imagine that you hold these two assets for a year and at the end of the year sell them for $103.50, 103.5. In economic terms you would be break-even. You would have earned income of 3.5, you would have made a gain on sale of 3.5 which would precisely offset your interest expense of 7. So economically no gain, no loss. But for taxation purposes you're treated as if you have made a loss. It's not a timing loss, it's not a tax deferral, it's a permanent tax saving. In the case of the rental property, the loss you're treated as making as a result of the depreciation deductions, the capital works deductions and the interest expense combined with the capital gains tax discount, you're treated as having a net loss on that transaction of 2.5. So even though it's break-even, for tax you're treated as having a net loss of 2.5.

If you compare it with equities the position is that you still are treated for tax on the equities as having a net loss, but because the equities don't have the capital works deduction and don't have the depreciation deduction, the loss is less. The loss on the equity investment I calculate, and trust I'm right with fingers crossed, at 1.75. Now, the difference is simply 50 per cent of the difference referrable to the capital works deduction and the depreciation deduction. In my view, the presence of the capital works deduction and depreciation deduction on rental property mean that the negative gearing treatment is different. All things being equal, the tax treatment of rental property will leave you ahead of an equity investment. So that seems to me to indicate a tax distortion at the micro level as between equities and property.

The capital gains tax discount, it would appear, was introduced by the Review of Business Taxation in 1999 to stimulate investment in equities; to make equity investment more attractive. I think the purpose of that reform has been frustrated by the fact that while it has made equities potentially more attractive, it has made property even more attractive from a taxation perspective. I suppose it was an unfortunate aspect of the timing of the reform that it came in just as equity markets were suffering a decline anyway, which seems to have magnified the shift of investment out of equities back into property.

I think, also, it's fairly clear that rental property with the capital gains tax discount is a product that can be easily marketed to individual investors. Rental property is something individual investors would feel they understand and it's obvious that financial institutions have felt comfortable in promoting investment activity in that area. So you have, I think, as your report suggested, a combination of the tax factors and other factors producing the surge of demand for housing. In the draft report, I think, caution is expressed against any kind of tax reform on the basis that you would need to have regard to the broader tax regime and the broader impact of the capital gains tax discount for negative gearing.

What I would just like to start with today is the submission that, at the very least, serious consideration should be given to putting rental property on the same footing as equities from a tax perspective. What I have suggested in my submission is that the way to achieve that is to ensure that when the property is sold there is a full recoupment rather than a 50 per cent recoupment of the capital works deduction and the depreciation deduction. In appendix B of the materials I have handed today I have given a mathematical calculation as to how that would achieve, but I trust the principle is simple; I am suggesting that capital works deductions and depreciation deductions should be subject to full recoupment on sale rather than 50 per cent recoupment.

That submission is consistent with the Review of Business Taxation in this sense: the Review of Business Taxation noted that in the 90s depreciating assets generally were eligible for this capital gains tax benefit. It was indexation then rather than the discount, but it was the same principle, that you could depreciate an asset and claim a full deduction. Then any gain on the sale of the asset was potentially eligible for capital gains tax relief. The Review of Business Taxation solution was to remove depreciating assets from the capital gains tax regime to ensure 100 per cent recoupment on disposal.

The review gave consideration to the treatment of buildings, identified as a general principle that buildings should be made subject to the same treatment as normal plant and equipment. They also observed that there were significant transitional issues in moving to that regime for buildings, showing the longstanding caution on the part of inquiries into dealing with property and taxation. They essentially left it on the footing that there would be further investigation of the position of buildings with a view to them being brought into the general depreciation regime with full taxation of the recoupment of depreciation.

Now, that hasn't happened to date and appears unlikely to happen in the short-term of its own force. There does seem to be a recognition, at least at the general level in those who are responsible for the Review of Business Taxation, that as a general principle if you can depreciate an asset and claim a full deduction for the depreciation, the quid pro quo should be that any gain on sale is taxed at the full rate and not at a half rate. In this context, the continuation of the concessional treatment of buildings is putting them at a tax advantage relative to equities. So, I think, if I can refer to what I called the micro issue, the relative treatment of equity and property, there is a clear distinction, from an income tax angle, and I think there is a case for reducing that distinction to ensure a level playing field within the capital gains tax regime, between property and equity.

MR BANKS: Thank you for that. You began by talking about the macro issue. Perhaps I could just ask you, briefly, about that and then we might get onto the micro issues. In your view - if I can put it simply like this - is the problem negative gearing per se, or is it the interaction of negative gearing with the concessional capital gains tax arrangements that presents the problem, in the macro sense?

PROF RIDER: In the macro level I think the problem is the combination of the negative gearing and the capital gains tax discount; that you are getting money for jam. You get a full deduction for the interest and only half of any offsetting gains tax. I would also suggest that the capital gains tax discount, as others have suggested, was intended to replace the previous indexation of capital gains tax cost base, which of itself was also concessional. I think it has been asked, quite reasonably, "Well, why has the capital gains tax discount appeared so much more attractive than the indexation benefit?"

Again it's a matter of timing. We were obviously going to go into a period of low inflation, where the discount had more value than indexation, as your report pointed out. I think it's also very important to understand that in tax planning certainty is worth a lot more than a prospect of a benefit. With the capital gains tax discount you have absolute certainty that one half of your gain will be tax-free. With indexation you don't have certainty. You are at the mercy of the consumer price index going in the direction you would like it to go.

Historically, perhaps it does tend to track interest rate growth and you would feel some comfort. I have no doubt that the certainty of the discount has made it appear more attractive. I also think that from a marketing perspective, when you are marketing investments the marketing of the CGT discount has been much easier when explaining indexation. Interestingly, the Ralph review itself recommended, as one of the grounds for adopting the discount that it would be easier to explain it to overseas investors as a reason for investing in Australia. Presumably if it's easier to explain to overseas investors it's easier to explain it to Australian investors.

DR SHANN: I'd just like to reiterate what Gary said about how interesting and useful we found the submission. My feeling is that the implications of the analyses that you have undertaken are broader than purely residential rental housing, so I would just like to take you through some of this. Are you familiar with the listed property trusts on the ASX?

PROF RIDER: Yes.

DR SHANN: Effectively they are in a position where they can pass through to unit holders the tax treatment on commercial property. They are investing in things like hotels, offices, retail, industrial estates, but effectively they can provide a distribution which could be, in full or part, tax deferred, based on the depreciation and the capital allowances. So in the hands of the unit holder there would be no income tax payable. But that's a deduction from the base cost for the capital gains tax calculations.

In my view it's analogous to what you are suggesting is true for residential property. Of course it's possible for someone purchasing those units to gear up on their own account. So they can both gear up their investment, they can receive a distribution, which is in part or in full, depending on the position of the property trust, subject to immediate income tax, and they can get the benefit of the capital gains tax treatment effectively at half the rate when they realise on their investment.

PROF RIDER: Yes.

DR SHANN: Would you agree that this broadens out this problem, if you like, outside purely its application to the residential rental housing market to in fact cover commercial property, depending on the legal structure in which that commercial property is held?

PROF RIDER: To start at the ground, the tax advantages I have said are present in rental property would equally apply if you were to invest in commercial property. Where you invest through a unit trust you would get the negative gearing deduction for the interest expense if you geared up. You wouldn't get direct access to the capital works and depreciation deductions. They would remain in the trust and the benefit of those would come through in the cash flow distributed by the trust - - -

DR SHANN: Distributed, yes.

PROF RIDER: - - - having a tax-free component. I think that doesn't put you quite in the same position as if you invest directly because if you invest directly you get the direct tax benefit off your tax return there and then.

DR SHANN: I don't see the distinction. Effectively if I am investing in them I get a distribution. If it were fully covered by - which in many cases they are – by the depreciation and the capital allowance there would be no income tax payable on the distribution.

PROF RIDER: No, there would be no income tax payable on the distribution. If you were to invest directly in the same property you would get a 2.5 per cent capital allowance, which would translate to a 2.5 per cent tax deduction.

DR SHANN: The capital allowance could be passed through.

MR BANKS: It is.

DR SHANN: Not as a deduction. It gets passed through as a distribution.

PROF RIDER: Yes, but there has to be the cash flow for that to be emerging.

DR SHANN: Yes, there has to be the cash flow.

PROF RIDER: In the direct property investment you don't need the cash flow. It's the commissioner of taxation who provides the cash flow. You claim your write-off, at say 2.5. Say your tax rate is 48-and-a-bit, you get about half of that back as a tax refund.

DR SHANN: Yes.

PROF RIDER: I think that's the advantage of the direct investment over the trust investment.

DR SHANN: Yes, you can do it through a trust. You can, of course, invest directly in commercial property as an individual.

PROF RIDER: Yes. In which case - the point you are making - you would get the full flow from it. In fact you would almost tend to think that with commercial property your prospect of higher capital allowance deductions and depreciation deductions would be very attractive. I could only speculate that the investors who are attracted to invest feel more comfortable with residential property than commercial property. They feel they understand it. I think the people marketing these investments feel their market understands residential property better than commercial property.

DR SHANN: I suspect you will go through cycles. It happens to be that the commercial market had a lot of excess capacity.

PROF RIDER: Yes.

DR SHANN: We've had booms in commercial property in the past, so the same could happen. To continue this on, as I said, you can do it through a trust, you can do it directly, you can do it for a property syndicate - which again aren't listed but are increasingly popular.

PROF RIDER: Yes.

DR SHANN: The same point also applies to listed entities in infrastructure and utilities. We've had a lot of privatisation. So again, with something like Transurban owning the road, and GasNet, who own and operate the gas pipelines, exactly the same situation can apply, in terms that they can pass it through to their unit holders, again, in the case of infrastructure and utilities, depending on the legal structure. So some of them are set up as companies but some are set up in forms whereby they can pass through these benefits to their unit holders.

PROF RIDER: Yes. Although again I just emphasise, they have to have the underlying cash flow to pass it through. You can have a lower yield on a direct investment and still get the - - -

DR SHANN: I guess the general point is, if you are constructing a tax system can you really only change the tax treatment for residential rental property? Doesn't it have wider implications for commercial property as well?

PROF RIDER: I'd have to agree, of course, that any change you make at any level will have implications in other areas. Say, for example, you were to confine my suggested change to individuals investing in residential property. The effect of that would be to push them, I guess, across to commercial property. That would obviously secure one of the objectives of reducing housing demand in the residential property market.

If you felt that you didn't want to then increase commercial housing properties you would then say, "Well, we would extent that rule to cover all negatively geared property investment in property that qualifies for the capital allowance and depreciation. From my perspective that would be perfectly sound tax policy. The underlying problem is that you are getting a full deduction for the depreciation in capital allowance and only offsetting half of it as a gain. So I would support that.

Extending it into the listed property environment I would say, for the reasons I've given before, that because the benefit of that doesn't get passed through unless you have the underlying cash flow and hence a higher yield, I think there would be a case for drawing a line there.

DR SHANN: What about an individual who directly owns commercial property or a super fund? Again, they would generally invest directly in commercial property rather than through a listed property trust.

PROF RIDER: In the case of the super fund the capital gains discount is not a half; it's two-thirds, so there would be a case for the reform extending there. It would have less impact because the discount is less, but also the tax rate in the super fund is less. It would be logical to extend it into that environment, but in my view not necessary, because the lower tax rate in the superannuation fund and the lower discount means that it's having less impact in the superannuation sector, I think evidenced by the fact that our superannuation fund returns obviously didn't benefit from the residential housing price increase over the recent period - at least my super fund didn't.

DR SHANN: I haven't dug out the numbers but I guess individual holdings in commercial property could be very substantial. A lot of small businesses are not companies. So there could be many small businesses where the commercial property they are operating from is actually in the name of an individual, or it might be in a trust, depending on the particular structure. I'm just flagging that we could be talking about quite substantial implications in terms of individuals holding commercial property.

PROF RIDER: Yes. I guess the particular fact scenario you raise is where an individual is conducting a business on property they own. Would we extend the CGT discount claw-back, if you like, to any gain on the sale of the land? Logically you would, but again the question will be whether that particular situation has other factors which mitigate against the mix of the gain and the property. I would tend to say that in the business situation the regime has already been changed to make sure that any gain on plant and equipment, any gain other than on land and goodwill is fully taxed. With the properties business situation you'd need to look at not just the property but the goodwill and so that would also be relevant.

I think also in the small business situation you'd need to take into account there are other small business capital gains tax concessions which provide significant relief. That being so I would tend to think that you could extend what I am proposing into that area without it having a dramatic impact, but it would obviously be something that would be a case for monitoring. I think it's a logical question in some way. From a practical perspective it's fairly clear that at the moment the real impact of the tax system is on the residential property sector.

DR SHANN: It is but you wouldn't want to be in a situation where you did something on residential property and then when there is a boom in commercial property in five years' time you need to change the tax treatment of commercial property. You want a tax system which is consistent in its treatment across the different asset classes, I would have thought, not changing the tax treatment according to which one is in a boom or bust.

PROF RIDER: That's probably another point where I tend to differ slightly. We always seem to live in the hope that we can set up tax rules of general enduring application, which will survive any change in economic circumstances and require no further change, and that usually lasts for about six months before we change them again. Tax is an intensely practical area and what usually happens is that there will be general structural features of tax law and tax planners look for practical situations, where they can combine some of the general features to produce an unusual result.

That's what we've experienced in the residential property market. People have seen the combination of negative gearing, depreciation and capital gains tax discount can be marketed as a residential investment product to produce a significant tax advantage. To me it makes sense to say, "Well, we have that problem. Let's deal with that problem." If another problem then emerges in the commercial property market we can deal with that problem when it emerges. The fear that you shouldn't change anything because you might have to change something else is extremely laudable. It's not really borne out by the experience of tax reform. I think, in reality, we have to accept that it's a system which starts not from a plain piece of paper but has anomalies already well imbedded and we spend our life trying to deal with one anomaly to keep things going.

DR SHANN: I quite agree we need to change something. I guess the question is what.

PROF RIDER: Yes.

DR SHANN: Can I suddenly change direction and perhaps it follows on from the point you're making. In your view are the depreciation allowance and the capital works deduction appropriate, justified, legitimate deductions for tax purposes as a deduction from income?

