Submission by

MASTER BUILDERS AUSTRALIA

To the Productivity Commission Inquiry into First Home Ownership

October 2003

Master Builders Australia Inc ABN 701 3422 1001

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EXECUTIVE SUMMARY

Any decline in housing affordability for first home buyers will ultimately result in a decline in the quality of life of the Australian community. (page 3)

The fundamental principles that should guide this inquiry are

- access by all Australians, should they desire, to affordable and quality housing;
- the creation of a stable and efficient industry to maintain and increase the affordability of housing;

The current increase in housing prices contains some fundamental elements that are usually present in a normal housing related macroeconomic cycle but would also appear to contain some elements of a more one off or speculative nature. (page 5)

A largely uninterrupted 10 year period of growth has resulted in an increase in wealth and rising disposable incomes. Inevitably this has increased purchasing power and provided a pool of funds for wealth acquisitions. This, together with low and falling interest rates, have created fears that we are entering a period of unsustainable demand for housing which is reflected in prices rising at what Master Builders considers an unsustainable rate.

In more normal circumstances, interest rates may have not fallen to and remained at such low levels for such an extended period of time. However, with increasing global weakness and falling stock markets the usual tightening cycle was truncated, creating an increased investor interest in the housing market.

From the perspective of builders there has been a clear worsening in affordability over the past 5 years, with most of this occurring in the past 2 years. Indeed, up until two years ago there did not seem to be a problem. (page 7)

House prices began to be overvalued relative to rental returns in 2000 and have become increasingly overpriced since then.

Most indices of housing affordability now suggest that affordability is now a problem similar to that which occurred in the late 80's/early 90's.

In this period the correction of mortgage payments back in line with rental growth was dominated by a fall in mortgage interest rates of over 8 per cent together with some small increases in rent and steady house prices. In the current cycle it would appear that prospects of lower interest rates are very low. This suggests then, that the over valuation can only be corrected via higher rents or lower house prices. With rental vacancy rates in most capital cities relatively high and rising, there seems little likelihood of the former, leaving only the latter to make the adjustment. (page 8)

The number of first home buyers has declined significantly over the past 18 months. This rapid drop off in the proportion of new home buyer no doubts reflects some pull forward of potential new home buyers in order to qualify for the higher first home owners grant.

However it would appear that it also reflects a second factor which is a worsening in affordability.

In order to gain an insight into the structural factors such as planning and regulatory problems as well as direct cost imposts caused by taxes and charges, Master Builders undertook a comprehensive national survey of its members. (page 20)

What emerges is a picture of inadequate and uncoordinated planning processes, increasing and in many cases supererogatory regulatory burdens that both slow the building process and directly add costs to the construction process.

Protracted and cumbersome approval processes, coupled with the tardy provision of residential infrastructure for new housing development, have caused land prices to rise significantly in most capital cities of Australia over the past four years.

There has also been an increase in the number of new codes and regulations, which add considerably to the cost of construction but have questionable public benefit.

In contrast, there appears to be little evidence to date to suggest that rising construction costs have contributed more than marginally to the rapid rise in house prices over the past three years. (page 30)

Master Builders considers that the current level of public and private infrastructure investment in Australia is too low and that the resultant decline in infrastructure stock is a concern and could be a contributory factor to the decline in affordability. (page 32)

The provision of, and equitable and affordable access to, infrastructure is an integral part of the performance of the Australian economy in general and the building and construction sector in particular.

Master Builders is also concerned with the general move towards a user pays framework for infrastructure.

Declining public spending on infrastructure at all levels of government has seen increasing demands on developers to fund the provision of infrastructure. This cost impost is inevitably passed on to the end buyer which, in many cases, will be a first home buyer.

These costs should not be borne by first home buyers alone. To impose such a burden is an egregious violation of the principle of intergenerational equity.

In order to directly address the problem of first home ownership, Master Builders proposes a Government backed scheme similar in nature to the Higher Education Contribution Scheme. (page 37)

Under this scheme the Government would guarantee a house deposit in the form of the issue to the banks of an interest only Commonwealth Government Security (CGS). The financial institution would provide 100% of the finance for the purchase of a home.

This proposal would enable marginal households to enter the home ownership market, would be attractive to financial institutions and would actually involve cost savings for the Government.

Sources: *Australian Bureau of Statistics*
Reserve Bank of Australia
Citygroup Australia

INTRODUCTION

Master Builders Australia represents the interests of all sectors of the building and construction industry.

The Association consists of nine State and Territory Builders' Associations with over 24,000 members. These members operate in the following sectors:

- housing
- commercial/industrial
- civil engineering
- manufacturing and supply
- specialist contracting

The members range in size from large multinational and national contractors to small subcontracting businesses.

The building and construction industry in Australia contributes over $70 billion of activity annually. It has approximately 210,000 businesses and 440,000 specialist trades businesses operating within it, employing some 773,000 persons.

Ninety-five percent of all businesses in the building and construction industry employ less than 5 people, while less than 1% have 20 or more employees.

Many of the smaller businesses are family run (often a husband and wife partnership whether incorporated or not), through which the husband typically carries out his particular trade.

This submission will address those issues raised by the Productivity Commission that Master Builders considers most relevant to the issue of first home ownership.

The submission will cover a range of overarching policies and principles as well as more detailed analysis of the issues surrounding first home ownership.

It should be read in conjunction with the submissions received from the various State and Territory Master Builder Associations which will provide the detailed analysis of state and local council issues impinging on first home ownership.

Master Builders is strongly supportive of the individual and national benefits of home ownership. Any decline in housing affordability for first home buyers will ultimately result in a decline in the quality of life of the Australian community.

The high cost of land, government charges, development contributions and unnecessary regulatory requirements adds to the cost base of new housing, placing home ownership beyond the reach of a growing number of aspiring first home buyers.

Affordability is affected by:

- changing levels of demand;
- interest rates;
- the regulatory and taxation environment;
- whether urban infrastructure for new housing construction is provided on time;
- the development of innovative and cost efficient building products and systems; and
- the supply of serviced residential land.

The fundamental principles that should guide this inquiry are

- access by all Australians, should they desire, to affordable and quality housing; and

- the creation of a stable and efficient industry to maintain and increase the affordability of housing.

This will require:

- a less costly and more flexible housing industry;
- responsiveness to the diversity of Australian housing needs by providing adequate choice of housing quality and form and by ensuring its affordability;
- a recognition that the private sector remains the best vehicle for delivering affordable housing;
- stable macro-economic policies which will improve the stability of the home building industry and the affordability of housing;
- flexible, performance-based and cost effective regulations aimed at ensuring the accessibility, choice and affordability of housing;
- all governments working co-operatively to ensure the adequacy and the responsiveness of the supply of residential land, labour and housing finance; and
- tax policies that recognise the fundamental importance of home ownership and housing affordability.

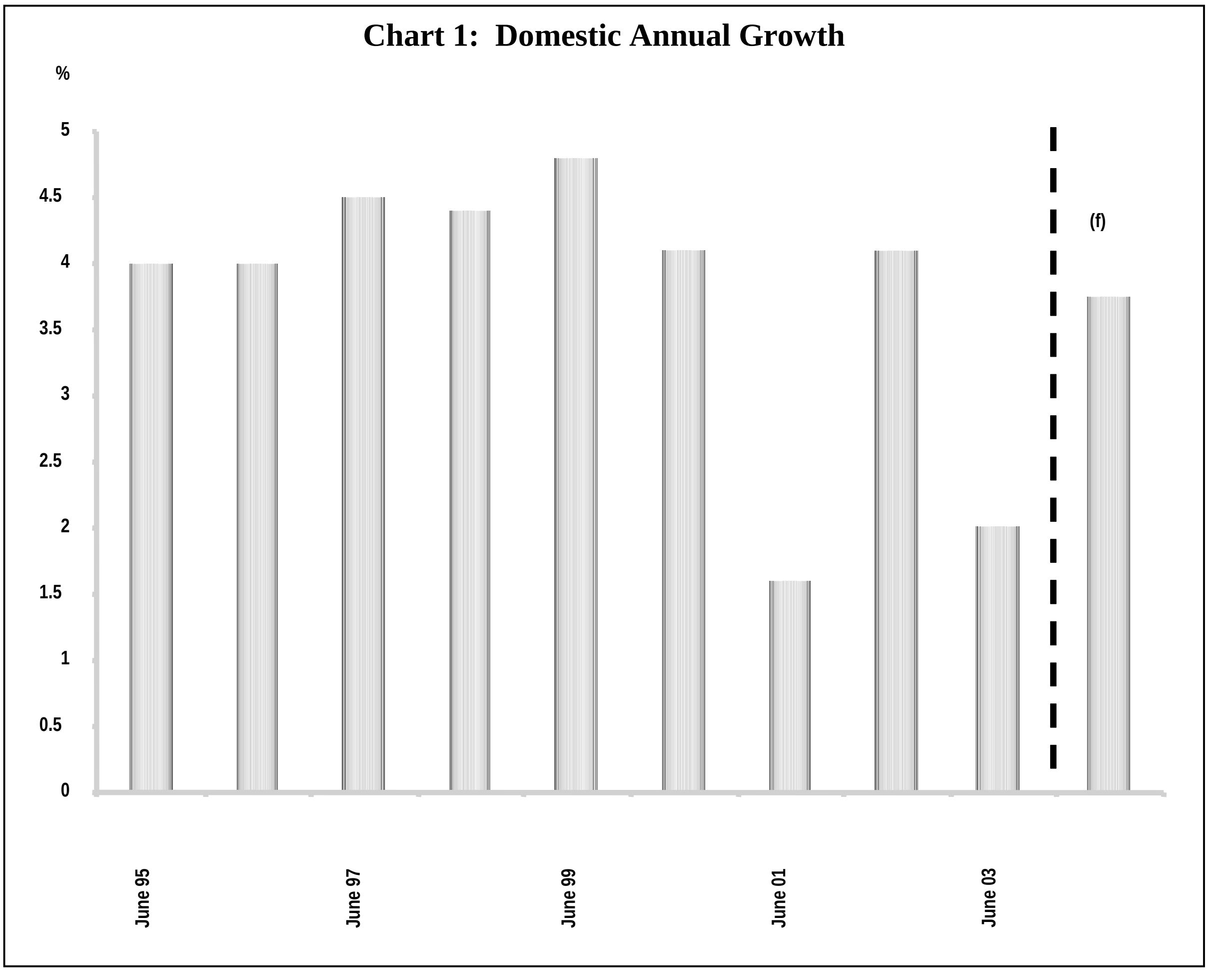
RECENT TRENDS IN HOUSING MARKETS

Prices in historical context

What factors have caused recent housing price increases? Are some of them temporary? What evidence is there of a 'bubble' in housing prices?

The current increase in housing prices contains fundamental elements that are usually present in a normal housing related macroeconomic cycle but would also appear to contain some elements of a more one off or speculative nature.

As shown in Chart 1, the Australian economy has been strong for the past nine years notwithstanding some temporary weakness in 2001.



This largely uninterrupted growth has resulted in an increase in wealth and rising disposable incomes. Inevitably this has increased purchasing power and provided a pool of funds for wealth acquisitions. This together with low and falling interest rates have created fears that we are entering a period of unsustainable demand for housing which is reflected in prices rising at what Master Builders considers an unsustainable rate.

In more normal circumstances, interest rates may have not fallen to and remained at such low levels for such an extended period of time. Indeed, the Reserve Bank had commenced a tightening cycle in 2000 (see Chart 12). However, with increasing global weakness and falling stock markets this tightening cycle was truncated, creating a renewed vigour in the housing market. The flow of funding to investor housing has been encouraged by changes to the tax system with regard to the 50 percent exemption on capital gains tax, but this is seen as a structural problem to affordability. Whether this represents a bubble in housing prices is difficult to say but there would appear to be evidence of some unsustainable exuberance in demand for housing. This issue has been addressed by the IMF and the Economist magazine with both concluding that an unsustainable increase in house prices has taken place.

What effects have recent housing price rises had on the affordability of home ownership? Are current trends in housing prices and affordability likely to continue for the foreseeable future?

Most indices of housing affordability suggest that affordability is now a problem similar to that which occurred in the late 80's/early 90's.

