Submission to the Inquiry into Home Affordability

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Introduction

Home affordability, as has been widely publicised, is increasingly beyond the average first home buyer.

While the housing market is buoyant, the proportion of purchases by first home buyers is at a low of approximately 13%. This results, arguably, from the increasingly high price of purchase of a home (in whatever form of accommodation).

It is a classic commonplace of economics that a fall in supply against demand will see an increase in prices until the market reaches equilibrium. To the extent that this is true, the increase in prices is homes is explained. But only in part. While demand can be funded, it continues unabated, bidding up prices of a deficient supply. If there was ample supply, prices would be expected to not move as they currently are. The supply we are talking about is, of course, supply of land, in the final analysis. The construction price of a modest dwelling is not largely different from that of a similar dwelling a generation ago, noting that real wages have increased since that time, so suggesting that affordability of construction isolated from land has declined.

Prices are being able to be bid up by a number of factors. In the main, these derive from the value of existing homes (whether realised through sale or raising a loan against a mortgage). Thus existing home owners fuel the market, whether home owners are selling to purchase another property, or using the equity in their home for an opportunistic purchase of an 'investment' property. This market fueling lies at the heart of the rate of increase in price, because without demand being funded it would peter out, bringing the market into equilibrium at a lower level than currently appears to be the case.

Two serious results flow from this set of circumstances.

1. Funds available for investment in other than home purchase are reduced. This restricts funds available for education, recreation, purchase of consumer durables, services, and investment in productive enterprises, etc.

2. The number of people forced into uncertain rental accommodation and with reduced involvement in the community which involvement typically follows home ownership increases.

Both these are bad for the nation, economically and socially.

Supply

The supply problem, the shortage of land for cottage development or the pressure on land that is available for apartment development, is perhaps the essence of the problem, but only because of demand issues. That is, that demand is outstripping supply in the larger metropolitan areas.

This perhaps provides a clue to the issue.

People are attracted to the larger centres typically because of employment opportunities. If employment was available elsewhere in the states, the metropolitan centres would be comparatively less attractive, easing pressure on land (and infrastructure).

It is remarkable that with the ease of electronic communications and modern transport making location choice less geographically dependent, that there is increasing centralisation, rather than dispersal of population. The effect of this on cities (particularly Sydney and Melbourne) is obvious: raising land prices, pressure on services infrastructure, and lower income service employees being driven out of cities. This means that they endure long commuting times to their places of employment. This is good neither for the people involved, their families, or their communities. That peoples' time is taken up with work and travel, there is no time for good quality recreation with families, or for participation in community or voluntary activities.

For those who are stretched to service large mortgages for homes closer to cities, similar problems occur, but in some cases, for them because they must devote their time to work or second or third jobs.

So, rather than the issue being one of affordability per se, it is one of population pressure driven by jobs. Jobs are driven by investment. Investment by the practicalities of business in an environment amenable to Government influence.

To meet demand in metropolitan fringes, where current land releases occur will do nothing for wider policy objectives related to the environment or community cohesiveness. These releases are typically so far from business and industry centres that extended and polluting commuting is required.

A suitable policy response to the metropolitan supply problem is to encourage supply in regional centres. To do this both Commonwealth and States need to co-ordinate policies to stimulate development of high value service and manufacturing industry (on an output basis, rather that the input basis implied by industry policy having to 'pick winners'). This relates then to education and investment taxation policy as well as broader industry policies to support venture capital investment (notably difficult to obtain in Australia) and deployment of investment funds in productive assets rather than the comparatively unproductive portfolio investment strategies of contemporary popularity.

However, regional centres cannot become popular without adequate electronic communication and transport and other service infrastructure. Their development must also recognise environmental vulnerabilities to achieve long run sustainable outcomes.

It seems that these policy areas as a group require concerted government action. Perhaps some of the current privatisation plans need to be revised or reversed to ensure that an appropriate level of investment is made in regional infrastructure. All major regional centres, and sub-regional centres between them, need high quality communications, road and rail access. They need government policies which simplify planning and other approvals without degrading the environment or engaging in ad hoc or haphazard planning.

Coupled with these positive steps, immigration policy could be brought into play too. Immigrants could be required to settle in regional centres, perhaps by having conditional visas for two or three years which require such settlement before they can gain permanent residency status. This would divert motivated people to regional centres to contribute to their economic and social development.

Taxation Issues

Some media comment has been made about the putative affect of taxation on property prices. While it is probably unjust to levy taxes on taxes, which is a factor in home prices, it is a minor point. Stamp duty is probably a minor point too, but one that is rather obvious to buyers. If stamp duty were to be removed, then the price of homes would quickly rise to take up the 'slack' in the market's buying capability and persist in running ahead of the market if the fundamental issues touched on above remained unresolved.

