SUBMISSION TO THE PRODUCTIVITY COMMISSION INQUIRY INTO FIRST HOME OWNERSHIP -BY THE SALVATION ARMY SOUTHERN TERRITORY (AUSTRALIA) OCTOBER 2003

Introduction

While the Salvation Army Southern Territory welcomes the inquiry into home ownership, we submit that to look at home ownership in isolation from analysing the effectiveness of the housing system in Australia as a whole, will miss the structural causes behind the current affordability crisis.

We submit that the Productivity Commission should look at cause and effect across the entire housing system. This will be the focus of the submission.

Background-crisis in the housing system in Australia 2003

Australia is currently in a housing crisis. Analysis of census data, of average rental costs for low income house costs, and the decline of low rent (private sector) housing stock show that the current policy settings are not meeting the general community's housing needs. In addition waiting lists for social (i.e public and community) housing continue to grow with little change in funding for growth at the Commonwealth level.

Structural factors at the root of the crisis

There are two sets of structural factors involved- broader changes in the economic arrangements/demographic changes, and housing system-specific matters. These latter have been caused partly by the former but also partly by the failure of government policy to address the emerging consequences of these broader changes.

The broader structural changes

These include

- The last twenty years of labour market reforms, and more general structural changes in the Australian economy. These changes relate to the move from an industrial to a post-industrial economy, which has seen the disappearance of most unskilled labour jobs. The result is that a group of community members have become what is in effect a permanent under-class, unable to access employment because of a range of disadvantages in a time of shrinking social services
- What employment growth there is for the low skilled has come in service industries, where work is unstable and often part time. This work has become increasingly difficult for The Salvation Army's traditional client base to access
- Change in household type/make up. The statistics on the prevalence of single parents with children among those community members under the Henderson poverty line are well known. In addition the last several Census data analyses have shown a big increase in single person households with obvious affordability and stock (to household) matching problems.

All of the above have had obvious broad effects on society, but in the context of this submission the concern is the way these changes have put the transition three-tier housing system in Australia under great pressure.

Before the 1980's more than 70% Australians would be expected to live in owner occupied housing, with around 20-25% living in private sector rental accommodation most of whom would move to home ownership later in life. The remaining 5-10% lived in State owned housing, which in itself was very different kind of housing than it is in 2003- in that where as much as 40% of such tenants were wage earners, with this proportion now at around 5-7%.

Changes in the housing landscape confronting low income earners

The current trends in Australia are

- The number of Australians in their 30's owning/buying a property will continue to decline[i], to as low as 20% by 2020 (from 50% now)
- Private rental properties for low income persons has become an relatively unattractive investment compared to selling and realising capital gain,
- Public housing investment has declined 28% in real terms over the last ten years[ii]

All this has meant that low income community members face a very different housing landscape currently. And this landscape is growing ever more difficult to navigate.

The specific housing system- related matters that have contributed to the crisis

These include

- A private rental housing sector which was never meant to house more than the 10% of the population who were working towards homeownership is now being required to house medium income earners, because of the difficulty in affording appropriate housing.
- Housing purchase affordability is at a 13 year low. Recent figures set the average first home purchase cost at $291,300. However in metro Melbourne this figure was $335,000 and in metro Sydney over $400,000.
- Ongoing backing away of State and Federal governments in matching increased direct housing funding to the growth of need for social housing
- Current (tax) policy instruments such as negative gearing and capital gains tax exemptions; discussed in detail below, do not act as an incentive to build low rental stock. The failure to respond to the need for increased low rent stock in the private sector has seen this stock declining since the mid 1980's.
  This need, relating to the boarder structural matters discussed above, has evolved into a crisis as the three tier (owning, private sector rental, social housing) housing system has broken down- with more relying on the latter two types a of housing in the face of decline in numbers of both these stock types.
- In addition to the above tax measures, others such as the increased First Home Owners Grant has contributed to overheating of the current market, resulting in low rent stock being sold off because of its new "value", and hence being loss to the private rental system.

In other words we have a system that has been headed towards crisis for some time. Current housing system policy does not address those flaws. In fact current policy fails to demonstrate any coherent framework or approach to housing need in Australia.