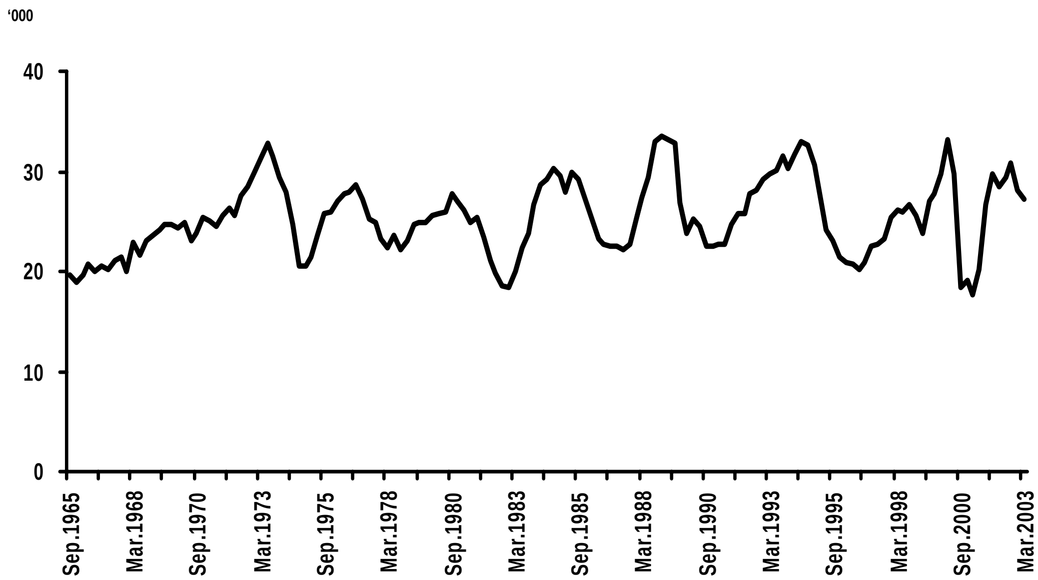
Are median price trends representative of trends within housing sub-markets?

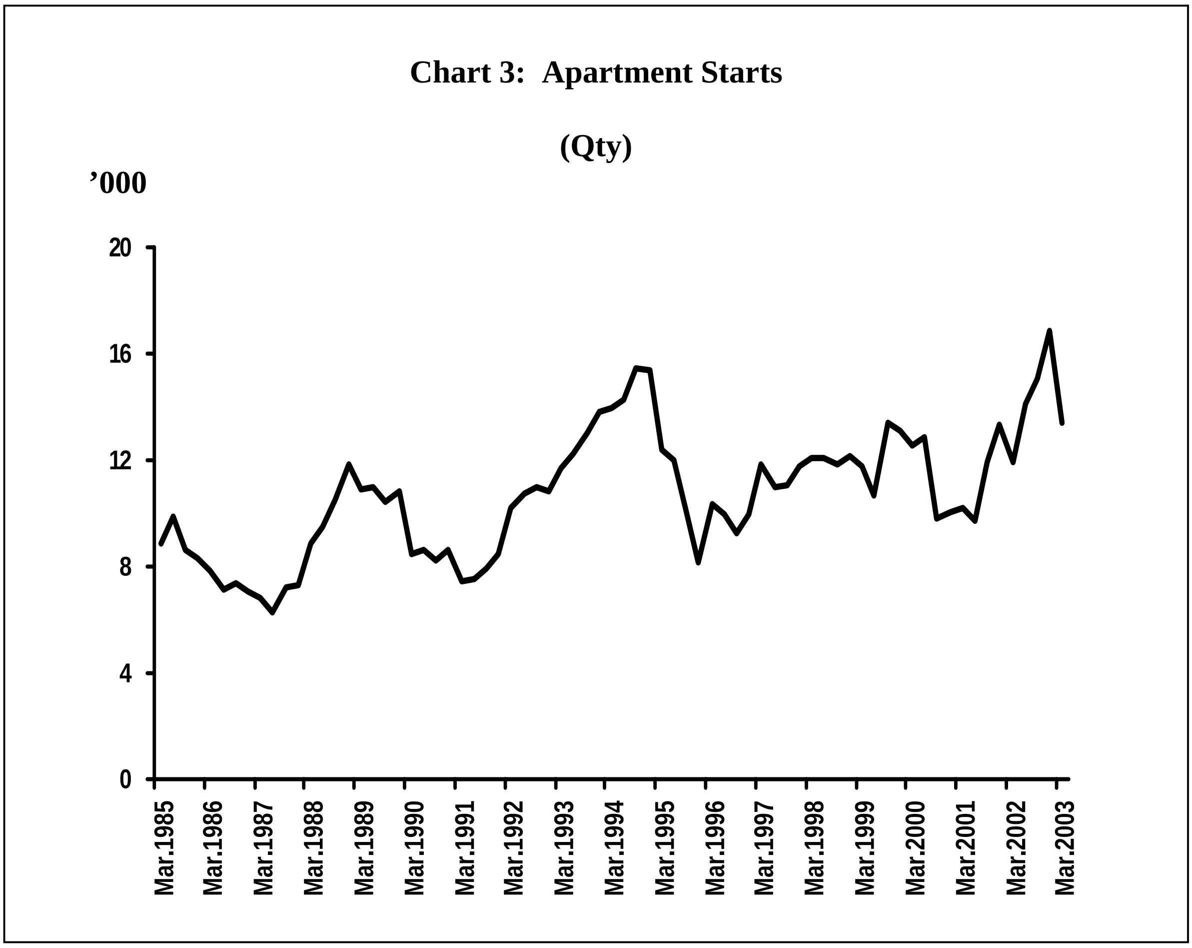
Is any 'bubble' in housing prices confined to particular market segments?

While house prices in general are high it would appear that the apartment market is the most overstretched. As shown in the charts below, apartment starts surged to a record level in late 2002. This was accompanied by large price increases and evidence of highly leveraged investment. It appears now that apartment starts are beginning to correct downwards quite quickly whereas detached housing starts are showing more resilience.

Chart 2: Detached Housing Starts

(Qty)





How do Australia's housing price levels and trends compare with those in similar countries? What are the reasons for observed similarities or differences?

Whilst Master Builders does not directly monitor international economic developments in house prices it would appear that the phenomenon of rising house prices is not confined to Australia. Various articles in the Economist and a recent article by the IMF suggest that rapidly rising prices are present in a range of OECD economies, but particularly the US, UK and New Zealand.

Indeed, the Reserve Bank of New Zealand seems equally as concerned with rising house prices as our own Reserve Bank.

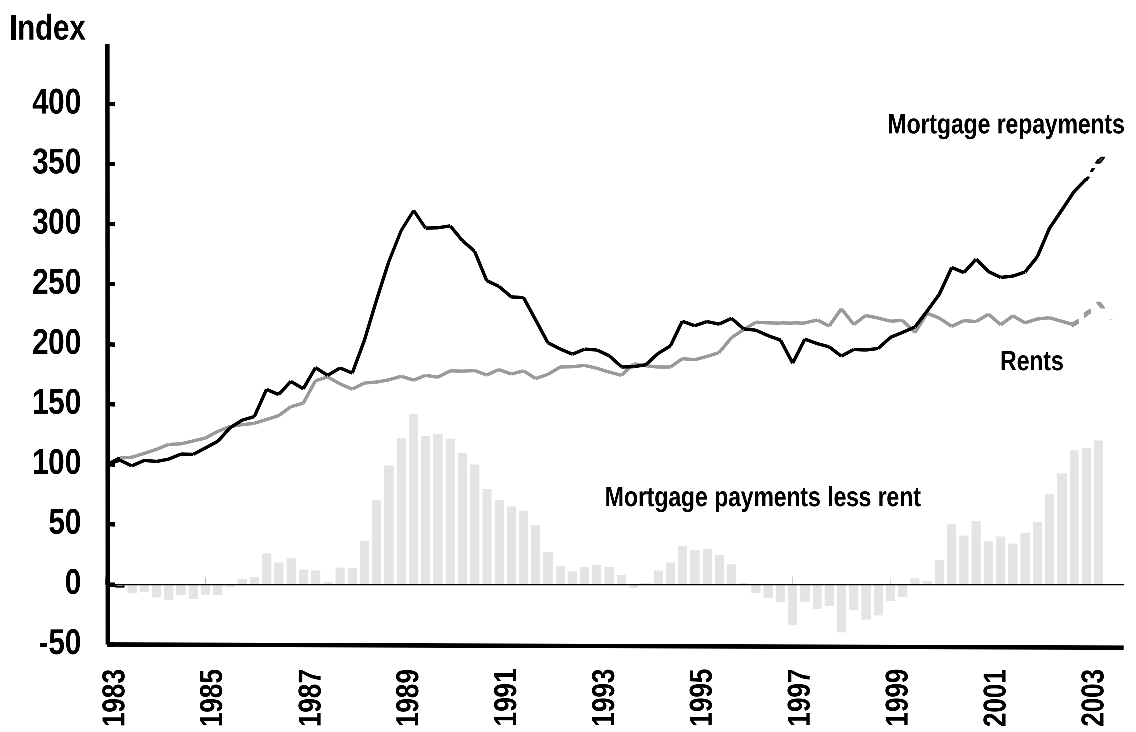
Trends in affordability

How should affordability for first home buyers be defined and measured, both in principle and in practice (taking account of data availability)? Is it possible to assess affordability using a single measure?

There are a range of existing indicators of housing affordability, most of which rely on an assessment of mortgage repayments to household income. In general, affordability is perceived to be a problem when mortgage payments exceed 30 per cent of household disposable income. These indices are obviously affected by the levels of interest rates, employment, wages growth and overall economic performance.

Master Builders prefers the approach adopted by Citigroup Australia which compares mortgage repayments to market rents. This analysis which is similar to price earnings ratio calculations used in stock market evaluations and is favoured because it takes account directly of the decision (rent or buy) that has to be made when considering property purchase. By comparing mortgage payments on medium established house prices with medium rental payments a direct comparison of the ability (or affordability) to buy can be made.

Chart 4: Mortgage Payments and Rent



What has happened to affordability over time? Is it lower now than at times in the past? Does it reflect different influences to previous episodes of declining affordability?

In order to assess the issue of affordability from the point of view of the members of Master Builder's an electronic survey was conducted. See Attachment 1 for a copy of the survey.

The results of the survey were compiled using the net balance approach where a result of 50 indicates a neutral position on the question posed. The closer the result to 100, the more severe is the problem as perceived by builders.

In order to test builders' perceptions of whether affordability has changes over the past 5 years, respondents were asked to assess the issue presently, two years ago and 5 years ago. The results are presented below.

From the perspective of your first home buyer clients how would you rate affordability?

	Net Balance (50 = Neutral)
Now	72.1
2 Years ago	48.5
5 Years ago	36.2

As can be seen clearly, from the perspective of builders there has been a clear worsening in affordability over the past 5 years, with most of this occurring in the past 2 years. Indeed, up until two years ago there did not seem to be a problem. This of course is in line with the results of other studies which indicate a severe decline in affordability over the past 2-3 years.

As shown in Chart 4, house prices began to be overvalued relative to rental returns in 2000 and have become increasingly overpriced since then. Although this over valuation is not yet as large as it was in the late 80s/early 90s based on current projections we could reach a level of over valuation similar to that by late 2003. The picture painted by Chart 4 is most disturbing when the late 80's/early 90's correction of over valuation is considered.

In this period the correction of mortgage payments back in line with rental growth was dominated by a fall in mortgage interest rates of over 8 per cent together with some small increases in rent and steady house prices. In the current cycle it would appear that prospects of lower interest rates are very low and indeed many analysts as well as financial market futures suggest that an increase in interest rates is likely in 2004. This suggests then, that the over valuation can only be corrected via higher rents or lower house prices. With rental vacancy rates in most capital cities relatively high and rising, there seems little likelihood of the former leaving only the latter to make the adjustment.

Are trends in reported measures representative of the experience of first home buyers?

It would appear highly likely that the experience of first home buyers is more difficult than indicated by aggregate measures of affordability. While first home buyers generally purchase at the lower end of the price range and can take advantage of the FHOG, they are also likely to be younger and therefore since they are at the start of their working life on lower than average incomes, and also likely to have lower levels of savings and therefore likely to qualify for lower levels of housing finance.