PROF RIDER: I think the depreciation deduction clearly is, and in fact the Ralph reform has put asset depreciation onto a true effective life basis, so I think it would be very hard to argue that it's not appropriate. The capital works allowance, I think, is more problematic. For residential property it assumes that the value of your building declines by 2.5 per cent per annum, which would mean anyone who bought a Federation house should have really been paid to take it away because it would have depreciated to negative - whatever it was long ago. I think there is a problem in the residential property market as to whether 2.5 per cent is an accurate depreciation.

MR BANKS: Just on that, is there any inconsistency with the ability to deduct maintenance and repairs as well, presumably to preserve the structural integrity of the building, or is that not an inconsistency?

PROF RIDER: No. I guess the capital works allowance works off the original construction cost, plus any non-deductible improvements, so I don't think there is any inconsistency. Your repairs and maintenance are deductible - I suppose what you're pointing towards is the question of, well, if you allow a deduction for repairs that actually also serve the function of maintaining the capital value, is that appropriate?

MR BANKS: Yes, apart from any value from antiquity itself or whatever.

PROF RIDER: Yes. That is a problem present not just with housing but with any capital asset, that there are certain recurring expenses which you allow as a deduction even though they add to capital value. Even with a business, I suppose, advertising is a recurring deduction, although it also adds to the value of goodwill. I think where the answer lies is to look at the effective depreciation rate. The new depreciation regime explicitly requires the depreciation rate to be set by reference to the expectation of recurring maintenance, keeping the asset in good repair and hence, as it were, protecting its capital value. That doesn't happen with the capital works deduction unless there is some implicit acknowledgment of that in the 2.5 per cent rate, but I don't think there is. I think the answer is to look at whether that really is a realistic depreciation rate for residential property.

DR SHANN: I suppose the other question is whether the treatment of discounted capital gains relative to income is appropriate.

PROF RIDER: One could write a thesis on the topic. I suppose I would suggest that so long as capital losses are not fully deductible there is a certain equity in some kind of concessional treatment for capital gains. I would also add that, strictly speaking, interest costs incurred in investing for capital gains should not be deductible as you go. They should only be deductible on realisation. The law states that. It may not be applied strictly in practice.

DR SHANN: Not at all, I would have thought.

PROF RIDER: But when you take into account the quarantining of the capital losses, the deferral of recognition of expenditure, I think there is a case for some kind of concessional treatment on the gain.

DR SHANN: Yes, some kind, but we had a concessional treatment before and we've moved to a different regime, so part of the question is, what's the appropriate concessional treatment, isn't it?

PROF RIDER: Yes, well, I felt indexation was appropriate because it matched the carrying cost in a loose way of the - - -

DR SHANN: But I guess the general point I am driving at is, an alternative to, if you like, putting a bandaid over the particular problem we have at the moment - is to address the general questions of the depreciation and capital works deduction or the capital gains tax treatment if you think that is inappropriate.

PROF RIDER: It's again a thing which is a practical thing rather than there being a correct theoretical answer. It's clear that many tax regimes offer a concessional treatment for capital gains. One reason for that is said to be to encourage people to invest for their own retirement. The Ralph review mentioned that as a reason. Another reason given is the proposition that capital gains tax investments are inherently more risky.

I notice in the latest tax expenditure statements produced by the commissioner of taxation that that's the reason now given for the CGT discount; that capital gains tax investments are inherently more risky. I'm not sure that if you ran a small business you'd agree with that completely, but that is one reason. As I say, most tax systems tend to now allow full relief for capital losses. I suppose when we look at the stock market crash we should probably be grateful for that, as the effect on the revenue would have been quite disastrous.

When you throw all those things into the mix I think there's a case for some kind of concessional treatment; whether it should be 50 per cent or 75 is really just a judgment call. The Ralph review, I think, wanted to make a dramatic statement with the 50 per cent discount because they wanted to dramatically encourage investment inequities. It may well be perfectly appropriate over time that you look at scaling that back. You also have to take into account the international aspect: whether your capital gains tax regime is considered competitive with other countries' regimes. The Ralph review seemed to feel that 50 per cent was in the ballpark of regimes overseas. To me, again, it's just a judgment call and there is no reason why a discount adopted at one point should remain the discount forever.

DR SHANN: As you pointed out with the super funds, in part it depends on the marginal tax rates, doesn't it?

PROF RIDER: Yes. I've noticed that ACOSS and others have identified that the CGT discount necessarily is worth more to someone on a high marginal rate than a low marginal rate. I think that is just a feature of having a tax system with relatively progressive rates. I guess the only option would be to offer some kind of rebate rather than a discount, or to cap the discount at certain levels; that you could only get the discount up to so many hundreds of thousands of dollars' worth of gain.

DR ROBERTSON: It's all very interesting but it needs a lot of thought, frankly.

MR BANKS: Certainly you have provided food for thought and our discussion today I think has taken another step further. As I indicated, we may want to talk to you as we reflect on these things in the weeks ahead, but we do appreciate the time you have taken. Hopefully you'll get some publication benefits as an academic out of this, as well.

PROF RIDER: I'll have to publish under an assumed name if I am too controversial about negative gearing.

MR BANKS: I did see that you had an article in a newspaper which, I thought for an academic, was unusual but of course you didn't choose the title. It was, How About a Pragmatic Approach to Negative Gearing? Thank you very much.

PROF RIDER: Thank you very much.

MR BANKS: We'll break now for a moment.

MR BANKS: Our next participants are the Housing Societies and Mortgage Managers Association. Welcome to the hearings. Could I ask you to give your names and positions, please.

MR J. McINTOSH: John McIntosh. I'm the president of the Housing Societies and Mortgage Managers Association.

MR BANKS: Thank you.

MR B. McINTOSH: Bernie McIntosh. I'm a committee member.

MR BANKS: Good. Thank you. Well, thanks very much for attending today and for the submission, indeed two submissions, that you've provided. As we discussed, we'll give you the opportunity to run through the key points and then see if we've got some questions.

MR J. McINTOSH: We'd like to say that our association stands by the comments made in the earlier submission to the commission. We hold the view that the governments, both federal and state, have the capacity to assist potential first home buyers into home ownership without imposing any further impositions on the tax-paying public. Whilst the commission has provided statistics which show that 80 per cent of first home buyers save the deposit for their homes, it appears unable to quantify the number of people actually wishing to purchase, but who are unable to obtain a deposit by whatever means, and therefore continue to remain in other forms of accommodation.

Our industry believes that the greatest impediment to home ownership is the individual's inability to save a deposit, whilst at the same time maintaining a high level of consumer spending, which includes home rental. A broad education program emphasising the need to budget one's finances could assist those who wish to make home ownership their goal. Furthermore, potential first home buyers should be educated to focus on their housing needs, rather than their housing wants, particularly if they have limited financial resources.

The limits referred to in our earlier submission - and we were talking there in areas which we believed should be the ones that are targeted with government assistance - is to set a maximum house price - and these again are Victorian figures - of $300,000, a maximum loan to 95 per cent of the valuation, a maximum home size of 180 square metres, and maximum family income - that's family income - of $80,000 per annum. Where applicable, we believe that these limits could be indexed. The first home owners grants could be limited to those who meet the above criteria, as should any other government assistance which may be contemplated. If people were encouraged to purchase homes as above, they would need less of a deposit than that presently which is the norm.

The state government of Victoria has the capacity to guarantee cooperative housing society loans to the banks in this state - Section 73 of the Cooperative Housing Societies Act 1953. When such a guarantee is made available, the borrowers from the cooperative receive a reduced rate of interest because the bank itself makes the funds available at a lower interest rate than normal, currently up to one percentage point below the bank's normal lending rate. By guaranteeing the society, the government is accorded the capacity to direct the funds to those who meet these criteria, such as that indicated above. Just as importantly, it can direct that funds either to purchase or build are loaned in certain geographical areas, for example regional centres or designated growth areas. The need for mortgage insurance is lessened because the Cooperative Housing Societies Act provides for a portion of each loan to be indemnified at no cost to the borrower.

Our industry sees the use of government guarantees and its subsequent directives as being of use, not only to first home buyers as such but as an important tool in rejuvenating regional areas in Australia, particularly in the area of government migration policy. There are waiting lists in Victoria and probably in all states for government-provided housing. The government of Victoria has in excess of 65,000 units of accommodation, and instead of continuing to provide more and more rental housing, state governments should be encouraged to also provide a home savings grant of, for instance, $5000 to eligible persons to vacate the public housing for home ownership, allowing current rental stock to be made available to those on its waiting list.

Together with the first home owners grant of currently $7000, this would assist with the deposit. The front-end lump sum payments for stamp duty and mortgage insurance could be amortised over a period of years, as the commission suggests, by way of an annual land tax. However, this would cause, we believe, short-term cash flow problems for the state government and the mortgage insurance companies more particularly. If the Western Australian government's annual maintenance costs of $5000 per unit of accommodation - which has been stated in other documentation - is transferred to the Victorian stock of 65,000 units, the annual maintenance bill for this Victorian stock is a staggering $325 million per annum.

We agree with the commission's finding that due to a number of factors the surge in demand and hence in-house prices is a bubble which will settle down to realistic levels when the pent-up demand has been satisfied and monetary policy starts to take effect. The commission's suggestion in regard to stamp duty - and we would include the one-off mortgage insurance premium - to capitalise these payments and have them paid for by a land or property tax over a number of years, is very sensible. Many lending institutions do not mortgage insure, but cooperative housing societies in Victoria insure all loans above 80 per cent LVR. If the societies are government-guaranteed, that insurance above the 80 per cent is indemnified at no cost to the borrowers. Further, our finance providers - the major banks - insist that loans above 80 per cent of valuation are insured.

We represent cooperative housing societies in Victoria and although we are only a small sector compared with the banks and mortgage originators, we assist segments that these institutions deem ineligible. We can make loans to these people because we are involved at the coalface, interviewing all loan applicants, continuing to monitor and advise during the course of the loan. Strict collection procedures are in place relating to any arrears collection.

The commission's report makes reference to the Keystart Home Loan Scheme in Western Australia, and having studied it in detail, we believe that it could be the model for such a scheme to be introduced by the federal government. Even though the scheme lends on 2 per cent deposit to individuals, its default rate is not significant, and it is self-insuring. The scheme is at no cost to the Western Australian government and, in fact, is accumulating significant profits on an annual basis. Four groups of cooperative housing societies are its lending arm in Western Australia. We trust that our comments are of some benefit to your commission, and look forward to its outcomes. Thank you.

MR BANKS: Thank you very much. I was just going to ask you perhaps to elaborate a little bit on the point you just made, that although you're a small sector, you are focused on a segment of the market that other institutions are not prepared to lend to, or deem ineligible. Could you just elaborate on, I suppose, the profile of your clients?

MR J. McINTOSH: Yes. The typical client we look at these days is a person who has a blemish on their credit rating. That is, they may have, say, in previous times been bankrupt. They may be getting on in years. They may have just started a new job and haven't therefore a long savings record. Those people typically go to the banks first up, and they're told, "The computer has deemed you ineligible." Nothing more, nothing less. "You're ineligible." No other reasons. They haven't fitted the box. In frustration, they then look around to see what else is available, and there are other lenders in the marketplace who have a much higher profile than we do, who pick them up. They'll also charge them probably a rate 3 per cent higher than the banks charge, and in some cases 3 and a half per cent higher than we charge, so they're not helping the people get out of whatever problems they've got.

They come to an organisation like us where we're hands-on. We're only a small operator. Not only do we assess the loan and look perhaps as to why the person was bankrupt or why he hasn't got a savings record, or the fact that he's getting on in years and has he got super that will pay out the loan in years to come - all those sorts of reasons that make the loan safe to lend, and because of our face-to-face with the person, we then also monitor the loan very closely right the way through. We counsel them in periods of difficulty, with both financial advice and - well, I believe when I retire I'll get a certificate for being a good marriage counsellor and all of that - all those sorts of things that help the people keep on the track. Even in the last, say, probably 10 years with this area of other lenders coming in, looking after the lower end of the market the same as we do, our procedures have ensured that we have an extremely low default rate.

Just to give you an example at the moment, in our book of two and a half thousand loans at the moment, there are three people more than three months in arrears with their payments. So we're right on to it. We work it that close. And that allows these people - I get back to the bit about the needs. Our average loan at the moment is about $165,000 for new purchasers, so it indicates that there are plenty of houses, in Victoria anyway, that are under the $200,000 mark, and that gets back to my statement that we should be looking at people's needs and directing them to what they need, rather than what they think they need or what they want. Now, that's a philosophical thing but that's that.

MR BANKS: Yes. You'd win another award, I think, if you were widely successful in that endeavour. Are you lending predominantly in the Melbourne area or - - -

MR J. McINTOSH: Predominantly in the outer Melbourne area, but we do lend all over Victoria.

MR BANKS: Right.

MR B. McINTOSH: It's Victorian based. Significantly in regional areas as well.

DR SHANN: What would be the size of the book? How big are you, I suppose, is - - -

MR B. McINTOSH: A bit under 200 mill.

MR J. McINTOSH: That's our particular business. That's not the association.

MR B. McINTOSH: That's not the association.

DR SHANN: So what about the association members? Just a sort of a rough guide, rather than a - - -

MR J. McINTOSH: I'd say 400.

DR SHANN: 400.

MR B. McINTOSH: Million. Yes.

DR SHANN: Million. Right. Okay. And I take it, reading the government guarantee you get in terms of indemnification - so you'd basically lend up to 95 per cent, would you, of the LVR?

MR B. McINTOSH: You can.

MR J. McINTOSH: We can. Yes.

DR SHANN: You can.

MR B. McINTOSH: That's right.

DR SHANN: But you wouldn't go above that, so you wouldn't - - -

MR B. McINTOSH: No.

MR J. McINTOSH: Well, the act doesn't allow us to.

DR SHANN: No. That's right.

MR J. McINTOSH: If the act were changed - - -

DR SHANN: I suppose the deposit problem is one of those things which people focus on. On the other hand, I mean, if you compare now with sort of 10 or 15 years ago, people can access borrowing up to 100 per cent or even more in some cases of the value of the property, but at a cost, in terms of the ongoing - but on the other hand, if you view the deposit as an entry barrier in terms of people having to save it, there's a trade-off there which is available these days which wasn't available to people 10 or 15 years ago. But it makes it a bit hard to analyse - - -

MR B. McINTOSH: The actual need.

DR SHANN: Yes - exactly what the important barrier is to home ownership. I mean, you could have said 15 or 20 years ago the clear barrier was the need to save for a deposit. I mean, that's less clear these days because you can, in fact, if you're unable to save for a deposit, go and borrow from an institution that will lend you the full amount of the value of the house.