The best thought out policy can fail. But if there is no rational, strategic framework within which policy is generated, any response will fail.

The Policy and Funding Environment For Housing in Australia

Direct funding for social housing/low income persons assistance

The current (2003-2004) Commonwealth policy instruments for direct assistance for housing are

- Commonwealth State Housing Agreement (CSHA) funding to States for social housing less than billion dollars per annum)
- Commonwealth Rent Assistance (CRA) $1.8 billion

It is our view that CSHA and CRA funding are fundamentally different schemes, in that the first provides actual housing while the second is a demand side aimed at improving affordability. Does CRA work to increase low rent stock? The last complete analysis of census data shows that CRA has made no apparent positive impression on supply of low rent stock, which has in fact declined.[iii]

Neither has it had much effect on affordability in that it has simply become an element in the "pricing' of rents.

Tax incentives to increase supply in private sector (indirect supply-side effects)

The measures below are housing related and therefore are subject to analysis in this policy context. The question as to what extent they are designed to respond to housing (supply) matters, and to what extent they have other policy aims, such as increasing economic activity is somewhat moot when they have an apparent negative effect on affordable housing supply.

In any case a great deal of money is spent/foregone to support a housing sector, which must ultimately pay social dividends given the resources applied. If the sector does not we are entitled to ask

- What *does* it do, and
- Why isn't it addressing issues of housing need?

The following current measures are relevant

- The exemption from Capital Gains Tax (CGT) for the principal place of residence may have some policy justification, but at a cost of an estimated $9-13 billion [iv] it represents a significant inequity in favour of those who own homes over those who rent. On sheer cost alone the CGT exemption must be at least looked at from an equity point of view as the percentage of households who purchase houses declines even further (and fewer people gain the benefit of this exemption).

- In addition the reduction of CGT by 50% in 2001 has meant that in the middle of a housing boom investors selling residential properties (and therefore being subject to CGT) have reaped a likely total of several billion dollars in tax benefits.
- Negative gearing (i.e. claims for loss on operation of rental properties which can be taken as accredit against tax payable) Cost in 2003-2004 estimated $4 billion [v]

An example of the often hidden effect and cost of tax policy is in relation to the 50% exemption from tax payable on capital gains (i.e. profits) introduced in 2001. This measure almost certainly has contributed to fuelling the housing price boom because it has made housing, in the middle of a boom, an attractive place to maximise capital gain at a time the equity markets were declining. The boom has clearly contributed to the affordability crisis.

The cost of this in relation to investment properties is difficult to identify. But the following calculation is based on available figures

If around $70 billion is spent on buying existing homes[vi] per annum and investors are 36% of this ($70 billion) market[vii], then around $25 billion of this amount may be subject to CGT because it is for sales where the seller cannot claim the full "principal place of residence" exemption from CGT.

This is based on the assumption that investors seel (i.e. take their capital gain) as well as buy. Even if this figure is too high for the current year, as the sellers move in to take their profit, the cost of tax foregone because of this exemption will continue to be high.

Of the $25 billion, half or $12.5 billion is subject to CGT currently, but half is not. Of this "lost half" ($12.5 billion) probably around 40% (or $5 billion) is capital gains, given the increase in house prices during the boom since 1997[viii]. So if we assess the tax foregone on $5 billion (at say a personal tax rate of 41%) the cost is around $2 billion in tax foregone.

This is based on figures from the month of June 2003. An alternative calculation producing a similar amount is to look at June when $6 billion was spent on investment properties. That figure for the month of July was $5.45 billion and for August $6.81 billion[ix]. We again must assume a proportion of these purchases represents investors taking their profit. Hence a spiralling ride for property costs as investors move into the selling cycle.

So even if the above calculation turns out to be off the mark, we can see that if $70 billion (extrapolated) a year is spent on investment and a fair percentage of this money represent profits to selling investors, then the proportion of that amount that represents capital gains to investors is another confirmation that there is a cost in the billions for this exemption- as well as this having the effect of fuelling the boom in house prices.

If we add to this figure of around $6 billion (for negative gearing and CGT exemption), to the $1.8 billion in Commonwealth Rent Assistance paid annually with no evidence of a positive effect on low rent stock numbers, we get a total of around $8 billion per annum.