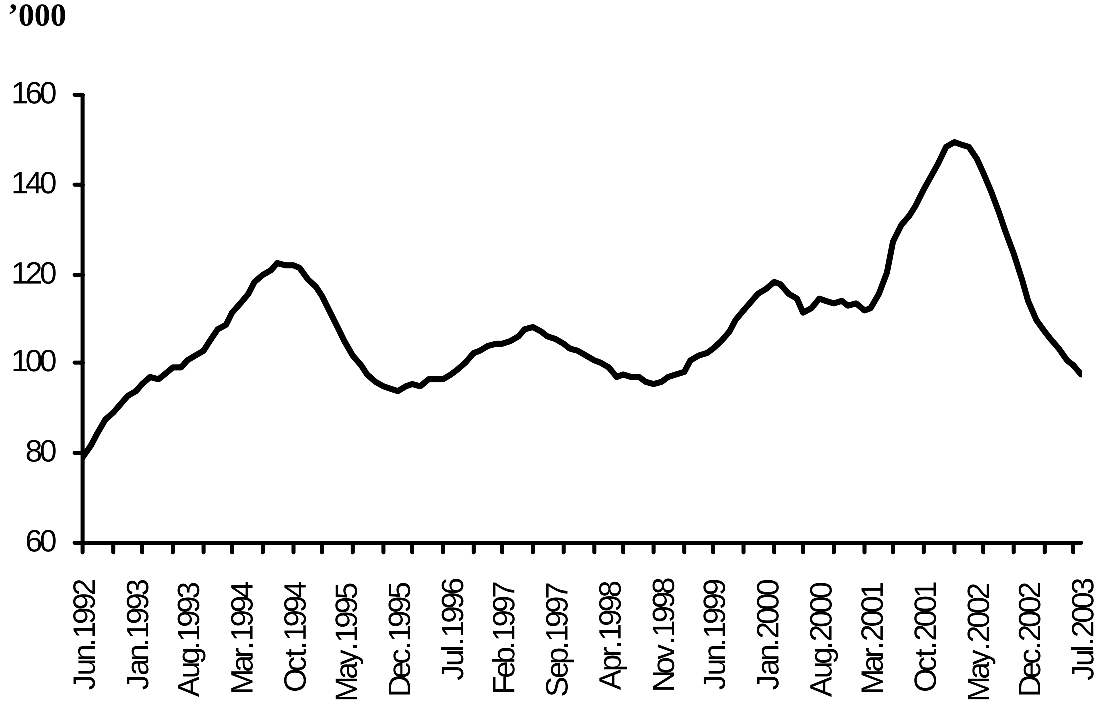
First home buyers

Is the fall in the number of first home buyers due to a decline in affordability or is it due to other factors?

The number of first home buyers has declined significantly over the past 18 months. As can be seen in Chart 5 which shows the 12 month moving average of dwellings financed for new home buyers, there has been a dramatic decline in new home financing since the peak in June 2002.

Chart 5: Number of Dwellings Financed (12 month moving average)

(New Home Buyers)



This probably reflects a combination of two factors.

Firstly, it is likely that the substantial peak in mid 2002 reflects a rush by first home buyers to qualify for the augmented FHOG which enabled eligible first home buyers to receive a grant of $14,000 providing applications were submitted by 30 June and provided that they were for the purchase of new dwellings.

This rush to beat the deadline shows up as a major spike in lending (to all buyers) for the construction of dwellings in early 2002 which was not apparent in lending for the purchase of new dwellings nor lending for the purchase of established dwellings.

A similar story is evident in the large fall in the proportion of finance approvals to new home buyers amongst all house purchasers.

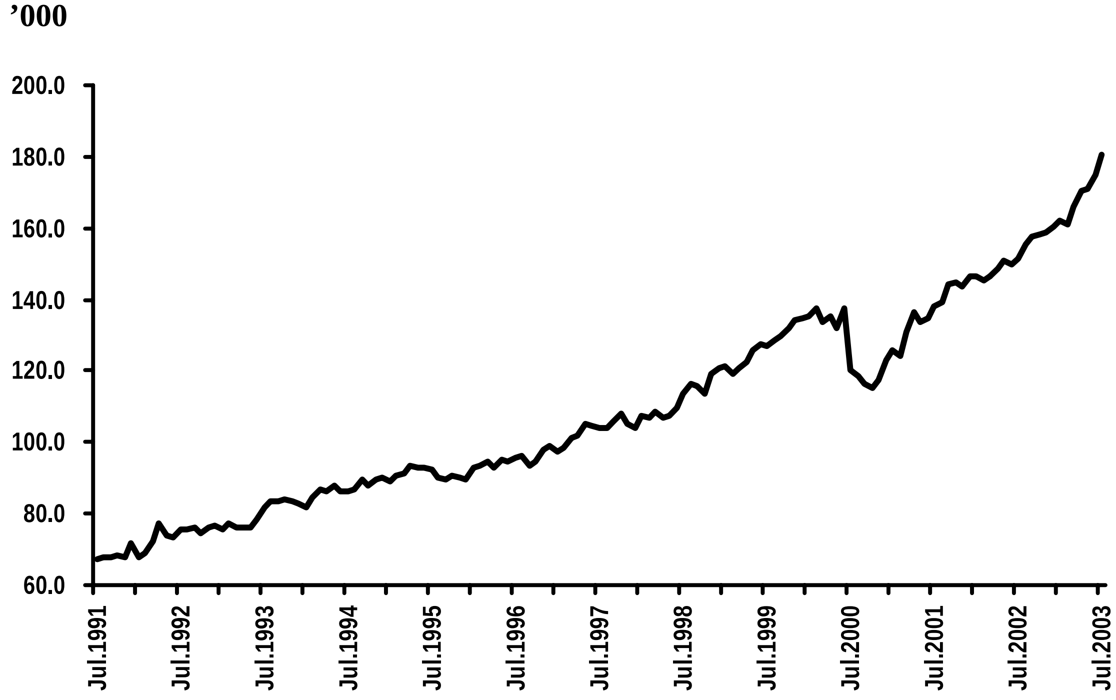
This rapid drop off in the proportion of new home buyer no doubts reflects the pull forward of potential new home buyers in order to beat the abovementioned deadline.

However it would appear that it also reflects a second factor which is a worsening in affordability. The rapid rise in house prices in the past two years is reflected in a strong surge in the average loan size taken out by first home buyers (see Chart 6).

From the post-GST low of $115,000 recorded in September 2000, average loan size has risen around 60 per cent to the current level of $181,000.

Chart 6: Average Loan Size

(First Home Buyers)



While there may be some element of aspirational bias as first home buyers look to purchase larger, higher quality homes, most of the rise in average loan size would simply reflect the rise in the cost of new and established homes.

- *What are the characteristics of first home buyers?*

According to the most recent ABS survey[4] households which purchased their first home in the three years to 1999 were relatively young, with the reference person in three-quarters of these households aged 25-44 years. After this, the proportion of recent first home buyers was lower for each successive age group as people aged 45 years and over are more likely to have previously purchased a home. Over 50 per cent of first home buyers are either couples (with the reference person over 35 or a couple with children).

- *Have these characteristics changed over time? Will these changes continue in the future?*

For a summary of these issues see Australian Social Trends 2003, Changes in Housing and Australian Social Trends 2003, Living Arrangements: Changing Families.

[4] Australian Social Trends
Housing – Housing and Lifestyle: First Home Buyers

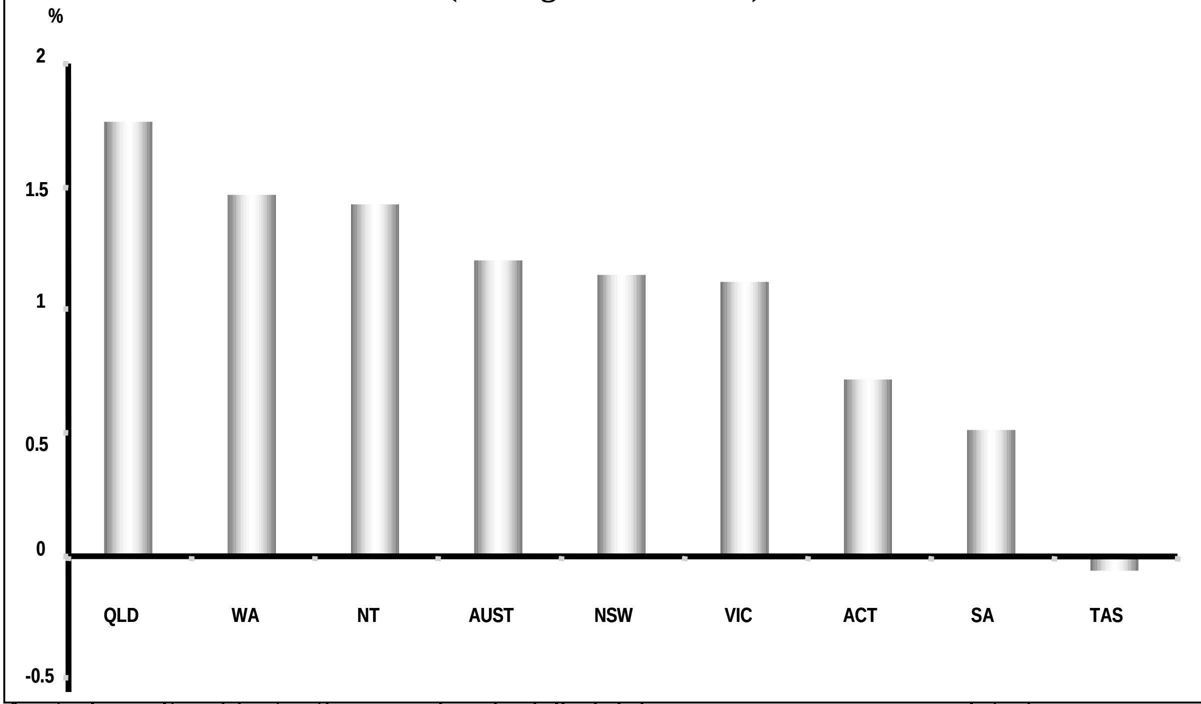


Chart 7: Population Growth (Average Last 6 Years)

Australia. It adds to the supply of skilled labour, increases accumulated savings and