MR B. McINTOSH: Yes. There's a great deal more flexibility in the marketplace now, a lot more products available than, as you say, 10 or 15 or more years ago, but at what cost is quite critical.

DR SHANN: So in terms of the people you're lending to, the problem isn't necessarily their income - it's their credit history. I mean their income -

MR J. McINTOSH: Not always.

MR B. McINTOSH: It can be a mix of both.

DR SHANN: Can be a mix of both.

MR B. McINTOSH: But I think importantly, too, with the instrument that we're talking about with housing societies, I mean, historically they have been used to represent state government policy in the marketplace, and funds have been made available with particular conditions attached to them - for argument's sake, funds made available by the government to develop Broadmeadows in the past, or Mooroolbark, so to access the cheaper funds, borrowers had to build in those areas, and so that's a way of using it, I guess, but then also similarly with income restrictions or being means-tested to allow access to certain funds. Those funds are no longer provided by the government. They're raised by the major banks in the main. They attract a favourable weighting, and that allows the banks to provide the funds at generally a per cent below standard home loan variable rates.

MR BANKS: You mentioned that the state government of Victoria has the capacity to guarantee the cooperative housing societies. In your earlier submission you indicated that that had been a practice which ceased in the early 90s - I think you said as a consequence of seeking to get back a triple A credit rating; it sort of implies that this had been a problem in that sense. I just ask you to comment on that.

MR B. McINTOSH: I don't think it had been a problem, had it?

MR J. McINTOSH: I think it's been a tool used by the bureaucrats at times to say when they didn't want to - the treasury people didn't want to make a guarantee available for whatever reason they viewed this credit rating bit, but if you talk to the politicians - and I can remember at one stage actually talking to Mr Kennett, a former premier - and he didn't think there was any significance there at all. So it's just what they are on about.

MR B. McINTOSH: No, I don't think you should draw the conclusion that they were called upon overly often at all.

MR BANKS: Okay.

DR ROBERTSON: Can I just raise a point - you asked in your third paragraph what is the big question: how many people want to buy a house; how many first home owners actually would like to have a house? Then, two paragraphs later you say there's a difference between needs and wants. We would argue that the "want" needs to be financed and if you try to survey how many people would like to buy their first home you'd get millions and not many of them would have the money, so you certainly would have to assess them all. That's why we can't go and find out how many people are waiting for a loan.

MR J. McINTOSH: No, I completely understand that. It is just an observation.

DR ROBERTSON: What is the period of the loans you give? Is it about the same as the banks?

MR J. McINTOSH: Yes, they're all 25 years.

MR B. McINTOSH: Yes, 25 or 30.

DR ROBERTSON: Yes, okay. Presumably on your book you've got something like 1400.

MR B. McINTOSH: Loans?

DR ROBERTSON: Yes.

MR B. McINTOSH: No, our personal book is about two and a half.

MR J. McINTOSH: Two and a half thousand.

DR ROBERTSON: Two and a half thousand, okay.

MR J. McINTOSH: If you're doing an average of - where I said the average loan there before, doing the arithmetic on that, you might get 1400, but bear in mind a lot of the loans have been going for 15 years or 20 years.

DR ROBERTSON: So they're smaller.

MR J. McINTOSH: And they only 25,000 or something like that.

DR ROBERTSON: Yes, okay.

MR J. McINTOSH: I was talking about the average new loan.

DR ROBERTSON: Yes, right.

MR BANKS: You emphasised, as Ed was saying, the question of the ability to save a deposit as being one of the big impediments. We've had a fair bit of discussion about stamp duty in the course of these inquiries, as you know, and I just thought I'd give you the opportunity to comment about how stamp duty fits in there, in terms of this deposit problem and, indeed, in your own lending, whether you take that into account or whether it's something extra that the home buying aspirant has to factor in.

MR B. McINTOSH: Stamp duty is an issue, I think, when you look at obviously the overall costs for the borrower to purchase a property, and then the amount that's required under normal lending guidelines - so typically they require 5 per cent deposit plus costs, of which stamp duty is one of those costs. Obviously that increases the amount that they are obliged to contribute towards the loan. Stamp duty is a really difficult one, I think, because it is across the board. I am not sure what direction I would recommend to go with that, to be honest, because of the implications that tinkering with it have. They are quite broad - - -

MR J. McINTOSH: You couldn't see the states giving it up, could you?

MR BANKS: No, but from your lending institution's point of view, it's not something that's covered in the loan.

MR B. McINTOSH: No.

MR J. McINTOSH: No, it's not covered in the loan and unfortunately when a person buys a house for say, $200,000, they think "$200,000 - I need 10,000 to buy the house," and it's only at a later stage they seem to think about the other 15,000 or whatever it is they've got to pay. That becomes a problem and it might be two years later on into the loan, and the person might be experiencing difficulty with their repayments, and you ask, "What other commitments have you got?" "I've got a personal loan of $10,000 which I didn't tell you about, which I took out to pay the stamp duty and the other costs." That's been there forever, that problem.

MR BANKS: Okay. Good. Thank you, we have no other questions. We appreciate again you coming in to discuss your submission with us. Thank you for it.

MR J. McINTOSH: Thanks very much.

MR B. McINTOSH: Thank you very much indeed.

MR BANKS: We are going to break now. I think we're scheduled to resume today at 20 minutes past 2. Thank you.

(Luncheon adjournment)

MR BANKS: Our next participant this afternoon is Stan Cooke. Welcome to the hearings. You might just indicate in what capacity you're here today and then feel free to go on and make the points you would like to make in response to the discussion draft.

MR COOKE: I'm here as a consumer of social housing and as an affiliate member of DHI but I'm not representing DHI. I need to make it absolutely transparent that I am here as an individual, not representing any company or any industry. I am here as a consumer.

MR BANKS: Thank you. That's good.

MR COOKE: First of all, I would like to thank both the chair and the commissioners for the opportunity to present, and I'll now go on to highlight some of the key points in my product. My key concern was that the inquiry didn't recommend a supply site subsidy model for the expansion of low-cost housing targeted to its shareholders in the bottom two wage quintiles suffering asset stress. I don't support the suggestion by the inquiry on stamp duty and I refer to the Victorian submission for further evidence. Also, I have provided some evidence in my first submission in which basically I said it was because of financial imbalance between the national and the various state jurisdictions. Yes, I don't see it as a viable option, nor do I see reforming that system as viable - it's not even on the agenda. We're really wasting our time so let's get onto the next point.

The total resources consumed by the housing industry assistance product and subsidy delivery systems, products in the marketplace, is $49 billion. I basically used the product they produced on the previous budget for the federal government and then used the Yates paper from the AHURI web site. I can't exactly remember the table but it would be sourced either in the first submission or in the second submission so you can follow it up from there. The total number of shareholders suffering asset stress is approximately 561,146. Again, in the first product in the appendices I have shown how I have come up with that figure.

The clear reform proposals I am proposing are the asset stress benchmark for housing assistance and subsidy delivery system product in the marketplace should be based on a UK key worker strategy. If the inquiry is interested I can expand on that. The supply site subsidy model was based on the national housing research consortium model which was mentioned by the Real Estate Institute of Australia, which I very strongly support. It should be targeted to the bottom two wage quintiles. The Brookings tax subsidy model for existing purchasers in the bottom two quintiles who are suffering severe asset stress - again if the Productivity Commission is interested I can take you through the key points of that.

The demand site subsidy I support for home ownership is based on the current FHOS and the Labor Party model which you mentioned, which is the savings model which the Productivity Commission would be aware of as it's in its discussion draft. I believe that any reform to the system needs to take into consideration the whole industry. I base that on the Housing Justice Roundtable. I base that on what the Real Estate Institute of Australia said to you today, that you need to be careful that you don't segment the market too much; that you take the whole. I have also provided you some further research evidence. I went to a national housing conference meeting last year in Adelaide and one of the keynote speakers was really insisting that if you're looking at good economic growth then you really need to look at your affordability problem because it's going to be a key factor.

I had some key questions. This is where it gets a little bit difficult. I mean, I should have said from the beginning I have sort of got an intellectual bias towards home ownership, but I have also got some market evidence that shows that in the future home ownership is not going to be as widely available or acceptable due to changes in the employment field, ie casualisation of the work force, globalisation of economic opportunities. I think the Industry Commission would be aware of those sorts of things. I have also sourced some key industry sources and the Industry Commission can follow that up if it so chooses.

I couldn't understand why the Industry Commission, given it said that lack of supply is the key problem. I mean, I refer to the national housing research consortium model. I refer to the ACOSS submission. I could make you a reference section of 100 different references where it is quite clear from research that I have done that it is a supply site issue, not a demand site issue. In other words, the key problem is that low-cost housing hasn't kept up with demand. I think Prof Terry Burke said that to you yesterday during the presentation to the Housing Justice Roundtable.

The other thing I would like to raise is there are some submissions that I very strongly support and which I would like to bring to the attention of the inquiry, which is the Housing Justice Roundtable submission; the Joint Housing Industry Group, which is a Sydney-based organisation; ACOSS; the national Housing Research Consortium; the AHURI submission and, of course, now the Real Estate Institute of Australia submission that was made this morning. My key recommendations are that there be a housing bond model, which is the national Housing Research Consortium model for the expansion of low-cost housing. That bond model could also be used for home ownership. It depends.

There is currently a paper in the marketplace, done by the Office of Housing, called the low-cost housing strategy which is now looking at setting up housing associations. Now, under that model there is no reason why home ownership can't be brought under that sort of model. Also, I would refer to the social housing innovative program done by Hal Bissett. Again, there would be a source in the submission, either in the first or the second. I don't see why that can't be done. The other thing I recommend is that the existing first home ownership scheme be targeted to shareholders in the medium wages and above. There is some research I have provided the inquiry in my first submission which shows how high; what wages it took.

It was my understanding from those appendices that the majority of people earning between 19,000 and 135 - there were very few people who would afford - if you use the 30 per cent benchmark and the after-tax disposable wages. Basically, if I remember correctly, what I did was I took a 30 per cent benchmark. I then deducted the tax. I then deducted living costs as they did with the Menzies Research Institute - I think it's paper 1 but I can't remember. It would be in my first submission. Then basically I used the ABS data for one which showed what the current living costs are; subtracted that, and then used the AMP Nastran child poverty model, which again would be sourced in the first submission; it wouldn't be in the second. And then sort of subtracted that and then used the ABS census data for both rental and home ownership.

If I remember correctly, most of the people in the 19 to 65 were certainly suffering high levels of asset stress. By that I mean they were paying over 55 per cent of their disposable income in either rental or mortgage repayments. Again, to the chair, I thank for the opportunity to present and ask if there are any points of clarification, questions or anything that the inquiry wishes to raise? By the way, the other recommendation I made was I very strongly support the Real Estate Institute of Australia's call for a national housing industry strategy and for a minister to implement that. That has been talked about for many, many years, ever since - it goes back quite a few years. It is really needed because without a national strategy and without a national focus I don't think you will achieve good market outcomes.

MR BANKS: Thank you very much. I should put on the record our appreciation for all the documentation that you have brought to our notice, particularly in the first submission. The reference list and also the reference list on this other submission have been very helpful to us. Perhaps if I could just pick up the last point that you have made about the national housing strategy, whether you would like to elaborate on what you see that housing strategy focusing on in particular?

MR COOKE: Again, I have provided what a framework would look like in my first product. Unfortunately I didn't - I should have printed out my first product but I didn't.

MR BANKS: Okay. We can go back. We've got a copy of that.

MR COOKE: Basically what I suggested, it needs to set a role: it needs to say what the role of the national jurisdiction is; it needs to say what the role of the state jurisdiction is. It then needs to set some transparent benchmarks. It then needs to sit with industry and work out what industry does, what industry role is, what the government's role is. It would involve local government. I would see this being set in what I call the housing industry assistance plan or what is called the CSHA, which is the Commonwealth-State Housing Agreement. It would have a very transparent role for local government.

I would see the federal government being responsible for demand site subsidies and the subsidy needed for the housing bond model. I would see the states providing capital subsidies or recurrent subsidies. If you're going to house people on pensions and benefits capital subsidies would not - you know, again, I would have to refer to the SHIP report for further evidence on that. Basically it would set out a role for the industry and just set benchmarks and stuff like that.

MR BANKS: The other question I had - and you said you supported the Real Estate Institute on that - in relation to the targeting of the first home buyer's scheme you may have been present when the Real Estate Institute said that it didn't see targeting as being feasible, I think primarily on practical administrative grounds. I just wondered whether you had any reaction to that?

MR COOKE: I would recognise that, but I think it is important that it is targeted. Like I said, currently $49 billion worth of assistance and subsidies goes to the absolute bottom and absolute top, so there's a big gap between the second to the fifth. When I'm talking about the absolute top, I'm talking about people earning over 200,000 a year. All right?

MR BANKS: Okay.

MR COOKE: I'm really talking about your key - like your bank CEOs and those sort of people.

MR BANKS: So you're not including them in the targeted group?

MR COOKE: Definitely not. They can afford 20 houses.

MR BANKS: What about this debate we've been having with other participants - ie, those who support targeting - as to whether it would be better to target it at income means tested benchmarks, as opposed to a price for the dwelling, a sort of ceiling price beyond which the subsidy would not be available? Do you have any strong preferences?

MR COOKE: I have a feeling, but I would strongly advise the commission to take other advice, too. My feeling is if you have an eligibility criteria it should be the regional median wage for each region - like, in Victoria it would be the inner urban or outer urban, or whatever the regions are now - and you would take the stress level as the asset sale price, the median asset sale price. It might be worthwhile if I go through what they're doing in the UK, which might explain now. My understanding is this is what they're doing. It comes from the UK government's web site.

Basically what they're trying to do is they are trying to establish housing forums on a regional level which will then look at such things as "What is the future of employment?" - sorry, they'll be looking at who is missing out in the employment market. I went to a Docklands forum last year. One of the speakers made it quite transparent that if you want your latte serve, you'd better provide for affordable housing. Most people would say, "Right, I just can't afford to live in the Docklands."

There is also some US evidence which I got off Professor Berry. I don't know if you know Professor Mike Berry. Yes, well, I got it off Mike Berry. He was saying to me during a conversation that there is a lot of evidence in the US, especially in the Silicon Valley, where they are now having to bus in their services, because those workers cannot afford to move to live in that area. The same thing is happening in the UK. I would suggest you talk to the Victorian Development Corporation on that. I wouldn't want to say any more than that.