However, there is room for incentives to be provided through stamp duty and capital gains taxation systems to influence the home market.

A system such as that outlined below may be viable.

Seeing most movement in the housing market is by other than first home buyers, first home purchasers could be exempted from paying stamp duty (unless that home were an investment property) on properties below the median market price for their suburb. If first home buyers sold their home within a set period, say, four years they would have then to meet the stamp duty for their property. Any person buying a home less than two years after a previous purchase would be exposed to increased stamp duty, and a sale after less than two years of *effective* ownership (to disable company structures established to avoid tax) would be exposed to full capital gains tax. Any person buying a home less than five years after a previous purchase, but more than two years, would face a stamp duty impost. A sale after less than five, but more than two years ownership would face a reduced capital gains tax. Purchases made after these periods would face no stamp duty surcharge. Sales of the family home after five years would not attract capital gains tax.

To avoid hardship there would have to be mechanisms whereby distress sales could be fairly identified to avoid those taxes designed to slow the pace of the housing market.

Taxation favoring property investment over productive investment is distortionary. It applies pressure to home prices and takes investment away from production. This needs correction, but coupled with policies which address the issue of long term rental accommodation, discussed below.

Rental Accommodation

With the Australian emphasis on owning a home as opposed to renting in the long term, there is possibly a reduction in housing options and distortion in investment markets.

Policies are required to make long term rental a not unattractive proposition for both investors and prospective tenants. The current unattractiveness is that most leases are short term (six or twelve months, and monthly thereafter) and tenants often face pressure to move when landlords sell their property. Stability in rental accommodation is critical to its increased attractiveness as a serious accommodation option. If tenants can expect to enter into long term leases (which they can sell), with predictable increases in rent, they may be more interested in renting rather than buying. This could also be a factor in making the labour force more mobile and responsive to demand for labour across the country.

The current fashion for opportunistic property 'investment' driven by negative gearing adds to uncertainty in rental accommodation, with landlords likely to sell their properties to realise early gains, to avoid financial distress, or to crystallize their investment for retirement. If tenants could expect to have five to ten year leases (or longer, as is the case in other countries), much pressure might be taken off the housing market and first home buyers could plan their finances in the comfort of certainty of accommodation.

Policies to encourage savings are also necessary. The chief enemy to saving is that all interest in savings, including that which accounts for inflation, is taxed. The inflation component of interest must be removed from taxation.

Government Activity

There is perhaps more that Government can do, extending beyond policy setting, to direct involvement. It is acknowledged that this government has a doctrinaire aversion to intervention in markets, on the assumption that markets left to themselves will achieve equilibrium. However, as is evident with housing, in doing this, citizens are being denied effective participation in society. Markets only work within constraints and it is up to the Government to effect appropriate constraints to achieve market outcomes which serve rather than frustrate the community.

One set of interventions which may be worth exploring is the work done by the South Australian Housing Trust in the fifties and sixties of last century. This agency successfully moderated the housing market in South Australia to enable home ownership by a larger number of people than would have been the case otherwise. Its approach offers a case study of managed intervention which may be germane to this Inquiry.

As alluded to above, Government is also able to intervene through the set of policies collectively termed 'industry policy'. In Australia this has consistently failed to encourage investment which will deliver highly skilled manufacturing jobs amenable to location in regional centres. Failure to invest, or lead investment, in economic infrastructure has deprived regional centres of the public goods which would make them attractive for private investment in high value added industries.

Action in such policy areas could be used to relieve the eastern seaboard metropolitan population pressures which are driving demand for metropolitan homes against the wall of inadequate supply. Until this happens we will have an increasingly distorted, and fatally short term economy. This economy will not be able to deliver for Australians as a whole. It might deliver to the powerful and wealthy (the inevitable outcome of markets run with the under-involvement of government) but it will fail the average Australian and threaten us in the long run with a fractured community. Fractured communities ultimately explode, history has shown.

Recommendations

- Develop industry policies coupled with infrastructure investment by government to lead to high value manufactures and services in regional centres, attracting population from metropolitan centres.

- Manage immigration such that prospective immigrants must live on restricted visas for a number of years in a regional centre before obtaining permanent residency status and freedom of location.

- Obtain States' agreement to stamp duty regimes which discourage high turnover of residential properties (often by business activity disguised as ownership) and ease first home owners' into ownership.

- Develop capital gains taxation rules which will discourage high rates of churn in residential ownership.

- Institute tax relief on investments and savings such that the effect of inflation is recognised. That is the proportion of interest income which is due to inflation is not subject to taxation.

- Change taxation incentives which attract excessive investment to property (speculative or otherwise) rather than productive investment.

- Develop managed intervention strategies to 'guide' the home market.

- Develop incentives to enable the development of properties for letting on extended term transferable leases.

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