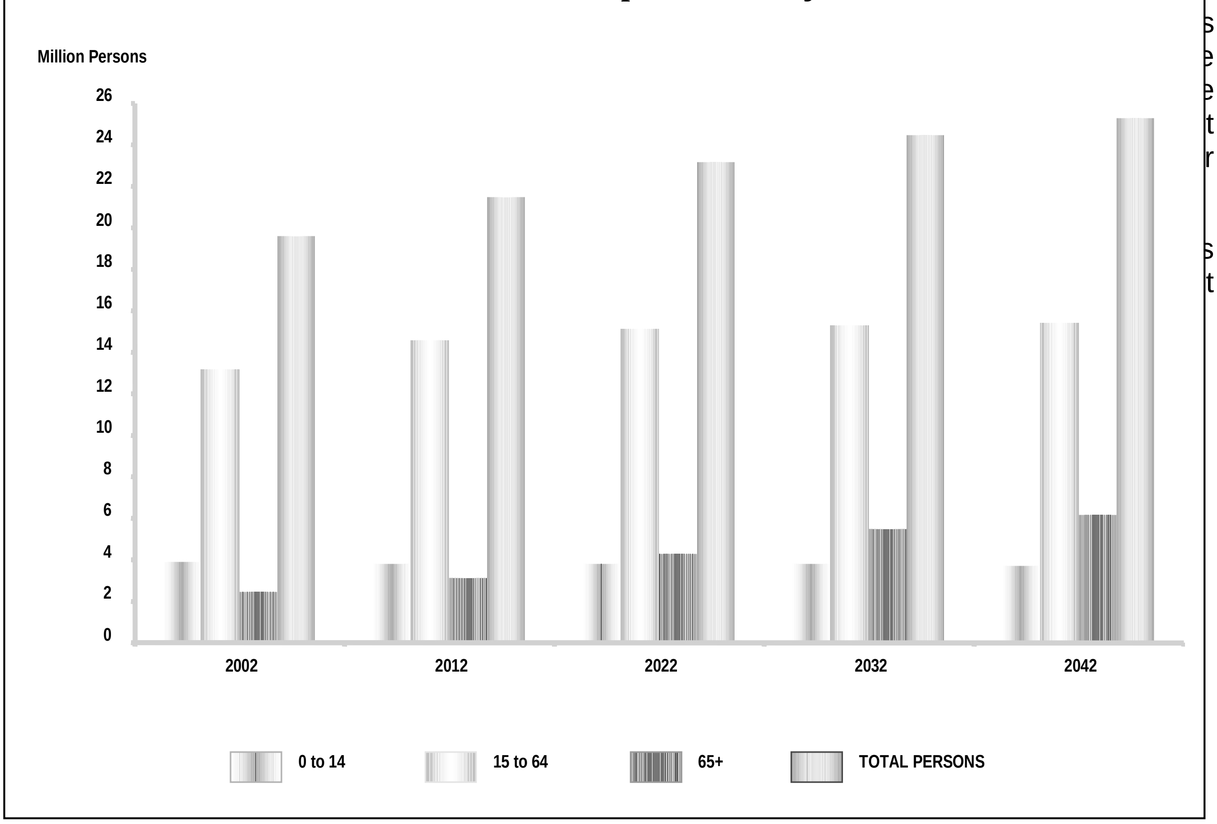


Chart 8: Australian Populations Projections

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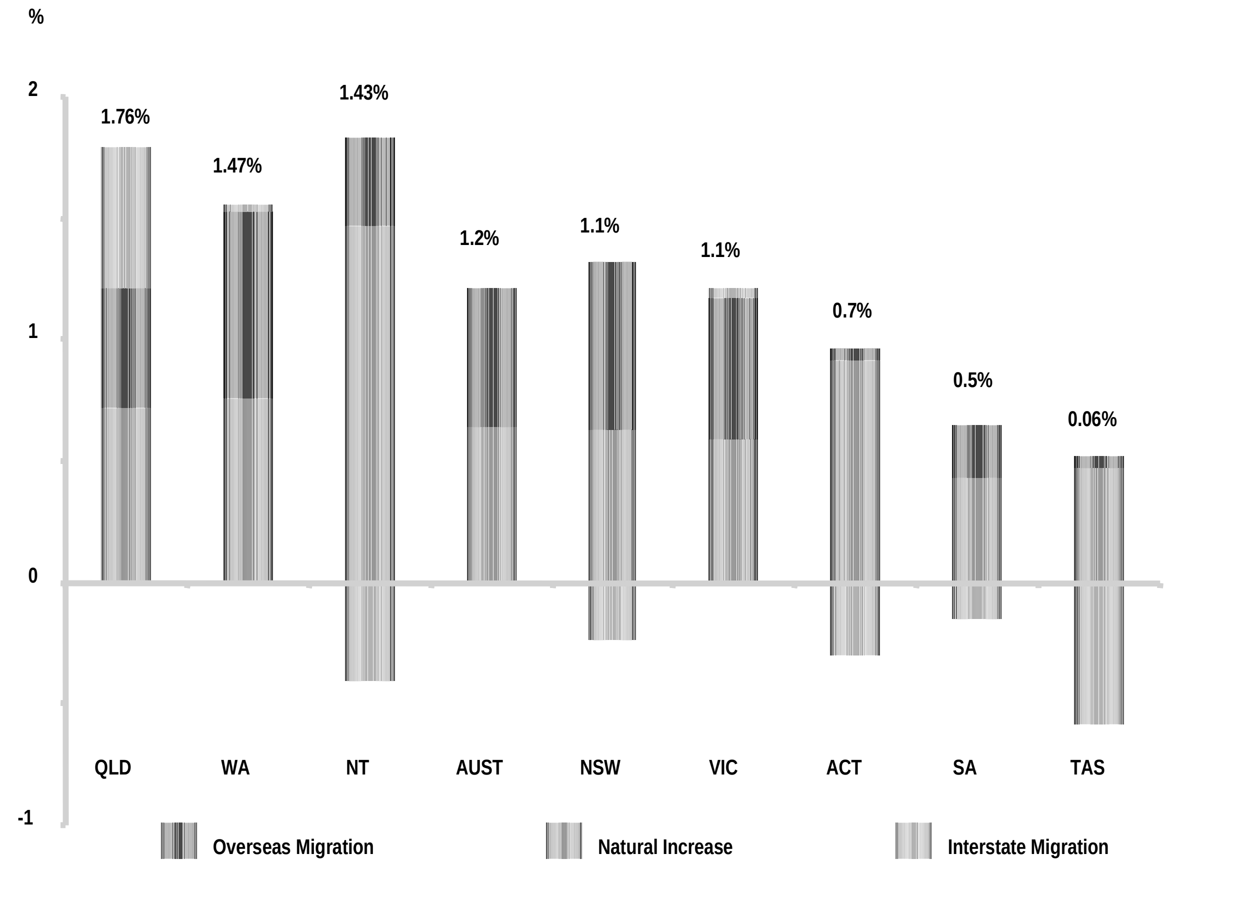
[5] Some doubt has been cast on the ABS net migration figures over the past 2 to 3 years with some researchers suggesting that figures had been distorted as a result of ABS assumptions regarding …..

It is likely that this factor has, in part, contributed to price increases but is not a reason for curtailing the current migrant intake program because of the other benefits that migration brings to Australia.

- *Where has population growth contributed most to rising housing prices?*

As shown in Chart 9, there have been significant state by state variations in natural increase net overseas migration and net interstate migration flows. For instance, while NSW benefits from net migration intake it is a major loser in terms of net interstate migration.

Chart 9: Population Growth
(Per Cent)



- *Has population growth been concentrated in the capital cities? If so, why? Is this changing? Does it need to change? If so, how should this be achieved?*

Population growth in capital cities is a natural function of a free and efficient market economy. However, the adoption of pro-active regional policies by all levels of government can reduce the price pressures that have emerged in the majority of capital cities.

Master Builders submits that a range of sensible regional policies are contained in the recently released independent report chaired by Mr John Kenny entitled Regional Business Action Plan. While not supportive of all of the suggestions contained within the report, Master Builders suggests that the Productivity Commission investigate these proposals as a means of fostering regional growth, thereby easing housing pressures in urban areas.

Government assistance

- *How do government housing assistance programs affect housing prices and affordability for first home buyers?*

The public housing system and housing assistance are an important part of the Australian housing market. While approximately 66% of Australians live in owner-occupied homes, 28% live in rented accommodation and of this, 6% live in public housing.

Well targeted government support for low income and disadvantaged groups is essential.

Australian governments provide housing assistance through the following major channels:

- capital funding for the supply of public housing in large part through the Commonwealth State Housing Agreement
- subsidising public housing tenants
- rent assistance to the private sector
- other assistance such as funding organisations to provide elderly care, aboriginal housing and special needs assistance

A number of trends are apparent in the provision of public housing assistance over recent years. Firstly, changes to tenure and eligibility requirements have meant that such housing is now largely provided to people on very low incomes or people who are disadvantaged in some way. Secondly, the amount of money flowing to assisted housing is now largely in the form of rental assistance rather than increases in the supply of public housing. Thirdly, the overall climate of budget cuts and the indiscriminate imposition of efficiency dividends have resulted in significant real cuts to overall funding under the CSHA.

Given these trends, it is likely that public housing assistance has had only a marginal impact on house prices and is helping fewer and fewer people into home ownership.

Therefore this reduction in funding must be reversed in future CSHAs. The Government should also look at alternative funding options for the provision of public housing. In particular, those involving private funding or private/public partnerships should be thoroughly investigated.

- *Has the FHOG Scheme stimulated demand for housing? To what extent, if any, are recent price increases related to the FHOG Scheme?*

The original underlying principle of the FHOG was to ensure that first home buyers were not financially disadvantaged by the increase in the cost of new homes as a result of the introduction of the GST.

The Government, in releasing ‘Tax Reform – Not a New Tax, a New Tax System’ (ANTS) in August 1998, recognised the importance of the housing sector in the Australian economy and, in particular, the impact that the GST would have on first home buyers.

The Government announced that:

> *"A First Home Owners Scheme (is) to be introduced to offset the net impact of the GST on the price of new homes…" (page 22) and*
>
> *"To maintain home affordability at its present high levels, the Government will require the States to assist home buyers through a First Home Owners' Scheme as a condition of receiving GST revenue." (page 97)*

The explicit policy objective was clearly to compensate first home buyers of new homes.

> *"A first home owner will be more than compensated of a home with construction value (excluding land) of up to $150,000." (page 97)*

The Government's compensation policy was premised on an assumption that the GST would raise the prices of new homes in the long run by about 4.7% and the fact that existing home owners would benefit from a rise in the value of their homes.

In the period since the introduction of the GST on 1 July 2000, a number of events have occurred that have diminished the value of the $7,000 compensation package. In particular:

- Treasury's estimate of price rises of new homes of 4.7% is significantly lower than the actual increase in the market during the transition period.
- the ACCC, in its Price Guide released on 23 May 2000, estimated the price change for a new house (excluding land) was in the range of 7.8 to 9.0%. The estimates by the ACCC closely resemble the actual outcomes.

Master Builders submits there is a strong case to index the compensation payment under the current FHOG Scheme to maintain the intended policy objectives stated in ANTS and to bring the grant into line with other areas of spending which are indexed annually to maintain their real value.

Failure to index the grant would invalidate the initial policy objectives of compensating for the impact of the GST on new home buyers so that intergenerational equity is maintained.

According to latest figures on median house prices, the actual rise for established houses has been closer to 35% and that for new houses closer to 50%, further eroding the original policy purposes of the Grant and exacerbating intergenerational equity.

Master Builders has argued in the past that a higher grant be applied to those purchasing new homes rather than to those purchasing established homes. It is the purchase of new homes which directly adds to activity in the housing area and which also brings advantages in terms of the significant flow-on effects to upstream and downstream industries.

Master Builders recommends an increase in the grant for new houses to $15,000 and that both this and the existing grant for established houses are indexed to the CPI. Consideration should also be given to means testing the grant.

- *What impact would improved transport links between cities and regional areas have on regional employment opportunities or in allowing employees to commute from regional areas to urban areas?*

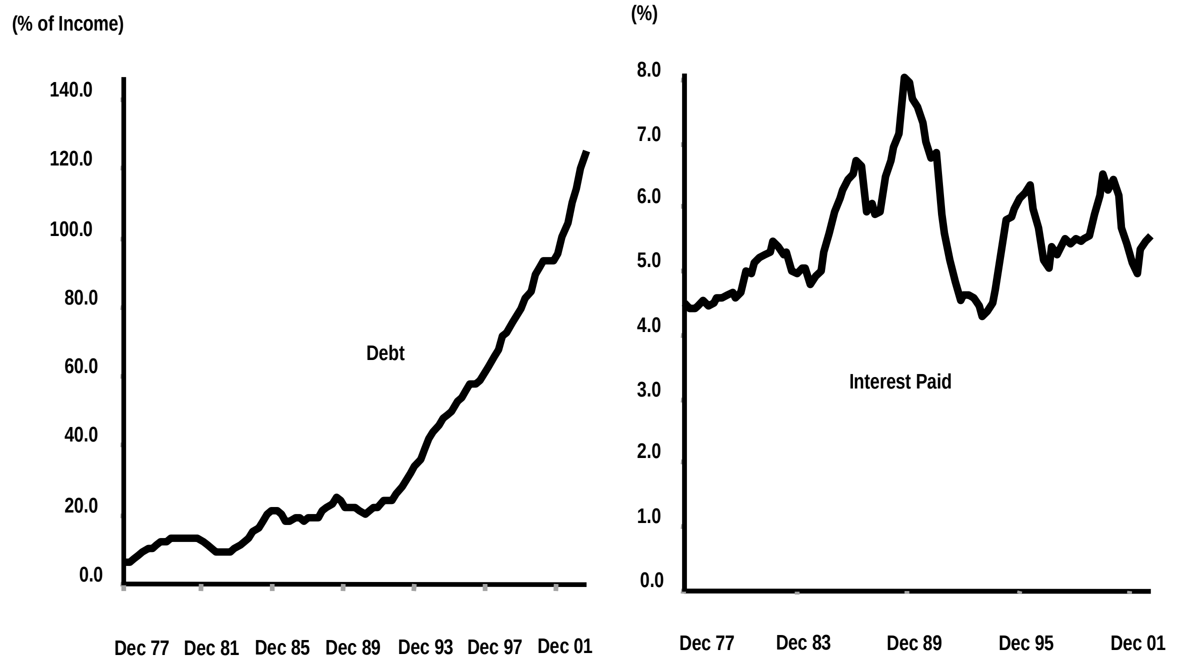
Master Builders is broadly supportive of policies that are economically sustainable.

- *What would happen to housing prices and affordability in the targeted growth areas?*

In capital cities house prices would be likely to stabilise. In regional areas prices would be likely to rise.