MR BANKS: Okay.

MR COOKE: So, yes, basically what they're doing is they're looking at where the future jobs are and who is missing out. Then they are looking at where the jobs are and then they're looking at what the median price for that is and what incomes are needed, and then they're setting the benchmark on that.

MR BANKS: Is this a focus for public or community housing? Do you know?

MR COOKE: My understanding is that it's broader than that; it goes into home ownership. I would strongly suggest you go to the ODPM web site, which I have provided in both submissions, and you can just open key worker strategy and you will get a whole lot of documents. My problem is that I haven't had the time to actually - I've downloaded the documents but I haven't had actually time to go through the documents. I mean, there are six or seven documents and they're pretty big. I just haven't had the time. Basically most of my time has been taken up with the inquiry and with the low-cost (indistinct).

MR BANKS: Good. Thank you. As we said, we appreciate the time that you've put into this. Are there any other questions?

DR ROBERTSON: No.

MR BANKS: Thank you very much for that. As I said, we appreciate the time you've put into it and for drawing all those various references to our attention. Some of those other ones you've mentioned we'll certainly follow up. Thank you very much.

MR COOKE: Not a problem, thank you.

MR BANKS: We'll just break for a moment, please.

MR BANKS: Our next participant today is Alun Breward. Welcome to the hearings. Could I perhaps ask you to just begin by telling us in what capacity you're here today, but before going on to that, I should thank you for the submission you provided - the two submissions, actually, both detailed ones and both very useful. After you've presented the main ideas, we can explore some of the issues.

MR BREWARD: Okay, thank you. I'm here as a private individual. I represent no organisation with an interest in this inquiry. By way of background, I am a public servant, I work with the Victorian government. Basically my interest in this inquiry is the issue of housing affordability generally, not specifically this inquiry, and is one that I've had for probably a decade or so. As you will probably be aware on the basis of my submissions, I believe that the problem that this inquiry has been asked to report on began around about a decade ago, more than a decade ago, so it's a longstanding problem, and I've been interested in it from the time that I believe it became a problem.

MR BANKS: Thank you.

MR BREWARD: Just to go through the second submission, the response to the discussion draft, I guess I'd like to say that I recognise that the task of this inquiry is a difficult one. There's a wide gap between the various interest groups that have a stake in this inquiry and its outcomes, and that's not something which is easy for anybody to find a sound and acceptable position on but, nonetheless, as you appreciate, here we are.

I'd also like to just note at the beginning that there are some areas of common ground between the position that I have and that which has been set out in the discussion draft. For one, I would applaud the statement on page 37 of the discussion draft that the banks decided to expand lending for housing. That's something which I've noted in my reading and I'm pleased to see that that's recognised in the draft that the commission has put out.

I also applaud the statements of the discussion draft in box 1.3, that movement of first home buyers from expensive areas of predominantly our capital cities to cheaper areas or cities that are near those capital cities is not a solution to the housing affordability problem. It merely displaces the problem.

To go directly to my actual second submission, I guess I can sum up the points that it makes by saying firstly that the situation for first home buyers is grim, that it is due to forces that are not self-correcting, and dealing with the problems that the situation presents I believe requires an understanding of long-term industry trends, and in that sense I'm talking about 20 or 30 years, and a recognition that mainstream economic management offers nothing but more of the same.

The first point I make in the second submission is that I do not see evidence that negative gearing and the role that the boom in negative gearing has played in the overall path of the housing sector in the last five or so years - I don't see that it can be explained by share market returns. In addition to what I've got in the written submission, I draw the attention of the commission to the work that the Menzies Research Centre did 15 to 16 months ago which was delivered to the federal government in the middle of last year.

Malcolm Turnbull, who was a spokesperson for that research, noted on Radio National on 9 June that that study had found that housing is an asset class that moves differently to other types of asset class. In other words, there's not a pattern where there's evident switching from one asset class into housing at certain times, and switching out of housing into other asset classes in other times. I'd also draw the commission's attention to the fact that in the news last week there was I believe - I'm not sure of the details but I imagine you may have seen the reports - news that 100,000 additional Australians had become shareholders in 2003. 2003 was a year of extremely high price growth in the housing market and I would take the coincidence of extremely high price growth in the housing market and entrance of a large number of people into the category of shareholders as some evidence that the two things can go up at the same time.

I'd also argue that the income tax system is not an explanatory factor for the boom in negative gearing. I'd draw the attention of the commission, in addition to what I say in my written submission - that David Hayward of Swinburne University on Radio National on 12 July last year pointed out, on the basis of ABS statistics, that negative gearing is not a driver of property investment. It's one of them but it is not the driver.

I'd also point out that business commentator Phil Riven has written at the end of 2001 that despite the fact that - as the discussion draft puts it - there may be some marginal tax rate issues that could be argued to make housing investment attractive to people, he put forward evidence at that time that rich people in fact shun property as an investment. So those are a few pieces of evidence that I believe point in the direction that you have to look for other explanations than the share market or the income tax system in understanding negative gearing's growth.

The second point in my written submission is that falling home ownership among young adults results from relative poverty, not choice. I don't have additional material to draw to the commission's attention on that, but there is material in my written submission. Following on from that point, because you have more or less - it's not a cast iron rule, but first home buyers tend to be young people and the rates of home ownership amongst those young people are demonstrably falling. The long-term prognosis and indeed the current state - because this has been happening for some time - the rate of home ownership is ordinary, it's not as good as it has been, not good in international comparisons and it will shrink further on current trends.

On that issue, in addition to what I've put in the written submission, I'd note that Dr Judith Yates, an academic, who has written for some time on the issue of housing affordability, was quoted in the Sydney Morning Herald of 5 April 2003 that home ownership is dropping amongst the under-45 year olds. She predicts that inheritance is going to become increasingly crucial as a determinant of who rents and who owns. A similar point was made by Drs Badcock and Beer in the book Home Truths, which was published by Melbourne University Press in 2000.

That combination of trends means that first home buyers have become a small and marginalised section of home buyers. In addition to the material that I've put in the written submission, I'd draw the attention of the commission to the views that a developer, Peter Civaroli, expressed as quoted in the Fin Review of 26 June 1992, and I suppose this is an illustration of the longstanding scope of the problem. He informed the Fin Review that the recession in progress at that time had forced some builders "downmarket" to build for first home buyers. They had been doing the real development but when nothing else was on offer, they'd settle for second best. Enzo Raimondo of the Real Estate Institute of Victoria described first home buyers similarly, as the lower end of the market in the press of 10 November 2001. This I would acknowledge is a point that the commission actually make in the discussion draft. They note that first home buyers tend to buy properties which are a fraction of the median house price, so I suppose that's another area where there's some agreement between our positions.

Furthermore, quoting Enzo Raimondo of the Real Estate Institute of Victoria - this is from ABCTV of 6 May 2003 - he at that point was advising first home buyers that there was nothing for them in Melbourne and that they should look in the bush or in the outermost suburbs. Again that demonstrates there's an awful lot of activity which in the eyes of representatives of the real estate industry first home buyers simply are not involved in and couldn't be involved in.

Moving on, there is some discussion in the discussion draft of various ways that you might perhaps ideally analyse price movements in the housing industry, and I've presented some counter-arguments in there in my written submission, that actually the median price is probably as good an indicator as you'll get, and I have nothing additional to say on that topic today.

I'd continue by picking up on again some of the arguments in the discussion draft about the cyclicity or the tendency to fluctuate - of house prices - and I argue in my written submission responding to the discussion draft that especially in nominal terms, house prices do not fall. There's some evidence that average people don't worry about what the inflation rate is doing to house prices, so long as the house price in any given time is the same or greater than it was when they bought. That is their main concern. I would note, in addition to the points that I made in my written submission, that I think the stamp duty data that the written submission presents in figure 5.2 on page 64 tend to illustrate the same point - tend to back me up - particularly because - and I don't have the capacity to adjust that chart for the effects of the 1987 stock market crash, but I suspect that the one big fluctuation in that chart - because stamp duty applied to share trading at that time if it were adjusted for the impact of stamp duty on share trading - would be a much smoother series than it is at the moment and, even in its current state there's only one major fluctuation in it. I would also draw the attention of the commission on this issue to an observation that Michael Davoren of the Real Estate Institute of Australia made which was quoted in the Age of 23 September 2002. His words were:

> For the average person there is no credible alternative to invest in but property. The stock market could mean losses.

In other words, for the average person residential property is the way that you can have an investment that never goes down - never loses value. The discussion draft makes some arguments that the supply of dwellings, new dwellings, might be higher than it is. There are ways that it could be improved but, broadly speaking, I think it would be fair to say that the discussion draft says that there's not a lot of evidence that there is a major imbalance there.

I would note in addition to what I put in my written submission that, again drawing on this Menzies Research Centre study that was done in late 2002 and through into 2003, Malcolm Turnbull - doing the media, I suppose, in association with the release of that report - noted that the number of building approvals in outer Sydney in 2002 was exactly the same as it had been in 1972. In other words, I think there are various things that might explain that, but that tends to suggest that supply is below what it could be. I will turn to this issue of supply a bit later on in connection with the issues of planning approval.

I will continue just going through the points I make in the written submission. The next point I make is that mainstream economics did not expect low inflation and low interest rates to unleash a housing boom. I therefore have serious concerns that there's no reason to expect that mainstream economics offers a cure now that we are dealing with a housing boom. Further to the points I make in the written submission, responding to the discussion draft, I note that the Economist on 22 August 1992 said that the shift to low inflation will end the appeal of property investment.

It's interesting to note in this respect that on 4 January 2003 the Economist noted in a retrospective of which investments had actually proven to be good over the last 10 years - it noted that London property investment had offered the best investment returns of the last 10 years. Similarly to the Economist's forecasts of 1992, Barry Dunstan, finance journalist of extremely long standing, noted in the Financial Review of 2 December 1991 that - as the Economist had put it - he wasn't quoting them, but he reached the same conclusion - low inflation spells the end of property investment as a popular investment. It's also worthwhile noting, I believe, in this area, that the Reserve Bank governor, Ian McFarlane, first predicted the imminent end of the housing boom in September of 2001. That's now getting on for 30 months ago.

Turning to some of the points which the commission actually asks for feedback on and there are two that I believe I have something to say on: the first is prudential standards and the second, as I indicated earlier, is the problem of supply emerging from the planning approval process. It's my view that there is good evidence that prudential standards have deteriorated quite severely and I would draw the attention of the commission to something I said in my initial submission of October last year, and that's two examples of lending - which were reported in the press, but can only be described as unusual, or certainly thought-provoking.

The first is that the ANZ Bank loaned a 90-year-old woman money to buy a house and the mortgage term for that loan was 30 years. Liberty Financial loaned a 92-year-old woman money to buy a home over 25 years. The probability of them collecting from those persons that they lent to is extremely low and, in that sense, you have to question who approved those loans and what they were thinking. They really have taken a bet that the market will not go down. I suppose one can only hope that those are atypical incidents.

MR BANKS: I might just mention there that I know for a fact in Switzerland they provide intergenerational mortgages, as well, which seems to be the accepted thing. I mean, I looked at that with horror, but obviously the financial system there is geared up to it. Whether this is the latest innovation in the Australian home-lending market remains to be seen.

MR BREWARD: I guess my response to that would be, yes, there are intergenerational mortgages and I suppose the most notable example of those was in Japan. Europe I'm not so informed about, but the Japanese during the 1980s property boom that they had also developed intergenerational - or intergenerational mortgages became very common and the Japanese property market has of course deteriorated drastically since then. It may be slowly on the mend as the Japanese economy is slowly on the mend, but I think there are big problems with that form of lending.

I would also point out that the discussion draft's raising of the increased use of mortgage insurance I think is something that needs to be regarded with some alarm. Mortgage insurance obviously solves problems for some people - enables them to get into home ownership - but I would simply observe that in the era of HIH and United Medical Protection - two high-profile insurance companies that essentially followed reckless business strategies - I guess my view would be that the Australian insurance industry might not be a good prop for the housing industry, given its recent performance.

I would also note that when the Reserve Bank of Australia raised concerns about prudential standards in August 2003, both the Commonwealth Bank of Australia and Westpac denied that there was a problem or that they were involved in any such behaviour, and pointed the finger at non-bank lenders. That's something I noted in the Australian of 12 August 2003. Two days later non-bank lenders, principally Wizard, also denied it was them. The Finn review of 14 August 2003 is my source for that. I guess that suggests to me that somebody is perhaps not telling the whole truth. There would appear to be a problem.

I would also query that the pricing of risk, which the discussion draft suggests is - changes in the pricing of risk is behind the removal of interest rate premiums on residential property investment. I guess I wonder, given that the discussion draft notes that our system and the system of premiums - relative to the system of premiums that premium interest rates that operate in other parts of the world - I guess I'd just ask the question, is our financial system really the most savvy in the world that it can do that and be right.

I guess time is getting on, so I will try to wind up fairly quickly. As I indicated a few minutes ago, I would make a few remarks about the problems of supply emerging from planning approval processes. My view on this issue is that the concentration of economic growth in Australia's capital cities over the last five to 10 years, even if it has had a minor influence on problems of supply or just simply, I suppose, log jams in the process of supply of new dwellings - even if it's minor, I believe it is adding to price pressures, and while I'm prepared to acknowledge that urban consolidation is probably a good thing, I am interested in how the consolidation process plays out.

If it is a good thing - if it's essential - my question is, what's the contribution from the various residents' action groups that - well, you see around Melbourne anyway, with placards on their front fences, saying, "Residents will strongly oppose inappropriate development." My view would be that if urban consolidation is essential, state governments would appear to have a task in educating people about why change in their neighbourhoods has to happen, or they have to become more prescriptive about planning decisions. I don't see that it can be left in its current system because it strikes me that there appear to be rather a lot of freedoms on the part of those who oppose development and relatively few responsibilities. The balance of freedoms and responsibilities is something that the government has to keep in mind all the time and I would just query what their responsibilities are to other Australians.

In summary, I would simply say that in my eyes - and I think the evidence is strong - the forces behind the collapse of affordability for first home buyers are in no way positive and nor are they temporary. The basic issue is that first home buyers are not attractive customers for anybody - other people are, and that puts first home buyers in a particularly bad position. On that issue I would just like to read an excerpt from a letter to the editor of The Age, of 16 October 2003, to indicate some of the forces that I believe are really out there and having an impact on the housing industry.

