Submission to the Productivity Commission on its inquiry into housing affordability by Peter Rosendorff, PO Box 659, Claremont WA 6910, email Editwest@iinet.net.au dated Wednesday October 15, 2003.

WA

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Productivity Commission
B2 Collins Street East
MELBOURNE VIC 8003

Dear Sirs

RE: Inquiry into first home ownership

Summary

The reason property prices have boomed are twofold:

1. **The first home buyers grant of $14,000 was not warranted because it interfered with the normal market forces.**
2. **The Prime Minister said home buyers did not need to provide a deposit because the Australian Government was giving first homebuyers the $14,000 to be used " as part of their deposit".**
3. **The banks began lending against people's equity in their homes so they could purchase more property**
4. **The taxation system allows negatively property to be tax deductible, no matter how many properties a person or company has.**

This is a submission from a person not involved in the marketplace but rather from an observer's position. I am not a member of any interest group. Like many people I have observed the real estate market and the stock market. And it is from this vantage point that I wish to make a submission. My comments are based on observations in Western Australia only.

There are several issues attached to the question of whether first homebuyers are being priced out of the home owning market. Australians are being told Australia is a free market based economy and while many think we are, Australia is not because there is Government interference at many levels. This in itself is not a bad thing – it's a fact of political life.

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It is when interference, particularly at a policy level (the political domain of the Prime Minister) goes awry that issues become noticed and when they become noticed the public becomes engaged in politics and policies come under scrutiny.

And this is what has happened in the first homebuyers market.

The decision to introduce a Goods and Service Tax was not carefully thought through. There were unintended consequences. The announcement of the GST decision caused a flurry of building activity both in the new home, first homebuyer and new homes, and in the renovation market as people rushed to avoid paying the 10 percent GST. Australians hate to pay taxation.

This outbreak of activity was good for the building and real estate industries but then the reality set in as building prices moved up, the cost of land moved up because holding costs moved up and eventually the building and real estate industries were being squeezed because no-one, particularly first home buyers, was buying.

Also interest rates were still relatively high compared to today of 4.75%.

The introduction of the GST was having a detrimental effect on the public psyche which was reflected in a slowing first home buyer market and the knock on effect to the retail sector in electrical, white goods and soft furnishings.

The Housing Industry Association began to lobby the Government and it responded with a first home owners grant of $7000, but this money from thin air did not kick start the industry. At the same time Liberal State Governments were falling, first Victoria, then Western Australia, I think there was only South Australia standing firm against the Labor surge.

On the eve of a crucial, politically crucial, by-election in Ryan, QLD, the Prime Minister announced the doubling of the $7000 to $14,000 for new homes while a grant of $7000 was available for existing residences.

This money was a handout to first time home buyers in which there were very little guidelines, unlike people seeking welfare assistance who are put through enormous hoops and are constantly having to justify themselves to meet new and changing guidelines.

The take up rate for this money was still slow until April 12, 2001 when the Prime Minister criticised Australian banks for refusing to include the Australian Government's $14,000 first home buyers grant as part of their deposit calculations (The Advertiser April 13, 2001)

The effect of that statement meant normal lending rules (back in the seventies single women who wanted to buy a property had to put down a deposit of 50% and have a stable employment record) were out the window.

Before that statement real estate agents and their representatives were arguing that the grant money should be included as part of the deposit. Basically anything to get people to sign an offer and acceptance was being tried.

Once the Prime Minister opened the Pandora's Box the market took off. One and two bedroom units leapt in price. (In Cambridge Street, West Leederville there are two almost identical blocks of units each with about 50 units in them, built in the sixties. These are number 40 and number 50. Units in 1999 were around $64,000 for a two bedroom unit. After the changes to the first home buyer grant these went up to $88,000 and unit 41/40 the market earlier this month 9 October) for $145,000.)

For the first time in Australian housing lending history the borrower did not have to put down any deposit for their first home. It had the effect of allowing people, using the $14,000 to borrow up to $280,00, (Previously they could borrow up to 95% of the purchase price, now it could be 100% with the Government providing the deposit, no questions asked.)

This was done all in the name of the offsetting the GST.

The snowball effect was people with existing homes could borrow against them, using the free equity to purchase more properties and negatively gear that property. All of which has been heavily prompted by the banks.

At the same time interest rates have come down to their lowest since the sixties which allows people to borrow even more.

When the "tax cut" of $4 a week came this allowed people to increase their borrowings.

All this in turn has led to a possible property bubble. I say possible because I believe it is an asset price bubble.

The asset bubble will break when interest rates rise because people will have to pay back more and therefore those borrowing will be borrowing less, therefore prices have to fall to meet the market.

The problem for Australians is they do not willingly accept capital losses. Real Estate agent Ray Fitzgerald of St Ives Real Estate, Wembley, believes the worst real estate market he had seen was in 1996 when the price of units, in particular dropped. It took investors four years to see prices return to their previous levels when many sold, glad to get out of the market.

Another reason why there will be an asset price drop will be the vacancy rate for houses and units.

Throughout the nineties and in WA historically the vacancy factor has been around 2%. Real estate and managing agents believe this figure provides a good balance between

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investors and renters in which neither has the upper hand. This has risen to 4% which the real estate industry now spruces as "normal", but when the amount of units under construction hits the market next year 2004, this vacancy factor will move towards 6%. In sections of the eastern states this figure has been met and widened further.

This will also put pressure on investors because the asking price for rents will drop to meet demand. That in itself is not a catastrophe because losses can be borne by the negative gearing in the taxation system. But it will have an effect at the margins.

It is also the first time in my memory interest rates have plunged and the house prices have rocketed at the same time as the stock market is again pushing towards its peaks. It usually works that one section of the market is up, be that house prices or the stock market but not both at the same time.

Inflation is under control, and must be kept within the upper limit of 3 percent as articulated by the Reserve Bank of Australia. In fact the RBA deserves a pat on the back in the way it has handled interest rates and inflation. Inflation must be kept under control or the economy will spiral out of control, i.e. "the recession we had to have" aka Paul Keating.

Which brings me to Stamp duty and the cost of land.

Stamp duty has risen faster than the inflation rate and herein lies a question, why hasn't the GST money flowed to the States faster. People in new subdivisions want – demand – the same if not better services than they had previously and definitely better than their parents had.

This puts pressure of the States to provide because the incumbent Government wants these votes at the next election.

In WA the Government wanted to put a "super tax " on properties with a land content of more than a million dollars. It was argued they needed the additional money to pay for services. The tax was dropped but the next WA State budget saw an increase in stamp duty. The "super tax" has been applied successfully in NSW.
The Real Estate Institute of WA cried foul because they believe the stamp duty is a disincentive for people to sell and buy another house. Partially they are right, but one of the biggest costs is their fees which pushes the price of houses and units up. The argument being is the purchaser pays for the fee not the seller. Either way this is also a reason prices are high.

Together stamp duty and agents fees put an extra minimum of 5 – 6% onto the price of a property. Holding costs of land are down because interest rates are down .

The sooner the full GST starts to flow to the States then other State-based taxes can come off or be lowered thereby reducing the cost of property.

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However I do not see that happening. If State taxes come off the gains will not be passed on to property buyers but I believe developers will hold on to those windfall profits. They have done so in the past and they will in the future, no matter how they sell the message.

Basically the Federal Government should not have tried to pump prime this section of the economy without sufficient checks and balances rather it should have allowed the market to correct itself.

Maybe I should get a $14,000 grant for making a submission to the Productivity Commission, but I won't be holding my breath.

Yours sincerely

Peter Rosendorff