Macroeconomic influences

Chart 10: Household Debt and Interest



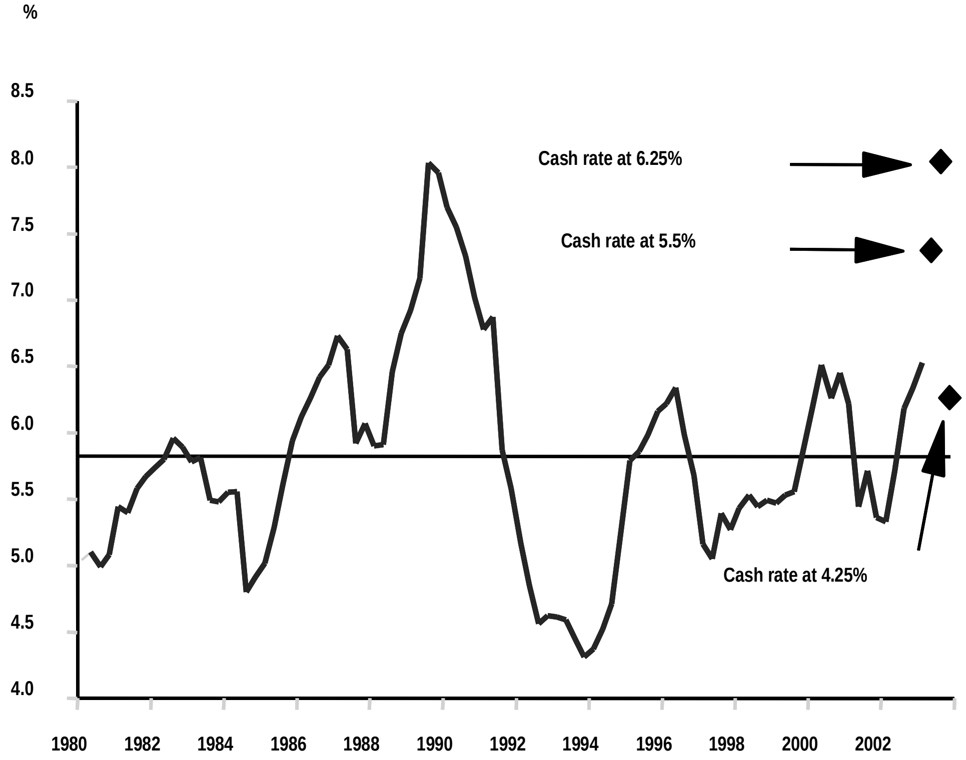
- *To what extent have low interest rates stimulated demand and increased housing prices? What would be the impact on housing prices and affordability if interest rates were to increase?*

The Australian economy has enjoyed a period of sustained growth for almost a decade now (see Chart 1). This has been the result of a range a favourable influences that have all added impetus to the economy at some stage over this period.

Apart from the positive yet subtle impact of ongoing microeconomic reform the economy has benefited from a competitive exchange rate, falling interest rates, low oil prices (at least up until 9/11), positive demographic influences with high spending baby boomers, improving terms of trade (which increase national purchasing power), the Olympics, and inflows of capital as a result of the Asian crisis of 1998 and the dot com crash.

However, in the past two years, low and falling interest rates have no doubt provided additional impetus to the economy in general and the housing market in particular. As discussed earlier, the truncating and reversal of the tightening cycle commenced in 2000 has lengthened the current cycle (see Chart 12). The impact of this is encapsulated in Chart 10. While debt levels have risen inexorably over the past 12 years, the servicing of this debt remains quite low because of the historic low level of interest rates. However, as indicated in Chart 11, consumers are vulnerable to increases in interest rates and it would only take a modest rise to raise servicing to dangerous levels.

Chart 11: Interest Payments Out of Disposable Income



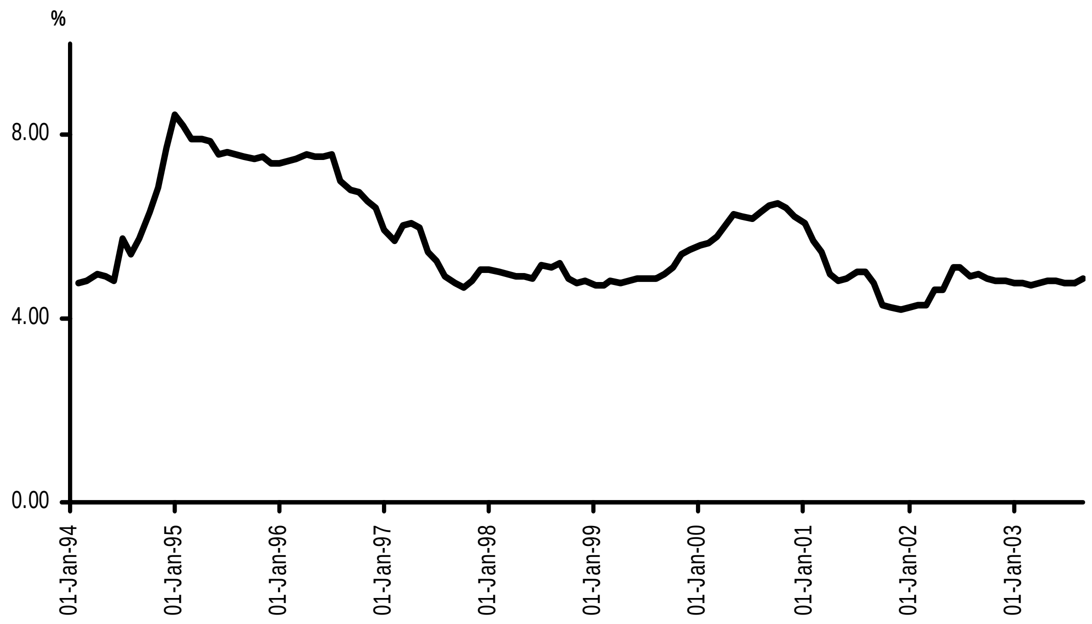
- *To what extent have housing prices been affected by the recent performance of equity markets?*

Investment in housing can be seen as complimentary at least to some extent to investment in other asset classes. With the recent underperformance of the stock market, there appears to be strong anecdotal evidence that investors have reduced investments in equity markets and increased those in the housing market. This appears most apparent in the Sydney and Melbourne markets where demand for apartments, bought on many occasions of the plan and with little or no deposit, have been seen as a replacement investment to the equity market.

- *How have returns on investment in housing moved over time and relative to other assets?*

Returns on housing have traditionally been below those of other investments such as fixed interest and equity markets. However, in the past 3 years this long run relationship has been reversed with returns in housing far outweighing these other two traditional investment classes.

Chart 12: Short Term Interest Rates



Availability of Finance

As indicated in the Master Builders survey on affordability (see page 21), the situation as perceived by builders is that availability of finance is not presently an issue for first home buyers with this category ranking last amongst the twelve and the only one with a net balance of less than 50 (suggesting that it is considered a minor impact on affordability).

It also appears that banks have over the past two to three years been more accommodating in assessing applications and applying conventional debt/equity valuations. More flexible mortgage products such as fixed interest rate loans and honeymoon interest rates for new borrowers have also improved the situation for first home buyers.

- *How influential have housing investment advisers and promoters been in the recent growth in demand?*

Master Builders is not aware, nor has any evidence, that this has been a problem for first home buyers.

Planning, land use policies and building controls

Planning and policies are an important part of the housing market. Policies determining where and when land is released for housing development, and where and when housing redevelopment may take place are a crucial first step in the provision of housing. Funding responsibilities for infrastructure and processes for the consideration of housing development applications all impact on production costs and the extent to which housing supply can adjust to changes in demand.

Development of policy in these areas has typically laid mainly with State and Territories Governments. However, the Commonwealth has played a leadership role from time to time, for example with the Better Cities Program and the establishment of the Development Assessment Forum. The Commonwealth Government also funds assistance through the Commonwealth State Housing Agreement.

It would appear that the delays in land releases on the urban fringe and infill sites is due largely to the lack of strategic planning being applied at local government level. The average time for release of a subdivision from start to finish is approximately 2 years.

These problems are exacerbated by:

- State policies to encourage higher densities and accommodating demographic change but these objectives are truncated by the inefficiencies of local government..
- Local planning schemes create unnecessary costs, for instance, due to requests by councils for too much information on simple proposals, for example:
    - Traffic reports
    - Large written statements
    - Arial photographs
    - Engineers' reports
    - Planning consultants' comments
    - Arborists' reports

In order to gain an insight into the impacts caused by planning an regulatory problems as well as direct cost imposts caused by taxes and charges, Master Builders undertook a comprehensive national survey of its members.

The ranking of the factors affecting affordability are presented below in Table 1.

Table 1

AFFORDABILITY SURVEY

What effect are the following factors having on affordability?

Land prices	91.3
State government fees and charges	80.5
Indemnity insurance	79.9
Land availability	76.7
Regulatory delays such as development approval	73.4
Availability of trades	71.4
Local government fees & charges	70.9
GST	69.2
Excessive buyer expectations	67.3
Price or availability of materials	63.7
Infrastructure costs	60.4
Access to finance	39.6

As can be seen clearly the major factors listed are not endogenous to the building and construction industry with the top five causes all outside the industry's control. Land prices are clearly seen as the number one cause of falling affordability with every respondent ranking land prices as either a moderate or major impact. The related factor of land availability also ranks highly at number four.

The pre-eminent importance of land in the current affordability crisis is further highlighted by
the
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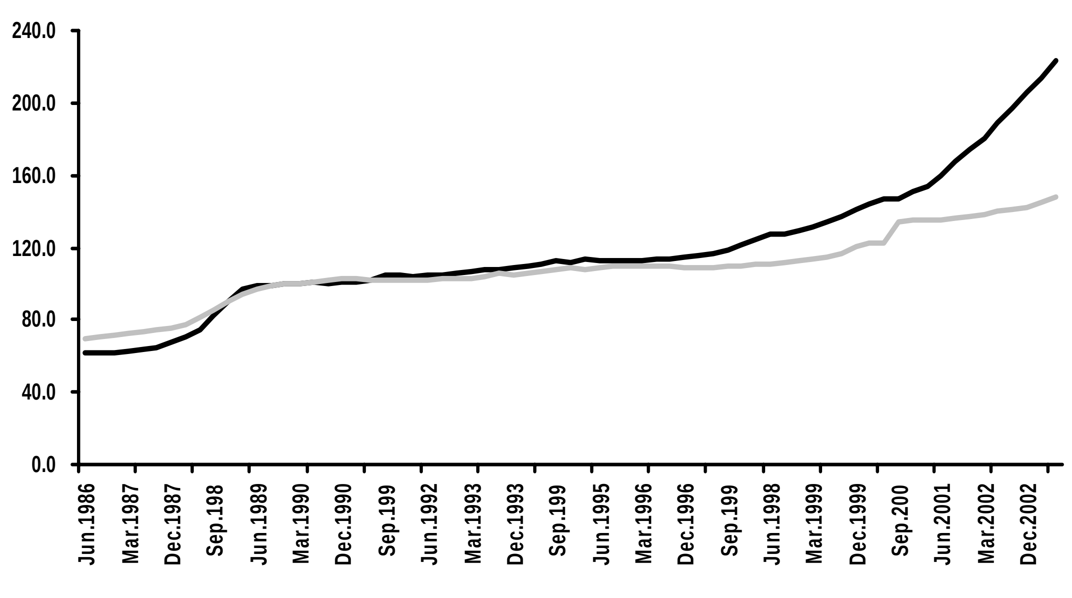
Chart 13: Housing Price Indices



The affordability survey also asked a number of voluntary questions the answers to which are provided below in collated form. The answers are left as far as possible in the terms as provided by the respondents.

What emerges is a picture of inadequate and spurious planning processes, and increasing, and in many cases supererogatory, regulatory burdens that both slow the building process and directly add costs to the construction process.

At the local government level, regulation and compliance issues clearly rate as the biggest obstacle to affordability with taxes, fees and charges second.

At the State government level, taxes, fees and charges become the clear number one issue with infrastructure and land issues, and home warranty insurance second and third.

At the Federal Government level, taxes, fees and charges are still number one, but (provision of) direct assistance to home buyers rates a close second.