The letter is from someone who says he is a baby boomer, and I have no particular beef with baby boomers; I'd like to make that clear. He writes:

> I am a baby boomer and I'm a person who has worked hard to accumulate a modest amount of capital.

He explains the boom in residential property investment as follows, regarding his own generation:

> We have been told, and have also come to realise, that the federal government will not support us in our old age. We must arrange our own private tax system by requiring the next generation to support us with the indirect tax of rental payments on the properties that we will put beyond their reach by our ability to pay for them.

I'd note that whether or not that's representative, there were no letters responding to this gentleman's letter that were published in The Age, on 17 October, 18 October or 20 October. So I think from my perspective that tends to suggest to me that nobody very much disagrees with him or thinks that his views are regrettable. I think, as I've said before, mainstream economics has no answer to the mentality illustrated in that. I wouldn't want to say that that gentleman is the sole problem but I think he is representative of something which basically does not have any regard for the interests of first home buyers.

I would simply say, in conclusion, that in my eyes the problem of housing affordability reduces to two key questions. One is, why should one group of Australians pay double - and this is on a like for like basis, according to calculations which are in my initial submission - what their parents did, especially for something which you can't do without? Everyone has to have a house. The evidence, I believe, is strong that that is the scale of the shifting prices over a generation.

I would also draw attention to some of the issues of information flow, and the quality of measures of affordability that I draw attention to in my response to the discussion draft and in my initial submission, and I would pose the question, "Can Australia and its economy grow strong with ignorance underpinning one of its most important industries?

MR BANKS: Thank you very much for that. You have covered a lot of territory. We probably won't go over all of that ground but just pick up some of the points for further elaboration and discussion. In your presentation and your submission you have ruled out a number of drivers of what we have observed and I thought I'd just give you a moment to put on the record what you see as having been the main drivers of rising prices and affordability.

MR BREWARD: I believe that the main drivers are - and this is something which I believe Glenn Stevens, one of the deputy governors of the Reserve Bank, first remarked on in 1997; the quote is in my first submission. That is, the banks decided in the aftermath of the lending excesses of the 1980s that the best way to increase their cash flows and their profitability was to market credit to households.

The second thing is that there is a deep-seated perception in the Australian community - and it's not the only community in the world that shares this view - but there's a deep-seated conviction from a great many Australians that house prices never drop. And more or less they are right, at least in terms of the memory of a generation or two. Those two factors mean that there is a view from many, many people that a good thing to put their money into is property, and the banks are quite happy; in fact they are overjoyed to help them, to facilitate that.

MR BANKS: Did you see the previous situation as one in which it was very hard to get a loan? It was probably before your time, but those who were seeking a home loan, certainly in the 70s, had to meet a lot of requirements and stand in a queue, and their ability to own a home, particularly as a young person or indeed a single person, was frustrated by the regulation of the system. You don't see any role of the unwinding of that system being behind what banks were actually doing: ie they were responding to the market?

MR BREWARD: I would make a few observations on that. The first is that despite the regulation and despite the problems of the regulation - the injustices of it - housing ownership or the proportion of people who owned or were buying was going up or relatively stable at that time, over those decades. Take away the regulations - as happened in the early 1980s - and that starts to unwind. The percentage of ownership has dropped from - I think the Reserve Bank figures I was looking at the other day say 73 per cent in 1981. It drops now to 67 per cent in the 2001 census.

As The Age noted on 19 December last year, in terms of first home buyers, in the age group 25 to 34 I think the percentage of 25 to 34-year-olds who were buying or owned a house in 1976 was in the middle 60 per cents. It's now below 50 per cent. That's in that sense - figures, I believe. Trying to be as fair minded about it as possible, what seems to have happened in the period of deregulation of the financial system is that that has gone to an excess. The problems of the 1960s, although they were relatively small - the problems of the 1970s, shall we say - have been replaced by bigger problems, especially for first home buyers. In that sense I don't believe that you can say that there isn't a case for some remedial action.

MR BANKS: There are a couple of other points I was just going to raise. Your point about home ownership in Australia not being high internationally, I guess is something we need to look at. I'm just wondering whether you have done any work - and we might have a bit of a look at it - in terms of looking at those international comparisons; whether they are comparing like for like? For example, one of the things you'd need to look at is household size and composition. What we've seen in Australia is a very rapid reduction in household size and it's projected to continue. I think in some other countries - in Europe and elsewhere - you still have the extended families being accommodated. I'm just wondering whether that might be a factor in terms of static comparisons?

MR BREWARD: No, I haven't done that work. I'm drawing on the work of the Economist in those statements that I've made and I regard them as a reliable source. On the issue of household size, I would make a few observations. I think that firstly some of the most - and I believe the ABS stats bear this out - the most rapid change in average household size actually happened in the late 1960s and into the mid-1970s. It's still going down but it's going down at a slower rate. I would make the observation that certainly there would be lags, or whatever. The 1970s were not a period where there was rapid change in home ownership, so I don't think that's likely to be a factor.

In Europe I guess I'd make the assumption that the large extended family is pretty much extinct anywhere in the developed world. I don't think that that applies in Italy, which is one of the countries that I noted the Economist singling out as a high home-ownership country. Spain would be similar. I would be surprised if that was much of an explanation.

MR BANKS: Okay. We will have a look at it in perhaps a bit more detail in the final report on that.

DR SHANN: You made a number of interesting points about the analysis, but I was wanting to concentrate perhaps on the policy solutions. In your original submission the main one you seem to be advancing is basically a differential interest rate for investors and older borrowers. So, in effect, trying to target where the finance is flowing. The main supply side measure you are suggesting, as I understand it, is an increase in public sector housing for the needy.

MR BREWARD: Housing development, yes.

DR SHANN: So those are the two main policy responses you would see as necessary to fix the problem?

MR BREWARD: I would also note that I propose in that first submission an advocate for first home buyers, which I believe is absent at the moment. Yes, those two responses you have outlined are those that I specify in the first submission. I believe that first home buyers will not have a - the reasoning, you might argue, is circular, but basically I see it as an issue of marginalisation. They have become peripheral. The property industry operates very happily without them and affordability will not improve for them until they are the best way for property developers and real estate agents to make money. I don't see that happening until there are some forces in place to make it relatively difficult for people who already have a home to be out there competing with first home buyers, for whatever - you know, whether for a second home or for a holiday home or for an investment property.

MR BANKS: Okay, are there any other questions? Thank you very much. It is the sort of submission that bears scrutiny on our part, making sure that we've picked up the main points you've made, and we appreciate you elaborating further today. Some of the points are probably too detailed to be discussing in the hearing but we do appreciate the effort you've put in to both submissions.

MR BREWARD: I hope that I got some points across. It seems that you've taken on board some of the ideas, so that's good.

MR BANKS: Good, okay, thank you. We'll break now for a moment, please.

MR BANKS: Our next participant is the Brotherhood of St Laurence. Welcome to the hearings. Again, I ask you to give your names and positions.

MR ZIGURAS: I'm Steve Ziguras. I work in research and policy unit of the brotherhood.

MS JOPE: And Sally Jope. I work also in research and policy at the Brotherhood of St Laurence.

MR BANKS: Thank you. Sally is becoming an old hand in these processes by now. There are probably no surprises. As I said, perhaps begin by giving you the opportunity to make the main points you'd like to make and then we can have some discussion.

MR ZIGURAS: Thanks for the invitation to come and present to the hearing. I should just make clear, on the hearing list it says that we're presenting on behalf of CEDA as well. We will talk a bit about some of the work that we're doing with CEDA, but our presentation is on behalf of the brotherhood only.

MR BANKS: Good, thank you.

MR ZIGURAS: I might start by just giving a bit of background to the brotherhood's work and particularly our concern about housing and housing affordability. The brotherhood provides services to people on low incomes, mainly in three parts of Melbourne: in Fitzroy and the surrounding areas, in Frankston and in Craigieburn and Whittlesea. Over the last few years we've been seeing an increasing number of people through our services that have been struggling to find affordable housing, and not just through services that we run for homeless people, but for a whole lot of different groups - young families, unemployed people and so on.

It's been something that our service providers have kept commenting on over the last couple of years and so it's an issue that we have been looking at, because we're very concerned about access to housing for the people we see. To give you an example of some of the things that have happened, we are on the board of management of a community housing association in Fitzroy which provides subsidised housing to people on pensions and Centrelink payments, and the waiting list for that service has grown dramatically in the last few years. They have to turn away something like 80 per cent of people who lob on their door. We are having that experience with quite a few other areas of the inner city.

In our services in Frankston and Craigieburn, to some extent there is a bit of a different issue, which comes to the heart of our submission with CEDA, which is that certainly people are more able to afford the housing in those outer areas, but their access to employment is much more difficult, both because employment isn't as available in the local area but also because transport into the city and around the city is much more difficult. So as well as the whole issue of housing affordability across the board, we're also concerned about what seems to be the disparity between the location of affordable housing and the location of employment. People are often having to make decisions about one or the other, which means they're stuck in unemployment as a way of finding affordable housing, or vice versa.

We did a small research project a couple of years ago where we interviewed quite a few people who were in this situation and they talked about having had to move to the country to find somewhere to afford - Latrobe Valley, Bendigo and so on - but then couldn't find employment or some people had moved in from the country and were having the opposite problem. Some of those people also talked about the experience of having to forgo things like health, medication costs, simply because they couldn't afford it with the rents they were paying.

That's the context for our concern and our work. Sally will talk a bit more about our partnership with CEDA, but CEDA has been very interested in this link to employment and, over the last year, we've been doing some work together to look at ways to promote more affordable housing and the connection with labour market flexibility. In terms of response to the Productivity Commission draft report, I might make some initial comments and then pass across to Sally.

First of all, we recognise that there is a strong emphasis on home ownership in the terms of reference and that's obviously the main area that the commission is focused on, but we think it's very important that we don't neglect rental housing, both as part of the whole housing market but also because for most of the people that we're talking about, that's the only option - whether public or private rental or community rental. It does seem that the terms of reference acknowledge that by asking the commission to look at the whole of the housing market. We also think that rental is an important stepping stone into home ownership, so it's not just important in itself but it's also an important cog into home ownership.

One of the things that we would argue is that because rental housing is becoming less affordable that has got implications for the degree that people can save for deposits and their entry into ownership. We'd certainly urge the commission to pay more attention to the rental issue. I think it's covered in a few places in the report, but we think that there is a need for greater consideration of rental and affordable rental housing. To that end we also are very pleased to see that in the last page, I think, of the report itself, on page 155, there is a pointer to the government considering more affordable options for low-income households.

We were a bit disappointed that there wasn't more flesh, I guess, on the bones of that comment and maybe that was simply that the time you had to do the report, or maybe - we hope that's something that's coming in the next round of the report, but it's something we certainly would like to see more emphasis on. We have, as you know, put in some work that we've been doing with CEDA and Allen Consulting around affordable housing, and so we will talk about that in a sec, after introducing that. They're just some opening comments.

MR BANKS: Good. Thank you for that.

MS JOPE: I think when we put our response to your discussion draft it was around three main areas, which were your terms of reference about the components of the price, the mechanisms to improve efficiency and to identify any impediments to first home ownership. Basically we say that because we have a focus on low-income households and that's where we're coming from, that basically low-income households can no longer afford to pay the price that the market is requiring of them. That is no news to anybody, but I think that is indicative that the market is actually failing to supply the housing needs of low-income households. Considering that housing is an essential service or need, that's fairly important to consider.

The component of the price that low-income households are being asked to pay has made - there is an impact of location so that, as Steven was saying, low-income households may be able to afford housing further out but then they face barriers to employment or to services, et cetera, or lack of amenity. Also, what has caused the price to rise is the return of a market rate on investment in housing, so that now housing is becoming unaffordable because there is an expectation that you'll get a fairly high rate of return on any investment - considering it has been up to 20 per cent per annum. So currently many lower-income households pay too much of their disposable income on housing and/or live in poorly located, poor quality and overcrowded housing and that cost is having a major impact on their access to housing.

The other thing is the price mechanism which is again to trigger - in a market model it's to trigger an increased supply. It's not doing that. If there's an increased demand for low-cost housing the price goes up and so there's a whole lot of people who can't afford that price. We also have a situation where there is no incentive to invest in the supply of low-cost housing because, by definition, low-income households can't afford to pay the price the market expects. What we suggest, as in a lot of other submissions, is that there is a really good argument to intervene in the market and there are already a number of interventions in the market that are not targeted. As a result of those interventions we've got an oversupply at one end of the market and an undersupply at the other.

What we're arguing is that we should be intervening and targeting some of those subsidies to stimulate investment in affordable housing. We are also looking at a different - leading on from Steve's discussion about rental housing, but this model could also be applied to owner-occupied housing - we're suggesting that the current rental market which is characterised by mums and dads landlords - we would like to see a move to more institutional investment in that market, so that we've got a longer-term more secure supply or rental housing than what we've got now, that moves around a bit too sporadically in relation to housing prices, et cetera.

As a result of that interest, we have a partnership with the Committee for Economic Development Australia, looking at the supply of affordable housing that will go some way to having housing close to jobs and perhaps close to the lower end of the wage spectrum jobs, so that where housing is, isn't a barrier to employment and also that labour markets can act efficiently. CEDA and the Brotherhood have commissioned the Allen Consulting Group to look at a number of different options to increase private sector investment in affordable housing. Three of the models that were considered - and I've got a copy of the report that will be launched next Monday, but I thought I'd bring a copy of the most recent report - we included, I think, a draft copy with the original submission.

MR BANKS: Yes, we've got this one which is dated November.

MS JOPE: Yes. So this is February 2004, and this is the final report.

MR BANKS: Good, thank you.

MS JOPE: I've brought a hard copy of that. It looks at three models. I will just take a step back. In the discussion draft there was the conclusion that really the commission wasn't able to come up with any initiatives or policy initiatives that they would see would overcome the difficulties of low-income households getting into owner-occupied housing or affordable housing. We would say that there are a number of initiatives that have not been acted on that certainly need exploration.

MR BANKS: I think the question for us was, I suppose, how to - the question of the margin. Those who potentially could - for whom home ownership would be viable over their lifetime and under current arrangements are having to defer home ownership. I think what we were saying was that we didn't see it as optimal that policy be predicated on the notion that 100 per cent of Australians should own their own home.