Project Homes

OTHER FACTORS (No. of Respondents - 71)

HOME WARRANTY INSURANCE **(11)**

Obtaining, regulations, regional, liquidity ratios
Cost
Additions and alterations

REGULATION AND COMPLIANCE ISSUES **(21)**

Compliance/Red tape
Occupational Health and Safety
Environment levies/policies
Workers Compensation – Green cards
Work cover/Public liability
Energy efficiency
Rainwater tanks
Council imposed architectural standards
Audits (GST, OH&S, Work cover, BSA)

TAXES, FEES AND CHARGES **(6)**

Stamp duty on mortgages
GST
Council fines
Preliminary site costs

INFRASTRUCTURE AND LAND ISSUES **(5)**

Land availability/need major releases
Transport infrastructure

MARKET FACTORS **(24)**

Price of trades
Investors buying cheap for rental/Rich buying
Land in poor areas
Trades availability
Land prices
Debt levels of consumers
Bracket creep
Mortgage insurance
Real estate commissions
Lack of Apprentices
Standard of trades
Lack of medium density developments
Margins
Obtaining deposit
Interest rates
Longer loan periods

DIRECT ASSISTANCE TO FIRST HOME BUYERS **(0)**

OTHER **(4)**

"Mainland" expectations
Buyer expectations for detached
TV shows – get rich quick
Relocatable homes

LOCAL (No. of Respondents - 168)

HOME WARRANTY INSURANCE **(3)**

Home warranty certification (insurance)

REGULATION AND COMPLIANCE ISSUES **(104)**

Faster approvals
Planning/zoning
Simple DA with less paid expertise needed
Obtaining approvals
DA consistent/fair
New regulations
Smaller allotment/dual occupancy
Reasonable period for LEP
Architectural standards
DA waiting periods
Garages in behind building line
Allow private certification of plumbing work
Bin permits
Compulsory inspections

TAXES, FEES AND CHARGES **(32)**

Reduce fees and charges
Fines
Standardise fees
Hypothecate taxes and development fees
Remove Section 94 levies
Architect/Engineer fees
Sewer contribution rates
Inspector/certifiers liable for their own mistakes

INFRASTRUCTURE AND LAND ISSUES **(9)**

Government release more building land
Re-zone more land for residential
Less costly infrastructure
Public utility services should receive higher
Government grants

MARKET FACTORS(1)

Encourage apprenticeships

DIRECT ASSISTANCE TO FIRST HOME BUYERS **(6)**

Tax rebate for first home buyers
Increase First Home Ownership Grant

OTHER **(13)**

Rates system like State title/subsidy
Co-ordinated understanding and policy
Concessions for affordable housing
Reconsider how rates are charged
Lobby on behalf of communities
Work with developers
Reduce land rates

STATE (No. of Respondents - 199)

HOME WARRANTY INSURANCE **(24)**

Home warranty insurance
Housing separate from commercial in OH&S
Abolish indemnity insurance

REGULATION AND COMPLIANCE ISSUES **(14)**

Better balance environmental legislation
Health and safety requirements/workcover
Approval times
Rights of appeal on re-zoning
Employers paying contractors workcover etc
Standardise DA process
Excessive planning/limited resources for small builders
‘ Reduce red tape/paperwork
Better vcat system

TAXES, FEES AND CHARGES **(112)**

Reduce indirect taxes
Remove/reduce stamp duty/timed payments/use threshold/tax on tax
Reduce Section 94 contributions/developer fees
GST stamp duties hypothecated to infrastructure and affordable housing

INFRASTRUCTURE AND LAND ISSUES **(25)**

Better planning of infrastructure/Excessive costs for new home buyers
Land shortages/artificial land boundaries
Land prices
Governments to provide infrastructure

MARKET FACTORS(8)

Apprenticeships system improved

DIRECT ASSISTANCE TO FIRST HOME BUYERS **(7)**

Rebate for first home buyers
More affordable incentives for first home buyers and investors
Subsidies for consumers
Increase first home owner grant

OTHER **(9)**

Excessive house sizes
Accountability tribunal for local government
Lobby Federal Ministers
Dual occupancy
Cheaper land for low income earners
Cap liability of builders
Regional policies

FEDERAL (No. of Respondents - 168)

HOME WARRANTY INSURANCE **(20)**

Fix home warranty insurance
Cap liability of builders

REGULATION AND COMPLIANCE ISSUES **(10)**

Occupational health and safety requirements
Less red tape and less paperwork
Reduce approval times
Drop stormwater drainage
Less ABCB regulation

TAXES, FEES AND CHARGES **(55)**

Cut GST on new housing
Remove stamp duty
Cut GST on building materials
Rebates on energy efficient buildings
Reduce land tax
Reduce cost of materials

INFRASTRUCTURE AND LAND ISSUES **(10)**

Release more land for housing
Provide infrastructure/tax concessions to developers of affordable housing
Create major viable regional centres
Improve infrastructure
Dedicated low cost housing

MARKET FACTORS(23)

Improve the apprenticeship system
Cut interest rates
Excessive house sizes

DIRECT ASSISTANCE TO FIRST HOME BUYERS **(42)**

Increase the FHOG
Apply FHOG to new properties only
Government loans or subsidies to first home buyer
Means test FHOG
Special home loans for low income earners
Finance on home tax deductible capped at $400K

OTHER **(8)**

Increase amount of steel in building
One-off payment for staying in same house
Cheaper fuel reduces transportation costs
Allowing people to access super for their home
Establish a Department of Housing
Inter-government co-ordination

- *Are state and territory government land release policies constraining local government decisions to approve land for development?*

In the Australian federal system housing policy, residential land policies and building approval processes are established and enforced at the state and local government level.

While attempts have been made to move towards the adoption of more uniform and performance based standards, and in the streamlining of approval processes, the ad hoc nature of past policies has resulted in a regulatory environment which is multi-layered and unduly complex.

Numerous studies by Commonwealth and state governments have established that the regulations governing the house building industry can delay the production of new housing, add to costs and restrict and discourage innovation and choice in housing.

- *Are policies designed to encourage higher density housing consistent with, and flexible enough to accommodate, changing community preferences? Can such consolidation occur at a sufficiently rapid rate to keep up with demand?*

Arguments for urban consolidation relate not only to the desirability of increasing housing choice and reducing costs but also to the intensifying need to minimise the adverse impact of urbanisation on the environment.

There is a substantial cost saving and considerable potential for improving urban form by encouraging forms of development other than the "quarter acre" block with its detached house.

The issue has become pressing as Australia’s major cities continue to grow outwards, infrastructure funding is constrained and environmental concerns become more prominent.

Changes in household formation have meant that traditional housing options are no longer appropriate for a large and increasing proportion of the population. Most households now consist of only one or two persons and this trend is projected to continue.

The challenge remains for greater co-ordination, integration and comprehensiveness of approach across all levels of government.

Policies on urban consolidation should be consistent with the overriding objective of ensuring that housing remains affordable to all Australians.

Commonwealth, state and local governments have already launched initiatives that encourage urban consolidation, and these should be continued. There is now greater acceptance by local councils and consumers that higher density and alternative forms of housing offer real benefits.

Master Builders recommends that:

- planning regulations be streamlined to encourage smaller-lots and to establish new development standards which allow small-lot subdivision either as of right or as a proportion of the total development;
- the introduction of performance-based medium density development codes in all existing local government areas;
- mechanisms for consultation with and appeal by residents and other parties be streamlined to reduce delays in the granting of approvals for medium density developments

- *Do local planning schemes create unnecessary costs?*

Protracted and cumbersome approval processes, coupled with the tardy provision of residential infrastructure for new housing development, have caused land prices to rise significantly in most capital cities of Australia over the past four years.

Such costs have a direct impact on the housing industry and the home buyer.

In addition, the planning process in Australia has become increasingly politicised by vocal pressure groups which lack adequate regard for the consequences of their actions.

On top of this, the NIMBY (Not In My Back Yard) syndrome plays a powerful role in keeping the current regulatory system in place.

There has also been an increase in the number of new codes and regulations, which add considerably to the cost of construction but have questionable public benefit.

The house building industry recognises the legitimate need for appropriate planning policies and technical standards for residential development but considers that it is imperative to:

- streamline the approval process;
- simplify regulations;
- rationalise technical standards;
- achieve greater uniformity in standards between states;
- remove other unnecessary and outdated barriers.

Regulations have a direct impact in delays and cost increases and therefore have a major direct impact on housing affordability. Master Builders suggests that any revamp of the current system should:

- seek to have all new regulations subject to cost benefit analysis and "sunset" provisions where appropriate;
- seek greater uniformity in regulations and standards across states and territories by supporting the introduction of national advisory codes that can be adapted to local conditions at the state and local government level;
- recognise that improved consultation is a critical element in the development of sensible regulations, and through the establishment of consultative committees, seek to improve communication with elected members and officials of state and local governments.

- *Do external or third-party appeal mechanisms unnecessarily delay planning approvals? Is the 'not in my backyard' issue being managed effectively?*

Local laws introduced by local government are adding costs by producing inappropriate regulations of buildings or building sites.

Third party appeals also delay planning approvals. Individuals, after putting their comments to Council, should accept Council's decision. Often an individual can appeal a decision and hold up the final approval for months after applicants have spent 6 to 18 months going through the application process.

Building controls

- *What evidence exists of unnecessary or inappropriate regulation of building? Is there evidence that the costs of such measures exceed the benefits?*

- *What effect have recent changes in building controls had on housing prices and affordability?*

Regulations exist that double up on referrals/approvals when certifiers are seeking approval in areas of demolition and flooding, i.e. once Council issues a planning permit for demolition of a building, in some States the builder has to go back to Council and get approval from the Building Office.

Similarly, when dealing with water authorities in flood areas, Councils are approached in addition to other authorities. This process adds delays and additional application costs.

Councils are producing local laws that cover a plethora of building controls and site controls. These inappropriate local laws vary from Council to Council, making it confusing to comply with many different laws and processes in obtaining approvals or consents.

Private certification in building provided efficiencies and was very cost effective, but over recent years the building regulations have demanded more reporting and referrals, many unnecessary that have simply added more costs without appreciable benefits.

Generally Master Builders believes that State and local governments have been producing continual red tape over the last 4-5 years that has significantly added to the cost of building new houses particularly in the approval process.

There needs to be closer dovetailing between planning and building to reduce unnecessary overlap.

- *Is there evidence that any insurance arrangements and building guarantee schemes are adding unnecessarily to building costs?*

The collapse of the HIH Insurance Group highlighted weaknesses in the current indemnity insurance schemes in all States/Territories except Queensland and the Northern Territory, where the Government administered schemes appear to be working well.

Since this collapse, premiums have increased and builders have faced more difficulties obtaining sufficient and timely insurance.

Any scheme based on the lowest common denominator approach by which the honest and technically competent builder who attends to his clients' concerns is treated in the same way as the worst of his peers is not workable. As a minimum, any insurance scheme must include a builders rating system to sufficiently differentiate between the high risk and low risk builders.

Technical competence which should be the primary criteria has in practice become a secondary consideration. It was not concerns with the financials of builders that created this problem so it does not need to be part of the solution.

There is also a concern with licensing whereby builders are able to obtain and renew their licences but they are effectively prevented from being able to work either because they are unable to obtain warranty insurance, or they are forced to obtain insurance cover for a quantity of work which is significantly less than that needed to guarantee their livelihood and commercial viability in the marketplace.

The current methods of assessment also make it extremely difficult for new and younger builders to commence building due to the stringent financial requirements imposed by the insurers.

The collapse of HIH has clearly restricted choice in the home builders warranty insurance market with most States now characterised by monopolistic or oligopolistic supply of insurance. This has placed upward pressure on prices as insurers "cherry-pick" the best risks and leave others uninsured.

The collapse has also had deleterious macroeconomic impacts. An increasing number of builders are being refused insurance or have insurance applications delayed.

In essence, what is occurring is a restriction in the availability of builders for any given project, a greater concentration of market power with the larger builders and the erection of artificial and unfair barriers to entry. This has resulted in increases in construction times, higher costs of housing, thereby exacerbating affordability problems, reduction in training and uptakes of apprentices, abrogation of employment responsibilities such as OH&S and a climate of 'short-termism' as builders no longer feel confident in undertaking long-term planning.

- *Is land release delayed unnecessarily either by inadequate supply of infrastructure services or a lack of responsiveness on the part of infrastructure service providers? If so, to what extent is this affecting development costs?*

(see pp 33, 34)

Performance of the building and land development industries

- *Have rising construction costs contributed to rising housing prices? Have construction costs increased because the level of building activity has risen more rapidly than supply capability? What other factors are relevant?*

There appears to be little evidence to date to suggest that rising construction costs have contributed more than marginally to the rapid rise in house prices over the past three years.

As can be seen in the chart below the price index of materials used in house buildings has not grown any faster than the CPI over an extended period of time. Nevertheless, the data from recent quarters and anecdotal evidence suggests that price pressures are growing.