MS JOPE: Sure.

MR BANKS: Now, I don't know whether you disagreed with that.

MS JOPE: No, but I would say that 100 per cent of Australians should have access to affordable housing and I know that's - - -

DR SHANN: That includes rental housing.

MS JOPE: Yes. I know that's a different issue, but we would take the point that if you've got access to affordable rental housing, you're in a much better position of moving on to affordable home ownership than at the present. There are households who perhaps will never manage home ownership, who should still have access to affordable housing. I would suggest it's a right that Australians do have that access - and they don't at the moment.

Basically the work by Allen Consulting Group suggests that with an investment of $100 million a year for the first year you could look at a supply of more than 15,000 units of affordable housing. This is targeted to people on below median incomes, so usually low-wage earners; not necessarily people solely on pensions and benefits, but they could be sole parents with some part-time work, people with some extra subsidy to their pension or benefit. That would increase up to a billion dollars over the lifetime of the program and stay at a billion - I think it's for about 10 years - and that would see an increase of 150,000 units of affordable housing in 2001. Based on 86-96 figures that Terry Burke was talking about yesterday, there was estimated to be a shortfall of 150,000 for low-cost dwellings. These models or policy options are the only ones that really talk about significant numbers to address the significant need of affordable housing.

Investment of this type will have economic and social benefits that would probably - while we can't identify how to measure those benefits - go some way to repaying that outlay. The Allen Consulting Group talked about the shared responsibilities and they look to the Commonwealth for leadership as well as that subsidy figure. Those are the main things that I wanted to say here today.

MR BANKS: Okay. Thank you. I need to look at the latest version and so on, but was there any discussion in that report about what the flow-on effects might be of essentially injecting this much additional demand - even though it has tended to be through the supply side of creating additional dwellings - what impacts that would have on the market generally. I mean, we don't observe - certainly in the current circumstances - a lot of spare capacity in the building industry, for example, or a lot of lower-cost land so this would be presumably squeezing out some other activity, and that question is always the trickiest one, of what the effects of a partial measure would be on the rest of the market. Was that something that was looked at, at all?

MS JOPE: Not directly. I suppose the most appropriate way, when they looked at that, was the thinking that the housing boom can't go on forever, and that there would be a decline in that activity, although I heard this morning that that's not evident so far. But in that, I think most of us are agreed there's an oversupply at one end of the market, there is an undersupply at the other end of the market, but there aren't any incentives to build at that end of the market. If lower-income households can't afford it, why would you invest there?

DR ROBERTSON: Actually, I think we heard that there isn't an oversupply at the top of the market. That's the problem I think that Gary is pointing at. Who was it yesterday that was saying that the vacancy rates in Sydney were very low, still?

MS JOPE: Okay.

DR ROBERTSON: So I think that what Gary is getting at is the problem that if you increase demand for any reason, whether it's a socially-just one or not, there's going to be an extra pressure on prices throughout the market as a whole, because the capacity is quite limited to expand housing production, never mind council approvals and those problems.

MR BANKS: It's just another thing to take into account. I mean, I think these arguments for more targeted support have some merit and they're worth looking at, but I suppose in assessing the costs and benefits, some of those second-order issues - I mean, as you'd be aware, a number of the initiatives that were designed to make housing more affordable have in a sense been part of the problem, in terms of fuelling demand. We argued in our discussion draft that, for example, the first home buyers scheme be more targeted and I think you agreed with that proposition, perhaps in your previous appearance here.

I suppose the broader issue for us is - and we've had a number of submissions urging us to look more carefully in this area and certainly it has become clearer to us that general observations we've made about the rental market were too aggregate in their basis, and that we should have perhaps distinguished a bit more between what was happening on the average or at the upper end of the market and the lower end of the market. So that's something we'll certainly look at in preparing the final report. I guess we still have a difficulty in terms of looking at the various ways of addressing affordable housing, going beyond ownership, of how credibly we can get our minds around that and propose something that would stand up to scrutiny, given that that is a big topic, together with public housing, and not central - I mean, the ACTU begged to differ yesterday - but not central arguably to our terms of reference. So finding our way through that I think is going to be a challenge for us, if I can put it that way. So we appreciate having this information. The question for us is how we best make use of that against some competing demands of our terms of reference and make best use of it in the final report. I should ask if my colleagues have any questions.

DR SHANN: Can I ask who you see as the renters who would have access to the properties that would be provided through this? Do you see this as a way of reducing public housing waiting lists, or is it aiming at target renters who aren't necessarily on the public housing waiting list?

MS JOPE: I think the people on the public housing waiting lists - it's so targeted now to those most in need that those who may be on low incomes, who are low wage-earners, aren't able to access public housing, but are still probably experiencing housing-related poverty, because of the high prices of housing and low incomes.

DR SHANN: So you see it as meeting a need intermediate between public housing and first home ownership effectively.

MS JOPE: Sort of like 20,000 per annum to the low median income. Yes.

MR ZIGURAS: As Sally was saying before, there's an increasing number of people who are on pensions or benefits who have got some part-time or casual work, so there's a group of people that over time have got bits and pieces of work, so they do have greater income, but they're really not able to get into the rental market.

MS JOPE: I think one of the points that David Edwards brought up when we were doing this work was that having a secure, affordable supply of housing probably would assist people out of public housing once they had overcome whatever crisis it was that led them to there. For some people, public housing might provide a time to get things together, especially for sickness that you recover from or sole parenting, once you've overcome the family breakdown, and they could actually move on to more affordable housing that's not public housing. At the moment, once you're in public housing, because the private rental market is so insecure and so expensive, you're not really going to want to move out, and that's not necessarily a good thing. So public housing could become, for some people, more of a stepping stone into more affordable rental housing, and then into more affordable home ownership if it's available.

MR BANKS: When you say that, are you implying that more affordable rental housing would still be rent-assisted housing?

MS JOPE: Yes. There has to be some form of subsidy.

MR BANKS: Yes.

MS JOPE: There has been modelling that shows it just doesn't pay. Even for households on 20,000, there is still a need for a subsidy, and that goes up to the low median incomes. There's still a need for a subsidy. There's that gap between what people can afford to pay and the market rate of return on an investment in that housing. That remains. It might not be this commission's responsibility but I think you need to acknowledge that that's the situation, because that's what making rental housing unaffordable, and that is a big barrier to home ownership. That's an impediment to home ownership.

DR SHANN: You're subsidising the supplier effectively in this model.

MS JOPE: Yes.

MR BANKS: I suppose the question would then be is it simply available at the market rate of rent that the supplier decides, or are you going to means-test access?

MS JOPE: Yes. It's targeted.

MR BANKS: It's means-tested.

MS JOPE: Yes. It would be means-tested.

MR BANKS: Okay.

DR ROBERTSON: It's easier talking in this general way, than it is talking about the point that you raised first, which is houses and jobs not being in the same place - I'm not quite sure how anybody can handle that, in the sense that if you're going to build houses, then that's going to take time as well as capital, and if you're not careful, the way things move these days, you could find that the jobs that were there aren't there when the houses go up. So location in this sense is slightly different from the one that we usually use it for. We say, "Location, location," meaning the price of the land. But matching those two is going to be difficult, I think, and you'd need to be sort of strategic about where you think those things should go, which means getting at local authorities in the right place. Does the Victorian state government have any programs for assisting with building of houses? You mentioned the federal government should do it.

MS JOPE: Just go back to what you were saying about location and housing et cetera - you're quite right. I think, for me, one way of overcoming that is that in any housing development, there is a component of affordable housing, because a lot of the jobs that are created around housing - I mean, if you take for example the industries of hospitality and recreation and entertainment et cetera - Docklands and any inner city developments - you've got a lot of housing, but not much housing for low income wage-earners who are going to be working there. So there's that, that you can always have some housing around where the population centres are.

VicUrban has a responsibility to look at the supply of affordable housing, but also to make a profit, and I think there's a bit of tension between the two of them. Office of Housing, Victoria and state government Office of Housing are looking at private sector investment in affordable housing, and at the moment are consulting around the development of housing associations, which would be the bodies to perhaps undertake more affordable housing development with private investment. So they would be exposed to the risk that government is moving away from. Their funds are limited. I was just looking at the document around that, and they are sort of not talking about any subsidy, so how they're going to house people with incomes below what we suggest is needed for investment, I'm not sure. I think there is a need for subsidy to make those models viable.

MR ZIGURAS: I think as we pointed out in our submission, this is a responsibility of both levels of government, and they're currently both involved - well, all three levels of government - so we're not sheeting responsibility home to one or the other, but we do think that there's a need for national leadership because it is such a big issue, and that's why we're calling on the Commonwealth government to take a lead, but getting together with the states and trying to work through some of this.

DR SHANN: Does the Key Worker UK Scheme - I mean, I've heard of it, but I must admit I'm not actually familiar with what's involved. Is that something you've looked at?

MS JOPE: I think that probably started the interest by the Committee for Economic Development Australia in this project, and basically Key Workers is about nurses, firemen, essential services, who aren't on very high incomes, who are forced to live out on the margins but who are working in the centre, and who would then perhaps choose to work on the margins rather than have to do two hours' travel or things like that. I think it's more specifically an issue in Sydney, more of an issue in Sydney.

DR SHANN: It's simply a rental subsidy to those particular workers, is it? Is that how it works?

MS JOPE: I'm sorry.

DR SHANN: Is it a rental subsidy for those particular workers or a housing subsidy?

MS JOPE: I think that it's about both. I think it's about supply as well as a demand subsidy.

DR ROBERTSON: I think that idea you mentioned about having some low-cost housing in a big development is one of the ways in which they're trying to do it in the London area.

MS JOPE: Yes. I think that's part of their plan - that it's a must any housing development has a percentage of local housing, yes.

MR BANKS: Again looking at some of the ramifications of that - I haven't the detail of it, but there has been the Barker review in the UK, reporting recently on particularly supply side issues in relation to housing in the UK and more focused on, I guess, home ownership, but one of the issues which I believe was raised there was this requirement on developers to include low-cost housing was an implicit tax on development, and there has been in some areas of London a strike of capital, where development is just not occurring.

I guess it comes down to the fact that it's a question of how transparent you make the subsidy and who bears the cost of that. That's why I say that working out the best mechanism is not a straightforward thing to do in terms of getting the biggest bang for the buck. I agree that the objective is obviously an important one and we're much more conscious of it now; finding your way through those various options of how you finance it and then how you direct it I think it quite complex. I think you should be commended for the work you've done and that CEDA has done - and the Allen Consulting Group, among others - just trying to build up a good analytical base for considering alternatives.

MS JOPE: Sorry to interrupt but, before you finish, I think the next stage and the next step is to explore that. I mean, we would certainly like a recommendation to explore that, but I think it's about time that we did some demonstration projects. I mean, you wouldn't want to embark on such a project and go - a huge amount of money. Let's do it. I know VicUrban is well set up to try some projects, but that subsidy is the thing that's missing to make it a viable solution, yes.

MR BANKS: Thank you for keeping this in front of us. We will certainly do our best to see how we can take on board what you have told us when we produce our final report. Thanks a lot.

MS JOPE: Right, thank you.

MR BANKS: We'll just break now, please, for a little while before our next participants.

MR BANKS: Our next participant is the Planning Institute of Australia. Welcome to the hearings. Could I ask you, please, to give your name and your position, or affiliation, in relation to the Planning Institute of Australia.

MR SPILLER: My name is Marcus Spiller, and I am appearing here on behalf of the Planning Institute of Australia, as the institute's national president elect.

MR BANKS: Thank you. Thank you for participating today, and we will hear from you wearing a different hat a little bit later on.

MR SPILLER: Yes.

MR BANKS: So thank you for twice the value. We found, I should say on the record, the initial submission by the Planning Institute very very valuable, in terms of preparing our discussion draft, which should be evident at various points in the draft itself. Likewise I think that the submission you provided in response to the draft is quite helpful. I will give you the opportunity to raise the key points and we can have some discussion.

MR SPILLER: Fine. First of all, the institute is broadly in agreement with the discussion draft's findings. We do believe that the analysis the commission has made is an accurate and helpful one to policy. So as an institute we support the thrust of that report and wouldn't expect to see major changes in the final version. However, we do have some points that we wish to make, in relation to the discussion draft, and I will summarise those quickly here.

The first point is that we felt that planning approvals and the planning system generally came in for extensive criticism in the discussion draft, and to some extent that's to be expected and to some extent we accept a degree of responsibility. However, the point that we would make is that environmental management, the impact of new development on the environment, is these days a much more complex thing than it was in the past. There are many many good reasons why decision making about development approvals needs to be a careful process, which inevitably will take a degree of time.

As we point out in our response, harking back to the good old days when decisions were made very rapidly without much of a policy context, it did lead to some pretty horrendous results in terms of the built environment. We think it's not a question of criticising planning or the aims of planning. The issue really should be one of finding ways of speeding up the process at the margin.

As we point out in our submission there are some best-practice models now starting to appear in addition to the Victorian experience, which is cited in the discussion draft, and we draw attention to the South Australian delegation's model, which does create a greater separation between the policy makers and the administrators of the rules. That's the first point then about planning policy, that it is a much more complex undertaking these days and needs to be understood in that way.

MR BANKS: Is it worth - unless you were going to go on to it; the question of separation. I note in the submission that there is a questioning as to what extent that is actually good practice, particularly in the context that you are describing, of a more complex sort of world as well. I'm just wondering whether you'd like to elaborate on that point?

MR SPILLER: Yes.

MR BANKS: I think we raised it as something that was deserving of attention.

MR SPILLER: Yes.

MR BANKS: We weren't necessarily saying that it should be done in a particular way. We were trying to provoke a reaction, which I suspect you have some other views that you could convey on that.

MR SPILLER: Yes. On behalf of the institute I would say that there is scope to create a greater separation and I think that should be the objective. There is a lot of effort happening now, at the federal level and at the state jurisdiction level, to find models to do that: the better decisions, the faster approach, the SA delegation's approach, are all steps in that direction.

I suppose we were simply trying to caution about the application of public policy principles taken from elsewhere, even in the development control area. The example that we cite is in fact around building regulations. Now, building regulations are about health and safety and structural sufficiency. It's almost - at the risk of overstating it - a black and white issue: either the building will stand up or it will fall down, depending on how it's designed.

When it comes to planning impacts, particularly the more conceptual issues that occupy that space these days - for example, what will a particular big box shopping centre do to the culture and character of a local strip shopping centre; what will a six-pack block of flats do to the culture and character of a street of Edwardian houses, or whatever - a degree of judgment needs to be exercised. It is not a question of a technical "Tick the box. Yes, you pass. No, you don't." Each of those decisions is a mini-political act and because of that there are certain inherent limits to the extent to which you make a complete separation between policy making and rules of administration even though we should be finding every possible means of doing that. I think we are making good progress in that direction.

MR BANKS: Yes. Okay.

MR SPILLER: The other points that we want to make relate to the question of land supply, both in a greenfields situation and also the release of land for infill or redevelopment. My opening remark here relates to what I think is a theoretical proposition put in the discussion draft. That is, in a theoretical world it's almost possible to do things without planning. If we get our price signals right we can allow development to occur in an optimal fashion. That is, households can choose where they would like to live and at what density, based on the true resource costs of that decision. And the true resource costs relate to the cost of extending infrastructure, and also there are private costs, in terms of commuting and so forth.

We make, I suppose, the simple point that there are some environmental constraints that can't be adequately reflected in pricing signals and therefore there is, in our view, an unqualified requirement for planning to set the framework within which an efficient market must work. Things like water supply catchment, areas of landscape value, areas of high quality agricultural utility, and areas that are flood prone, for example. These areas, we believe, for the sake of efficiency, should be taken out of the equation by planning processes and then within the land stocks that are left, we agree with the commission, yes, the timing of development to some extent should be left to price signals.

In that regard we endorse the reference made in the discussion draft, that the Victorian proposals for sequence development, but with opportunities for developers to go out of sequence by meeting the additional costs, are perfectly logical and is one way of encouraging a more flexible land supply situation and a more rapid supply-side response to spikes in demands such as we have experienced recently.

As I say, and this is all against the background of the institute being quite happy with the discussion draft, perhaps the more serious concern we have relates to the commission's assertion - as we see it, because we couldn't find much evidence in support of the comment - that the land development sector is probably competitive. We don't have the resources to provide quantitative evidence to the commission, so to some extent we can't prosecute this case too well. Anecdotally, we feel that the land development market is in fact highly prone to concentrated ownership, oligopolistic practices, whatever you want to call it.

The sector has seen the introduction of major large-scale developers, who are community builders, and to some extent as planners we welcome that. They are not like one of my colleagues, Lindsay Nielsen, would have called them: the cutters and runners. These are developers who have an interest in creating well-planned, well-resourced communities, so to that extent there is a major benefit.

Our sense is that a number of these developers hold very large stocks in crucial growth areas. For example, in the western growth area of Melbourne, the Wyndham area. A very large proportion of the greenfield land there is held by one, or maybe two, landowners. As I say, the anecdotal evidence - and that's all it is, really - is that developers in these situations don't have a great incentive to release land in a timely fashion. In that context we would like to see, in the final report, greater attention given to appropriate precautionary mechanisms to stimulate timely release of land.

So the sequencing idea that I referenced earlier perhaps could be backed up with appropriate sticks as well as carrots to require the timely release of land when there is evidence that that land is ripe for development. That's one issue. Another safeguard might be the operations of government-owned land developers who can, whilst operating within appropriate financial and commercial disciplines, ensure that there is healthy competition and therefore the incentive to release land in a timely way.

On the same issue of the role of land commissions, whilst some people may debate their role - and I know that the commission has in the past - in maintaining a competitive land supply situation in greenfield situations, we believe that there is a very clear case for their involvement in infill and redevelopment scenarios where a well-recognised market failure is the fragmentation of landholdings in areas which are well suited to redevelopment and perhaps don't face the same Nimbi-type backlash problems.

We feel that there is a very clear role for land commission-type organisations to break through those barriers, assemble land and make it available in a wholesale fashion - making it available wholesale or in joint ventures or whatever - to developers, to retail developers.

DR SHANN: The Wyndham Council was actually here yesterday and someone specifically asked them about this issue. Their reaction was that there were 20 projects under way in Wyndham, and projects in surrounding areas as well. So they didn't see this as a problem.

MR SPILLER: Yes.

MR BANKS: I think their concern was more how to cope with the growth, the proliferation of housing and whatnot in the shire. It's very hard to get to the bottom of some of these things.

MR SPILLER: Yes. On the greenfields stuff, I suppose we would be - and maybe you have tried to assemble some data in that area but some basic data on what proportion of the greenfield land is held by x number of landowners would be a useful thing to know. I believe that the industry is characterised by, still, a broad spread of operatives as well as community developers there would be people who are holding residual pieces of land that are doing a little bit of subdivision, so whether or not - if you consider that a very large proportion of Melbourne's growth will be accommodated in Melbourne's western growth corridor, 20 projects, to me, doesn't sound like a lot. Our key point here is really that there's a need for some numbers so that we can all feel confident about the level of competition in that market.

MR BANKS: We've certainly had evidence in Sydney - about Sydney actually, that was presented yesterday - that that situation does exist more particularly in Sydney, I think, where the potential growth areas are more constrained, geographically, I suppose, or geologically, compared to Melbourne, and I think that point was being made.

MR SPILLER: Yes.

MR BANKS: In principle the way you have expressed it - or the way the institute has expressed it - I think it is undeniable that in certain submarkets or segments of the market concentration of ownership is likely to be high, and I suppose the question is, how much of an influence that is on the overall market and over time - and I suppose from our point of view, how influential that will be on sort of trends that we observe and have observed.

MR SPILLER: We do make the point in the submission that with the entry of the larger scale community building developers comes with it the need to assemble a very long pipeline of land supply coming through. It's essential for business operations and, in some ways, you could say that's a good thing because at least it puts the industry in a position to hit the accelerator button if necessary, but that structural change in the industry is causing land to be brought under more consolidated ownership. Urban growth boundaries are doing that. We're supporters of urban growth boundaries because of the environmental benefits that they bring but, I suppose, without dwelling on this point - because, as I say, we can't really help the commission too much because we haven't got any figures to put before you - our simple call is, “Let's see if we can get some numbers”.

If we can't get some numbers, should we not have some precautionary policy positions relating to active competition in those markets via a land commission type organisation and/or some other incentives - or sticks - within the land taxation system or the local rating system, which would accelerate the release of land that is right for development based on properly prepared structure plans and release plans. We haven't gone into it in the submission, but we can probably supply this information later - that it is possible to think of ways in which if land is left behind - in a sequence of development, land that is designated for early release and development - and development has engulfed it and gone past it - and it's retained for an excessive period, then you know maybe there are some triggers that could kick in to induce the landowners to get on with it then.

DR SHANN: But isn't the alternative - I mean, since you have touched on it - to have a large pipeline of land which can be developed and to allow out-of-sequence development, so if someone holds off a piece of land there are alternatives?

MR SPILLER: Yes.

DR SHANN: I mean, rather than introduce a government body in the greenfields area - I tend to agree with what you're saying about there may be a role in infill areas areas but, in the greenfields area, I would have thought that as long as the pipeline of land available is large enough; that's the protection.

MR SPILLER: I would have to agree with you really. I mean, we haven't talked about this in the institute much, but I think base number 1 is to maintain a large bank of planned land, so that if a developer decides to go out of sequence the structure and future planning of that area is not an issue. The only issue is, who's going to pay to extend the arterial roads, water supply, schools, hospitals and everything else that might be required, and that is, I suppose, your first line of defence. I suppose there has been talk around that type of approach for probably about a decade, in part, triggered by the Industry Commission's inquiry into this area in the early 90s. We don't really know whether that is good enough yet, and I suppose we would like to be doubly careful and urge a triple-pronged approach. A lot of raw land that's sequenced, an active government land developer and perhaps some incentives for land release.

MR BANKS: Just one further thought there. I think it was the UDIA - I am just trying to think who it was who objected to land tax as a tax on stock-in-trade and saw the development industry being, in a sense, discriminated against relative to other industries who didn't face such a tax, and I guess an obvious response would be however that that would be a tax which would - at least at the margin - have the effect that you are suggesting; ie, it would be a penalty to holding land.

MR SPILLER: To hold it, yes. That's true, I would agree.

MR BANKS: Okay.

MR SPILLER: I have talked about land commissions and their role in established areas, as well. The only other point that we would make is that we note in the submissions that are cited in the discussion draft that some of our brother-and-sister peak organisations have alluded to the need for Commonwealth government involvement in urban policy and that the PCA in particular has called for almost a cascading approach of regional metropolitan and local plans. We would just like to say here, publicly, that we strongly support Commonwealth involvement in urban policy.

We do have our own views in fact about the best way in which the Commonwealth can involve itself. We would perhaps urge the commission to think about, as we have - and in fact have adopted, or will be announcing soon - a model that is much closer to the national competition policy model, whereby COAG, under Commonwealth leadership, establishes a set of outcomes that it wants to see in terms of urban development, including all the issues that are on the agenda for your current inquiry to do with timely land release, maintaining adequate land stocks, et cetera, but then the states and the territories should be allowed to find their own ways of meeting those targets and, should they meet those targets, should be eligible for additional untied funding from the Commonwealth in exactly the way that the national competition policy works. We feel that that gives the greatest opportunity for innovation in urban management, whilst meeting national objectives, and certainly provides the Commonwealth with a role without having to - if I may use the term - "meddle" in local affairs, for which it really isn't terribly well suited. That's my submission with my PIA hat on.

MR BANKS: Okay.   The last point you were making is something which we would have to think about a bit more. I don't know whether you wanted to elaborate on that a little. I suppose the glue that held the competition policy agreement together was the payments, but the payments had a kind of internal logic of, if the competition reforms went through there would be additional tax revenue being generated, a large proportion of which would go to the Commonwealth and therefore recycling it back to the states can close the circle - the circle of commitment or whatever.

MR SPILLER: Yes.

MR BANKS: I am just trying to think of whether - you know implicitly there - there's a similar logic here, but it probably isn't reflected in real dollars.

MR SPILLER: I don't have the evidence here to leave with you, but we can certainly make it available to you. Well, I don't know. It's up to the New South Wales government, but I know that when the New South Wales government was contemplating reforms to its planning system - called Plan First - it actually commissioned econometric work to look at what the flow-on effects would be to a more efficiently structured metropolitan Sydney, so that went to issues like, what if the cost of providing infrastructure was less? What if we had more efficient utilisation of existing infrastructure? What if we had more efficient commuting patterns, et cetera, and with some reasonable assumptions, very large returns were shown to be on offer.

Really, that's almost self-evident when you think of a city as a major production machine, a network of costs, a more efficient structure brought about through more incisive planning and urban management, and the package we're talking about isn't just about town plans. It's also about things like introduction of road pricing in appropriate situations, appropriate water pricing policies, appropriate land taxation policies to encourage the sorts of behaviours and outcomes that we were discussing earlier, so it's a broad definition of urban management, not just town plans, so that New South Wales evidence is quite interesting.

That's the first point I would make in relation to that: that we would argue that there is a similar gain to be made in terms of national efficiency and therefore a dividend to be distributed back to the states. The other thing we would say about that is that the Commonwealth already spends a lot in urban development, although not necessarily within an urban development, urban policy portfolio, shall we say. Its national roads program, for example - the funds that are being provided for the Mitcham to Frankston - here in this city; its various decisions about university funding, the physical side of it.

We would argue that there is already a large expenditure on the part of the Commonwealth on urban infrastructure which could be bundled into this package, so as well as a dividend from more efficiency some of the expenditures which are currently tied in, we would say, sometimes less than efficient ways, can be untied and returned to the states and territories in ways that are demonstrably linked to achievements of certain milestones on urban efficiency in the way that NCP works.

Incidentally, our idea has in it - to take a cue from the discussion draft about separation between rules administration and policy-making, because we see this issue of money being an important glue to get the thing going, we believe that the whole thing should be supervised by an institution quite similar to the NCC, so we're proposing a sustainable development commission that would operate at arm's length from government, provide independent advice to government about the extent to which a state or territory is in fact hitting the milestones that it proposed to hit in the plans that it puts up in return for this stream of payments.

So the sustainable development commission would operate in public hearings like this and would properly scrutinise, first of all, the efficacy of plans and policies being put up by the states as part of this package, but also monitor and audit the extent to which progress is being made, and give the green light, the amber light or the red light, in terms of the - so we feel the national competition policy was an outstanding success in terms of micro-economic reform, but also an outstanding success in overcoming a whole lot of political difficulties at the local jurisdictional level, and this planning in urban management area is rife and, without something which, in a sense, comes over the top of all that and provides a real incentive for local politicians and state politicians and government and communities generally to take what, at the moment seem to be almost intractable problems, we feel that progress will be slow. Although that is in a sense a slightly peripheral issue to your inquiry, we feel that it's important.

MR BANKS: Right. There's a report coming out shortly, or a document that will flesh this out more.

MR SPILLER: Yes. I actually take up the position of national president at the institute's Hobart conference, which starts on 22 February, and the actual policy will be released at that time - a detailed policy.

MR BANKS: We neglected to congratulate you on being president.

MR SPILLER: I don't know what I have got myself in for.

MR BANKS: Just one more important role that you have.

MR SPILLER: I'm looking forward to it.

MR BANKS: Okay.

DR SHANN: The Property Council were pushing the idea of an audit of government lands - federal, state and local - in terms of trying to identify land that was potentially available for residential development. Is that something you think would be useful or is it something that has effectively been done?

MR SPILLER: I don't think there would be any harm in it. I think though that the way in which governments have reformed their property portfolios, in part in response to NCP incentives, is that they've given themselves very little incentive to hang onto land which is surplus to requirements anyway. They have advisers and administrators who know or who can find out the highest and best use of land so, in a sense, it's a little bit different I think to what the situation might have been 20 years ago, where you had land that nobody knew the value of and went slow in terms of making it available to the marketplace.

Nevertheless, I think such audits can help, partly because it might just bring more information into play in terms of developers out there who have innovative ideas to do quite special things with areas of land that otherwise might be deemed to be, in their wisdom - or lack of it, by these property managers - not useful for that purpose. So I think just having more information in the marketplace is helpful.

And the other thing, too, I suppose, at the risk of repeating my earlier points, is that government is often the holder of land in highly strategic situations and because of the separation of policy from administration, quite often the advice that goes to government is that you should maximise your profit, even though that might come at a social cost. So getting the best out of a particular site in one sense could be holding up, for example, densification around a key node that would then cause the wider market to respond more positively to that idea. So the external benefits of taking and making such a move may or does not enter into the thinking of some of these government property managers because if you ask them they'd say, "Well, that's not our business. Our business is to commercially optimise the value of the government's land-holdings," and then the government can do what it sees fit with the returns.