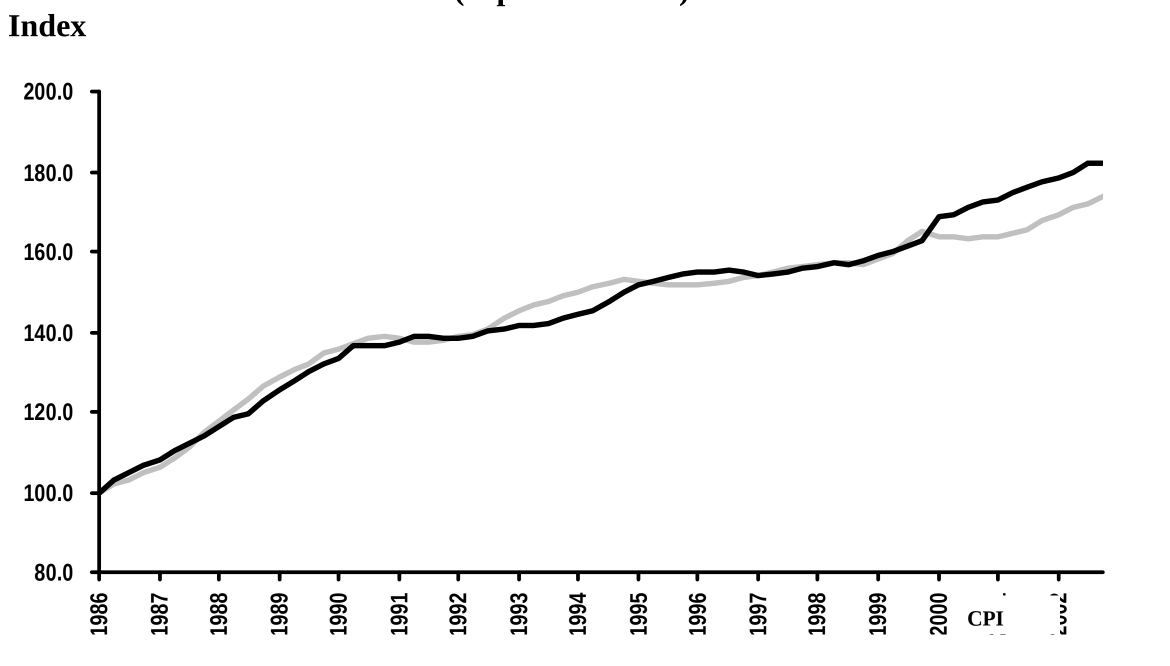
Confidential material provided to Master Builders' suggest that to date builders and developers have been absorbing these costs because of fixed price contracts with a consequent deleterious impact on margins. Such a situation cannot continue indefinitely and eventually these higher material prices must flow into building prices thereby exacerbating the affordability crisis.

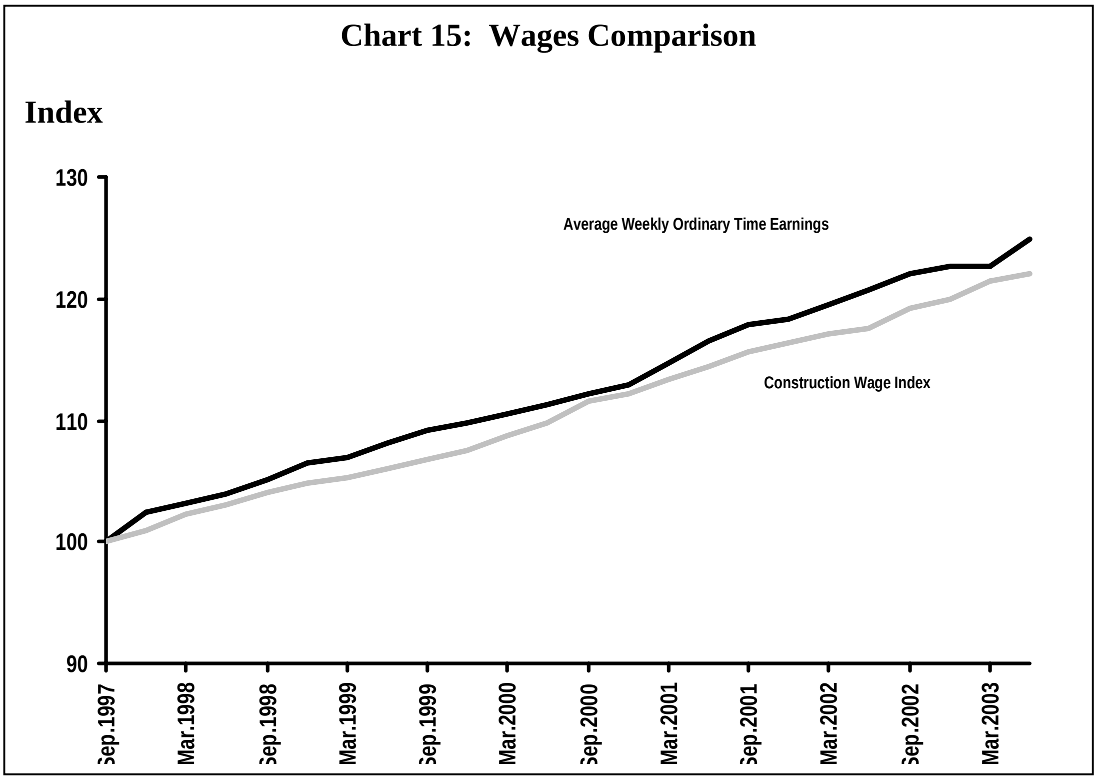
- *Have skill shortages in the dwelling construction industry contributed to rising housing prices and reduced affordability? Are such shortages temporary or are there long-term issues? Have the costs of skills shortages been more significant in particular regions?*

There also appears to be little evidence to date to suggest that wages have contributed to rising house prices. With contractors facing fixed price contracts these pressures may yet be reflected in future contract prices.

As can be seen in the chart below, wage growth in the construction sector has not been out

Chart 14 House Material Prices & the CPI
(Sept 1986 = 100)





- *Are the structures of the land development and dwelling construction industries competitive and likely to deliver efficient outcomes? Do developers have market power in some areas and does this increase prices?*
- *Are there any significant barriers to businesses entering the land development and dwelling construction industries? Have any barriers to entry changed significantly over the past ten years?*
- *What is the nature and extent of these requirements, rules and regulations and their impact on housing prices? Do they vary across jurisdictions and between metropolitan and non-metropolitan areas? Who bears these costs?*
- *Have any of these requirements, rules or regulations changed significantly over recent years and, if so, what has been the effect of these changes?*

The building and construction industry features as close as one can get to a perfectly competitive supply situation with many small suppliers in direct and open competition and few natural barriers to entry. However, the current situation with home warranty insurance and the increasing burden of regulatory changes may be creating deterrents rather than barriers to entry.

The building process is a complex and time-consuming procurement process, involving planning, design, approval, site preparation and, only then, construction.

The builder operates in a volatile industry environment. It is not unusual for the industry to experience fluctuations of 40 per cent in demand between boom and bust. This volatility is often triggered by changes beyond the control of the industry, such as changes to monetary policy.

In this highly competitive market, builders frequently work at low profit margins in order to maintain their business operations. As discussed earlier in this submission, the results of the Master Builders survey of affordability clearly indicate that excessive and ill defined regulation and increasing contributions to infrastructure costs are considered the second or third most important contributor to falling housing affordability.

Infrastructure charges

- *What infrastructure costs should be recovered through infrastructure charges? Should the costs of providing services such as schools, parks and libraries be recovered via infrastructure charges?*

Infrastructure pricing is a major influence on the residential land market and, therefore, housing outcomes. States increasingly require developers to contribute to "hard" infrastructure, such as reticulation and head works, at varying rates. Increasingly, developers are also required to contribute to the cost of providing "soft" infrastructure, such as child care centres and other community facilities.

Master Builders considers that the current level of public and private infrastructure investment in Australia is too low and that the resultant decline in infrastructure stock is a concern.

The provision of, and equitable and affordable access to, infrastructure is an integral part of the performance of the Australian economy in general and the building and construction sector in particular.

Without this, economic performance will deteriorate and living standards will fall.

Government has a key role to play in facilitating the provision of infrastructure both in its own right and by creating favourable tax, regulatory and capital raising systems that will encourage increased private sector involvement.

Master Builders is also concerned with the general move towards a user pays framework for infrastructure.

Since infrastructure provides benefits to the general public, in addition to the direct use of the service, there will by necessity be under-provision of infrastructure if the full cost is attempted to be recovered from the user alone.

Australia must not allow short term political imperatives to drive a run-down in infrastructure stock.

Meeting infrastructure needs in Australian cities and regions is of paramount importance.

Australia in particular has a comparative advantage in low cost and well serviced urban land and this underpins the productive capacity of the economy. If this advantage is allowed to be eroded, then overall economic performance will suffer.

- *Are current infrastructure charges justified by the efficient cost of providing services? Is there evidence of over-recovery of infrastructure costs?*

Affordability for first home buyers is undoubtedly affected by infrastructure costs.

Declining public spending on infrastructure at all levels of government has seen increasing demands on developers to fund the provision of infrastructure. This cost impost is inevitably passed on to the end buyer which, in many cases, will be a first home buyer.

Local councils should adjust development levies to reflect those costs spread over the whole community.

These costs should not be borne by first home buyers alone. To impose such a burden is an egregious violation of the principle of intergenerational equity and the Productivity Commission should urge state and local governments to revisit the issue of funding of infrastructure to ensure that the costs of infrastructure provision are borne evenly by the entire community.

Taxation

Home ownership is an integral part of Australia's social fabric. It has contributed much to the social harmony and stability which has brought so many social benefits. The role of home ownership as a social good must therefore be properly recognised by governments.

The Australian housing industry continues to be subject to new charges and to increases in direct and indirect charges, from all levels of government. Examples of such increases include increases in allotment levies, application fees and contributions.

Increases in taxation and charges add to the cost of housing and negate the efforts of industry to deliver a more affordable product.

Government charges directly affect the affordability of home ownership. They also reduce accessibility, particularly for first home buyers, who are likely to find themselves locked out of the housing market, particularly in periods when interest rates are high.

- *How have taxes affected price and affordability outcomes in the housing market, especially for first home buyers? Which of these taxes are of most concern?*

The importance of taxes and charges with regard to declining housing affordability was highlighted earlier in this submission when the results of the Master Builders survey of affordability were discussed.

In particular, the range of State and local government taxes and charges add directly, inefficiently and inequitably to the cost of home ownership.

Further, stamp duty which in most cases is a progressive tax (the percentage payable increases as house prices increase) has become a larger contributor to declining affordability as house prices rise. This is because State governments have failed to adjust stamp duty scales as prices have risen.

In this regard Master Builders notes and endorses material contained within the Real Estate Institute of Australia submission to this inquiry.[6]

The Productivity Commission should recommend an immediate inquiry into stamp duties as part of the promised Intergovernmental Review of State taxes by 2005.

Whilst stamp duties represent the most visible and onerous of State and local government taxes and charges, there is a range of other taxes and charges that also add directly to the cost of home ownership. These are covered in the results of the abovementioned survey and include property taxes and s.94 contributions. The Productivity Commission should also undertake an analysis of these taxes with respect to the accepted principles of taxation and also in terms of the increased compliance burden.

This analysis should be done against the background of increasing State revenues associated with the GST.

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[6] Real Estate Institute of Australia, Submission to the Productivity Commission Inquiry into First Home Ownership, October 2003.

MECHANISMS TO ASSIST FIRST HOME BUYERS

- *How important is home ownership to the well-being of people? What are the societal benefits? Do these warrant policy intervention to assist home ownership, and first home buyers in particular?*

Shelter is a basic human need and is increasingly recognised as a fundamental right. Even those who are unable or unwilling to achieve this goal expect appropriate accommodation whether publicly or privately provided.

Affordable, quality housing remains essential to Australia's quality of life and it is important to pursue policies which will ensure the effective delivery of such housing to all Australians.

Decent, affordable housing for all Australians has been a goal of all governments since Federation. The importance of striving towards this goal cannot be underestimated. As well as providing shelter, secure housing helps people to copy with economic, social and health issues.

Home ownership is therefore an integral part of Australia's social and economic fabric. It has contributed much to the social harmony and stability which has fostered improved socio-economic outcomes. This is why the role of home ownership as a public good has always been recognised by all governments.

Widespread falls in housing affordability will ultimately result in a decline in the quality of life of the Australian community.