Sometimes - I'm not talking about routine chunks of land here and there that governments hold; I'm talking about strategic parcels of land - I think a government owner is obligated to take into account the external costs of not releasing that land early and at a reasonable price, in effect to pay a CSO to the property owner and say, "Well, look, there are social benefits which will be forgone unless this land is turned over to X, Y, Z purpose early on." And to get back to Commissioner Shann's question, the more these sites are in the public domain and able to be debated from that perspective I think is a good and healthy thing, so I do support the PCA in their call.

MR BANKS: Thank you. I think we could move right along, unless you had a further point in relation to the Planning Institute of Australia.

MR SPILLER: No.

MR BANKS: And now perhaps for the record I should indicate that you'll be appearing as a representative of the Municipal Association of Victoria. Is that correct?

MR SPILLER: Yes, correct.

MR BANKS: And maybe I'll just get you to give your affiliation with that body before we start.

MR SPILLER: The affiliation that I have with the MAV is as a consultant to the MAV, so the MAV commissioned the firm of which I'm a partner, SGS Economics and Planning, to make this submission on their behalf.

MR BANKS: Thank you.

MR SPILLER: And again, if I can just launch into the key points - again the MAV broadly agrees with the discussion draft and its findings. The principal points that the MAV wants to raise in relation to the discussion draft relate to the distinction between taxes and charges and the whole issue of double dipping with development contributions. The question of double dipping - that is, where a developer pays for the extension of infrastructure, and we all assume, and we agree, that cost is passed on to the buyers of the units or dwellings and therefore is a user-pays mechanism, and a double dipping is alleged to occur when those same households are subsequently asked to pay the same rates as neighbours who mightn't have been faced with an up-front contribution through the development contribution system. So that has been popularly referred to as double dipping, and we note at the MAV that the commission is suggesting that perhaps properties that were the subject of development contributions should be eligible for some sort of reduction in their rates in future, in order to overcome what is an equity problem.

We don't deny that owners and residents of property that were the subject of development contributions are treated differently from what happened in the past, and we don't deny that there is a question of equity to be resolved, but what we say is that this is not a matter that can be resolved on the basis of economic efficiency principles. This is an equity matter that needs to be resolved by councils as part of the political process, and let me explain that, if I may.

Our argument stems from what we think is a very clear conceptual distinction between a tax and a charge. A tax - and we regard local government general rates, not special rates or road construction schemes and so forth, but general rates - as a tax. We regard them as a tax because there is no obligation on the part of the tax collecting body to deliver to the payer of the tax anything, in theory. There is a redistributive element to the application of general rates and there is a capacity-to-pay element to the application of general rates and, as I say, there is no commercial implied or explicit obligation to return back to the payer goods and/or services commensurate with what they pay.

So a tax in that sense is quite different from a charge, and in Victoria certainly it's explicitly acknowledged in official guidelines that development contributions are a charge. Now, a charge is quite different from a tax in that there is a commercial discipline at play. Those who seek to levy a charge have an obligation to return the service. If they don't provide the service or the infrastructure, then the money shall be returned. Now, that is actually explicitly stated in the legislation governing development contributions in Victoria, at least insofar as those contributions are administered by municipalities.

Our point is that development contributions are a charge, general rates are a tax, and there is no necessary connection between the two. The fact that a council decides to introduce from a point in time a user-pays charging system for infrastructure in our opinion does not imply at all that it should make an offsetting charge in its taxation regime, and the example that we provide in our submission relates to other areas of taxation.

Those people who were caught at a time when they had to pay for the university education through HECS may see themselves as being entitled to a tax break in the future to offset that, compared to the previous generations who enjoyed a so-called free university education, but it doesn't necessarily follow that they're entitled to it. There is a political question there, and one that needs to be resolved at a political level, but to our way of thinking there is no connection. A council is entitled to tax in the way that it thinks is in the community's best interest, and it's entitled to introduce charges in a way that it thinks is in the community's best interest.

Taken to extremes, this double dipping issue could be so constraining to the opportunity to introduce charges because of the difficult problems of adjustment rates to reflect charges that were paid previously that we would argue would act as a major disincentive to the introduction of charging systems, and we think that would be terribly counterproductive in terms of efficient urban growth. We don't really want to go back to a situation where urban infrastructure was funded mainly on a taxation basis rather than a user-pays basis because that provided incentives basically for inefficient urban sprawl.

So we have a fairly simple point, therefore, and that is a tax is a tax, a charge is a charge. The fact that a council introduces charges at a particular point in time in a particular segment of the community doesn't imply any obligation to adjust its taxation arrangements to compensate those particular households, and in that sense we believe the word "double dipping" is misleading and inappropriate.

MR BANKS: That's an important point and I must admit right at this moment I'm feeling a bit confused about it all, so you've obviously made a good point and I need a bit more time to think it through. I suppose the way that seemed most clear to me was not so much the council but a public utility which has an option of charging a user of its service up-front or over time, or some combination of the two, and you could imagine circumstances in which it charges more than once. In other words, it charges up-front but then in its usage charge it has some component that also potentially can be picking up some of the capital costs, so there's double dipping in the sense of charging excessively, once up-front and then over time. So that seemed clearest to me, and it doesn't get into the question of taxes versus charges, because they're both charges for the same service.

MR SPILLER: That's right, and that's almost verging on the abuse of monopoly power.

MR BANKS: It is.

MR SPILLER: But we would say that with a utility you're not talking about an elected body; you're not talking about a body that has a mandate to levy taxes, and in fact the double dipping that they may engage in from time to time I would have thought one could go and seek remedy for before the ACCC as an abuse of monopoly power. I don't think you could go to the ACCC and seek remedy for being - you know, "I'm being taxed the same in this local area, even though I know my house was the subject of a $2000 contribution, whereas the house over the road wasn't." I think the response you'd get is, "Well, times change. We've moved from a community pays/taxpayer pay approach to infrastructure funding to what is a mixed but increasingly more user-pays approach, and you were caught at a time when that decision was made." It's not an economic issue. It's a political issue that we believe local governments are entitled to resolve in the way that they see fit.

DR SHANN: I had the same reaction. You're saying you do taxes in a certain way but it would be open to a council to - I would have thought particularly if it was a council where there were large-scale developments and that was a high proportion of the activity in that area - to be potentially concerned about the reaction of ratepayers.

MR SPILLER: Absolutely.

DR SHANN: So to take an example, Wyndham City Council in their submission addressed the issue and said they recognise the importance of ensuring that double dipping does not occur. They were hoping to do it by way of making sure that it was clearly identified that the money was being used for capital works; that they weren't using money for ongoing expenditure.

Well, you're quite right. You can draw a distinction and say taxes can be levied according to the ability to pay, but it would also be open for a council to take a view, on equity grounds if you like, that it wants to avoid loading rates on to a particular area if it thinks there is a danger of - well, whatever you want to call it - double dipping or putting too much cost on to new development areas.

MR SPILLER: There is no doubt there is an equity issue and a political issue there. What we're at pains to try to point out is that it's not a matter that's resolved by resort to an economic argument; for example, the people of the eastern part of Melbourne are maybe paying a toll for a road that they thought was going to be paid for out of their taxes. Now, some of them may be concerned and might want to express that concern politically, but there is no doubting the right of the state government to introduce that policy and to take a decision for which they will be politically accountable not to compensate those people by way of a tax break of some sort, which they could do.

In Wyndham Council's case they decided to approach in a certain way and that's good. The discussion draft seemed to imply that it would be a good thing if routinely councils, if they introduced development contributions, should, if at all possible, do something to their rates. We're saying that doesn't necessarily follow the taxation policies are quite different. Do you want to keep talking about that one?

MR BANKS: No, I think we will discuss that among ourselves and it may well be that you get a phone call at some point as our own thinking develops on it. But, no, I appreciate you bringing it to our attention.

MR SPILLER: That's fine. The only thing that we want to bring to your attention is - and this also came from Wyndham interestingly enough. Ian Robins chaired an exhaustive and comprehensive review of the development contribution system in Victoria and if the commission hasn't already examined that carefully, we would urge the commission to do so because we feel that that review and the guidelines that have come out of it, address most of the concerns the industry has - when I say "the industry" - the development industry has about up-front charging and therefore could serve as a best practice model.

Just four important points about the outcomes of that review: one is that it does set out very clear methodologies, generic methodologies - not customised ones for each individual situation, but a general methodology for apportioning costs according to share of usage, underlining the fact that when councils engage in up-front charging it is a commercial exercise and they are charging and not taxing and that brings a whole set of disciplines with it in terms of provided - or return to funds. The system embodies safeguards against gold plating, both in terms of the scope of infrastructure that's included and the quality or the standard of infrastructure provision.

One last point about up-front charging is that the MAV would say that it's very important that they are non-appealable other than, I suppose - having heard the discussion this afternoon - other than through the normal rights that people would have in any other commercial-type environment: resort to the ACCC if they feel that monopolistic charging is being practised. But as a planning matter, we feel it's very important that up-front charges not be appealable because that, in a sense, would undo a lot of the positive value of these regimes in terms of providing certainty in the supply and release of land.

If councils were denied the certainty that development contribution plans provide them in terms of having the funds to supply infrastructure into growth areas, if they were put into the situation where they would have to negotiate on a case-by-case basis on those matters, it's not unreasonable to anticipate that they would be much more cautious and indeed, developers would be much more cautious. So you could have the perverse effect - whereas you might be thinking that you are protecting the rights of the development industry and preserving their opportunities to respond to demand pressures efficiently, you might have the reverse effect of creating greater risks in the land supply situation. As I say, we would argue that they already have appeal rights in terms of commercial practices via the ACCC.

MR BANKS: What do you see then as the discipline on the councils to get that right? Is it through this process that you talk about, that leads to the - - -

MR SPILLER: There is an exhaustive process of public inquiry. In a sense, or in effect, the council must pre-notify a schedule of charges for the areas affected by development contributions. The council has to lock in on those charges, has to lock in on the infrastructure they will deliver using those charges and that is then scrutinised via a public inquiry process. A panel is appointed by the minister - well, first of all the schedule is put on public exhibition; submissions are sought; there is a public inquiry. The matter then only becomes law, only becomes operative, when the minister has approved it and it has been tabled in both houses of parliament. So there's a fairly exhaustive process.

MR BANKS: Yes.

MR SPILLER: After that exhaustive process we say it shouldn't be appealable, unless there is some fault at law in the process that was pursued, or if somebody uncovers - not that we would anticipate this - some quasi-monopolistic practices.

MR BANKS: Yes, and where it gets trickly is where one has to make estimates of - in apportioning costs - a joint facility and what amount is appropriately paid for by project X relative to project Y.

MR SPILLER: Sure.

MR BANKS: They're not totally without judgment, I suppose, being required.

MR SPILLER: As I say, we would urge the commission to look at the methodology set out in the Robins review. For one thing, it proposes that development contributions should be levied across whole municipalities, rather than particular areas, so in terms of a commercial fairness thing, it's equitable across the board. It works on the basis of dividing the municipality up into the smallest possible - what are termed in the review, charge areas or charging areas, which are about the size of a census collector's district - about 300 households, dwellings. Charges within a census collector's district will not change under these recommendations, but any development within any census collector's district will only pay for those infrastructure items where that census collector's district forms part of the usage catchment.

So you can imagine that any census collector's district - it may be the member of a local catchment for a maternal and child health centre - but then it may be the member of a much larger group of census collectors' districts for a district park, and then an even larger area for an arterial road. In that sense - in fact, the review contains words which talk about minimising cross-subsidy. The only residual cross-subsidy that is left is that in any given CCD - census collector's district - of 300 households, they will all pay the same amount in that area. But if you're in a census collector's district that is the member of only one catchment, you only pay for that one item and not for the others.

We feel that that exhaustive process that was gone through over two or three years has really ironed out some of these long-standing problems with development contribution plans.

MR BANKS: Okay.

DR SHANN: What's your view of the system in other states?

MR SPILLER: I think the thinking in the Robins committee, to some extent, is working its way through all the jurisdictions. I think the Victorian system is probably out in front now. I can't really comment with authority about the current situation in Queensland or in New South Wales. My general sense is, though, that some of these principles are clearly - well, I know in fact that these principles about charging according to share of usage and avoiding cross-subsidy, are articulated in the Integrated Planning Act in Queensland, but the actual methodologies to implement that are still being worked through. My sense in New South Wales is that there is less prescription about how you make these calculations.

Without criticising our colleagues in New South Wales - and we're not really in a position to do so because we don't have the information - if that were true, that it does provide flexibility and discretion, then I think you start to move away from; if you don't have these commercial disciplines properly enforced then, dare I say it, you are operating more of a taxation system than a charging system.

DR SHANN: So there seems to be more angst amongst the developers in New South Wales, I would have thought.

MR BANKS: Yes, and more disputation, I think, as well. Is this report publicly available now?

MR SPILLER: The Robins review is available via the Department of Sustainability and Environment, but I can certainly make it available.

MR BANKS: If you wouldn't mind, that would be - I'll note that and mention it to the team. Is it actually a public document?

MR SPILLER: It is.

MR BANKS: Yes. When was it publicly released?

MR SPILLER: I think it was released in the very - about this time last year.

MR BANKS: All right. It may well be that we've had it, but I haven't personally seen, for example, this diagram you've got here which lays it out.

MR SPILLER: Yes.

MR BANKS: All right. Thank you, again, for that.

MR SPILLER: Just on that, the government has signed off on the review and the department has subsequently issued detailed guidelines for the application of these methods. They are actually available on the DSE web site. They are actually online guidelines.

MR BANKS: Okay. All right, any other questions? Thank you very much.

MR SPILLER: Thank you.

MR BANKS: You have the honour of being the last participant in these hearings.

MR SPILLER: It's always good to have the last word.

MR BANKS: Yes. There being no other participants, I will take this opportunity to thank everyone who has appeared, for the benefit of the transcript. We have learnt a lot through the course of the hearings and we'll try to reflect that in our final report. The submissions are due over the next week, if we're to do them justice in preparing that final report, and the report itself is due at the end of next month. It just remains on behalf of my colleagues to thank all participants, and I'll close the hearings now.

AT 5.53 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY

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