- *Are the objectives of government programs to improve home ownership clearly defined? Are the programs achieving their objectives efficiently?*

Every effort should be made to provide quality shelter for those individuals and families who, for social, health or other reasons are unable to avail themselves of home ownership or rental assistance. Every Australian needs security of tenure, and every effort should be made to provide the necessary support systems that can be offered through the public housing system. For certain target groups public housing stock provides the most secure form of accommodation and should therefore be maintained and funded appropriately by governments. The existing Commonwealth-State Housing Agreement should be maintained as the primary means of funding public housing and setting criteria for the quality of housing stock and levels of assistance. Public housing should not be expected to provide an alternative to home ownership. Public housing should concentrate on solving the problems of those in housing difficulties. Rental Assistance also has an important role and should be properly targeted to maximise its benefits to low income households in the private rental market.

- *Would the (Prime Minister's Home Ownership) Taskforce's proposals enhance the accessibility and affordability of housing for first home buyers? Are there any barriers to equity participation schemes? Is shared equity likely to be attractive to potential investors?*

In its submission to the Home Ownership Task Force, Master Builders suggested that there were a number of issues that needed to be addressed before any such proposal would find widespread community or financial market support.

Household Asset Allocation Decision

The discussion paper issued by the Task Force assumes that individuals do not include the home as part of their overall asset allocation decision. This assertion is very difficult to support.

The high rates of home ownership in Australia (currently just below 70% of all households) and the ongoing and rising levels of alterations and additions, suggest that the home forms a very important part of household asset allocation decisions.

There would be few home owners that would not, at any given point, know precisely the value of equity that exists in their home. Most owners look to the home as a "nest egg" that will provide security at retirement.

Use of Term "Cost"

The discussion paper by Christopher and Joye asserts that the "cost" of home ownership is reduced under this proposal. This is an erroneous use of the word "cost". For instance, if half an ice cream is purchased, it would cost half as much but in the end you only receive half an ice cream. There is no actual reduction in the "cost" of home ownership under the proposal because individuals are only buying a smaller proportion of their house. While it is acknowledged that the individual receives full "occupational rights" in the house, this benefit is likely to be offset by the terms of the partnership agreement which may place abnormal burdens or restraints on the occupier.

While only purchasing a smaller asset would, in some cases, enable a faster transition to home ownership, it is important that it is noted that it is purely this faster transition that is the benefit and not the so-called lower "cost". This also applies to the financing of the new lower loan. The proposal frees up disposable income but cannot be said to lower "costs".

In essence, the proposal results in a hybrid situation of half owning and half renting. While the deposit barrier has been lowered, the situation cannot be said to be one of true home ownership.

Who Provides the Equity?

Under this proposal, in the first instance at least, there is a decrease in householder home equity which must therefore be replaced by an increase in institutional or financial sector home equity. This must be the case if the same amount of money is to be invested in housing. While the paper adequately covers the mechanism whereby there is a decrease in individual equity, it has less detail on the mechanics of the increase in the institutional equity. In particular, the issue of who is making the investment and what incentives exist for them to do so, is not adequately addressed.

The proposal has already met with some sceptical responses from the financial sector. Indeed, this issue has been broached in the past and the problem of source of funds has always remained a difficult one. Commercial institutions have shown little or no interest in equity participation in residential properties and cite problems both with the treatment of equities in their accounts and difficulties in managing interest rate risk arising from mismatches in cash flows. They also raise concerns with regard to management of the investment, the ability of the active partner to fund the remaining share and the illiquidity of such an investment which significantly reduces its attractiveness to institutions, the more so in the current uncertain investment climate.

All of these issues will need to be addressed before significant financial market involvement can be expected.

The Partnering Agreement

The paper provides few details on the form of partnering agreement. Issues such as maintenance, tax, renovations, overall control, timing of a sale etc would take a great deal of time to settle and remain a significant obstacle to this proposal. These issues are important in determining whether the householder is a renter or a homeowner and therefore the attractiveness of the proposal from a consumer's perspective.

Returns on Equity

As indicated in the paper, equity returns to housing are similar to returns received on cash and significantly below those accruing to equities and fixed interest investments. This is not surprising, given that owners of residential real estate receive a significant implied return as a result of home ownership, which of course is not captured in pure financial market aggregates. The volatility of these financial returns, as indicated by the standard deviation, is of course, much higher than those of cash.

Since the passive equity partner would receive none of these implied returns, the question must be asked what incentives would exist, at least on this basis, for institutional investors to choose residential real estate over cash. The paper attempts to argue that there would be some incentive for this choice due to the historically weak correlation with other asset classes. It argues that optimal investment decision making would indicate that such diversification could achieve higher overall returns with lower overall risk. While the overall risk would, by definition, be lower with the inclusion of an additional asset class, the overall return would also be lower. There is no certainty that investors would choose one result over the other. In addition, the cross-correlations of cash with the other asset classes, is strikingly similar to those of residential real estate. This of course is not surprising given the sensitivity of the residential real estate market to interest rates. Once again, cash would be preferred to residential real estate given its lower standard deviation.

Maturity Profile

Since there is no certainty with regard to the length of time the active equity partner would maintain ownership of a home, there can be no certainty of the maturity profile to be established for the new product in the secondary market. This uncertainty must inevitably add to the cost of this investment or reduce expected returns, further reducing the attractiveness of the asset to passive investors.

Macro Economic Perspective

The paper implicitly assumes that less individual investment in housing is good for the economy. Master Builders takes particular exception to this assertion. This issue of the optimal overall individual investment in housing has been addressed on many occasions and the overwhelming evidence is to the contrary. In addition, it should be noted that Australia's total investment in housing, given the unique economic, spatial and social characteristics of the country, are not out of line with international experience nor is there any evidence that macro economic performance has suffered as a result of the proportion of investment flowing to housing. Indeed, housing as a form of investment or wealth accumulation, provides significant benefits to the national economy. As a form of forced savings, it is not too different to the current superannuation system supported by this Government. Housing also has significant positive multiple or flow-on effects with the rest of the economy and is a major source of employment.

In addition, by unlocking this investment and allowing home purchasers to consume more, this switch from investment to consumption could have significant deleterious effects on the economy in the medium and long term.

- *Are there other mechanisms that could be adopted to improve accessibility and affordability for first home buyers?*

The current system of housing finance has many benefits and is tried and tested at least for the majority of aspiring home owners. It makes more sense then to work within the current system but provide a mechanism that would enable more of these aspiring home owners to qualify for home finance.

However, within the current system the usual checks and balances and credit risk assessments mean that some individuals and households fail to qualify for home loans.

Master Builders proposes that the Government adopt a model similar to the Higher Education Contribution Scheme (HECS). HECS is, in essence, the result of a Government decision to provide loans to individuals to acquire higher educational qualifications than they otherwise were able to afford. The Government has decided that there are public policy benefits in greater uptake of higher education and is therefore prepared to provide finance to achieve this aim. The economy and society in general receive the benefits from this investment of public funds via higher levels of economic activity as a result of a more educated workforce.

Since all levels of Government clearly accept that high levels of home ownership amongst poorer and disadvantaged individuals also provides public benefits, then HECS could provide a template for a similar housing scheme, hereafter referred to as the Housing Acquisition Contribution Scheme (HACS).

The biggest barrier to entry to the housing market for poorer and disadvantaged individuals is the accumulation of the initial 20% deposit. Under this scheme the Government would guarantee this deposit in the form of the issue to the banks of an interest only Commonwealth Government Security (CGS). The financial institution would provide 100% of the finance for the purchase of a home. The financial institution balance sheet would record 80% of this amount as a loan to an individual (identical to the situation that would occur under the traditional 80-20 home loan) and would receive from the Government at no cost the remaining 20% in the form of the interest only CGS. For certain groups needing additional assistance, the Government could, perhaps, increase the size of its holding to as high as 40%.

This proposal would enable marginal households to enter the home ownership market, would be attractive to financial institutions and would actually involve cost savings for the Government.

Advantages to Individuals

From the individual point of view they would effectively have a standard 80% bank loan payable to the lender in the usual way. The remaining 20% would be a liability to the Commonwealth Government (although the management and record keeping associated with this liability would be done by the banking sector with an appropriate charge to the Commonwealth). Interest payments on this 20% of the loan would, for some significant period of time, be capitalised so it would not create a cash flow burden for the individual. For the individual, the scheme provides all of the same benefits as the Caplin/Joye proposal. However, the individual can now enter the home market without the significant barrier of acquiring a 20% deposit. Indeed, this proposal makes it easier to overcome this barrier than the Caplin/Joye proposal.

The capitalisation of the interest on the remaining 20% will, over the long term, be offset against the capital appreciation of the value of the home.

Advantages to Lenders

From the prospective of the lending institution, very little has changed. Indeed, the proposal has many advantages. For instance, banks currently hold around $11billion in CGS at any given time. Under this scheme it is likely that they would run down their existing CGS holdings and replace them with the new housing bond which, as noted earlier, would have a slightly higher interest rate to cover administrative costs. The final situation from the financial institution perspective would be little different from that under a traditional loan. However, the financial institution would have an expanded balance sheet as a result of the higher value of loans and a higher yielding portfolio of Government securities with minimal extra cost.

The Government

The Scheme can be adopted by the Government at very little cost. Indeed, as other areas of expenditure on housing can be reduced or eliminated, the Scheme can actually be positive for Government revenues. Under this scheme there would clearly be less need for funds to flow from the Commonwealth to the States under the Commonwealth State Housing Agreement.

The outgoings in any given year are simply the interest costs on 20% of the loans taken up under the Scheme. For instance, should the Government wish to target total additional loans of $2 billion (enabling some 15,000 households to purchase homes) the interest cost would be:

$2billion x 0.2 x Government Bond rate

At the current Government bond rate of 5.5% plus an allowance of 0.5% for financial institution administration charges, amounts to $24 million per year. This figure would be offset by savings in other areas of the programme as spending falls under various components of the Commonwealth State Housing Agreement.

In fact, as the Scheme matures and individuals elect to repay part of the Government loan or sell the house, interest outgoings would probably be matched by incomings of interest and actual repayments.

Eligibility under the proposed scheme needs, as a matter of course, to be limited by appropriate criteria to ensure that assistance is targeted and to limit the Government's liability.

The Government would have a contingent liability in the form of the loans to individuals but, unlike many other contingent liabilities, this would be offset by a very real contingent asset in the form of the housing stock guaranteed.

In addition, there would be no need for a major dedication of administrative resources which could easily be subsumed into the current departmental resources of either Treasury (Office of Asset Management), Finance or Industry and Tourism. Alternatively, a very small new agency could be formed purely for monitoring purposes.

ATTACHMENT 1

Affordability Survey

Component	Form
Master Builders Affordability Survey	
From the perspective of your first home buyer clients how would you rate affordability?	0(no problem) 1 2 3 4 5 6 7(major problem)
How did it rate 2 years ago?	0 1 2 3 4 5 6 7
How did it rate 5 years ago?	0 1 2 3 4 5 6

7

What effect are the following factors having on affordability?

Availability of trades

no impact
a small impact
a moderate impact
a major impact

Price or availability of materials

no impact
a small impact
a moderate impact
a major impact

State government fees and charges

no impact
a small impact
a moderate impact
a major impact

Local government fees and

no impact

charges	a small impact a moderate impact a major impact
Regulatory delays such as development approval	no impact a small impact a moderate impact a major impact
Land prices	no impact a small impact a moderate impact a major impact
Indemnity insurance	no impact a small impact a moderate impact a major impact
Excessive buyer expectations	no impact a small impact a moderate impact a major impact

Land availability	no impact a small impact a moderate impact a major impact
GST	no impact a small impact a moderate impact a major impact
Infrastructure costs	no impact a small impact a moderate impact a major impact
Access to finance	no impact a small impact a moderate impact a major impact

Other (please list)		

What policies could be adopted to improve affordability?

By federal government		
By state government		
By local government		

ATTACHMENT 2

LAND PRICES (Outer Brisbane)
(700 Square metres)

1993	$68,000
2000	$78,000
2002	$114,000
2003	$195,000

PROJECT BUILDER PRICE
(219 square meters)

01/07/98	$80,300	
01/04/99	$81,900	
01/01/00	$86,900	Labour/material rates effected by pre-GST market pressures
01/05/00	$94,600	(inclusion of GST)
01/10/00	$94,900	
01/02/01	$96,500	
01/05/01	$98,400	
01/08/01	$99,500	
01/12/01	$102,900	
01/07/02	$104,500	
01/12/02	$111,200	(allowance for energy efficiency + extra items $4500 approx)
01/07/03	$113,900	
01/09/03	$119,400	(allowance for higher labour/material costs)