Surely the justification for this cost to the public purse had to be that this resulted in an increase in stock of affordable housing, since the reform has resulted in a significant shift in resources from the public purse to investor's pockets. Has this social outcome been achieved? There is no evidence that it has and much that it hasn't.

Beyond the Policy Framework –The Impact of the Housing Boom
Australians borrowed $61 billion in the year to March 2003[x] to buy or construct housing. This sounds a good thing given the shortage of affordable housing-any increase in supply must reduce pressure on the system. But the actual effect of this spending spree is much less satisfactory

Much of the money has gone into existing homes meaning relatively little new stock has been built and it is likely given its cost that an even smaller proportion than has been true in the past will become low rent stock.

But the effect of this boom activity is not just neutral in terms of its impact on low rent stock numbers, it's actually negative. This is because-although figures are not yet firm-it is likely that a lot of the poorer quality housing stock rented out has now been sold. This is because in a housing boom it I much easier to make money selling than renting. Again we see the cause for the decline in low rent stock availability.

What has the boom done to the shape of the housing market
We now have a housing boom dominated by investors who account for 36% of all housing loans. These investors are generally competing to spend money in established suburbs. In other words they're not helping to meet anyone's housing needs, there are arguably merely speculating.

The flow-on effects are numerous but, if we move away from our focus on low-income housing for a moment, perhaps the most stark effect has been on the average cost of houses for first home owners in Australia. The average is now $292,000 across Australia, but $335,00 in metro Melbourne and over $400,00 in metro Sydney

This has a number of potential flow ons for the private rental sector

- People who would, in usual times, move into home ownership will stay in rental putting pressure on stock numbers. Figures analysing the last census show the effect of this on low income renters is that the wealthier renters occupy a large proportion of low rent stock out-competing low income community members.
- Cheap houses previously rented out for modest rental are sold with only half of any capital profit taxable because of CGT changes.
- Investment in property is now a big money business. Where previously "ma and pa" investors would buy a cheap house to gain some rental income while the property appreciated in value over time, now investors with large debts are

looking to maximise any return. And of course if they don't to make money renting the properties to higher income renters (since no low income person could afford them) then the community ends up paying for it through allowances for negative gearing which I'll discuss below.

Some policy solutions
We have significant expenditure but no positive social outcome in housing. We submit that the federal should consider shifting its dollars to schemes that would actually address the problem-i.e. Give incentive to build low rent stock, and reduce pressure on house prices by limiting the incentives for unsustainable house price speculative booms.

As a concrete proposal we suggest that the Government investigate the impact of negative gearing and the recent Capital Gains Tax exemption to determine the effect of these measures on the supply on affordable housing. If such an investigation determines that there are not significant enough social gains to justify the expenditure it may consider implementing the following kinds of measures

- The proposal of Professor Gavin Wood[xi] to allow a tax credit of 2-4% on the costs of rental housing that is given over to management by a social landlord. This means the investor gets tax relief, and the community gets low rent social housing, taking pressure off low rent private stock.

- Invest in infrastructure to promote partnerships in social housing to bring into the sector the resources of the social and benevolent sectors. This could be facilitated by the setting up of an Affordable Housing Innovations unit, within a strengthened organisation for housing policy matters either within existing Department of Family and Community Services or in a new Department of Housing, with a housing Minister.

- Consideration of a scheme similar to the one put forward by the National Affordable Housing consortium where a bond issue is raised with the proceeds being used to build social housing. Capital is available to bridge the gap between a commercial return required by the bond and the actual rent receipts. This would mean that for a relatively small amount of money-compared to some of the costs outlined above- we could see the development of a thriving construction industry for social housing.

- More direct cooperation between the level of government including local government to identify resources from commercial construction activities and from existing government resources such as land, to contribute social housing to the local community. This would extend the social obligation to provide housing to the local communities. In other words a social contribution would become part of the benefit gained from an increase in commercial and residential building in a community

- Concurrent with the above the development of a National Housing Policy to bring coherence to the array of policy instruments with direct and indirect impact on the housing system. Given the billions of dollars involved and the evident need surely this is essential.

Major John Vale
Secretary for Social Programme
The Salvation Army Southern Territory (Australia)

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[i] The Age 5 August 2003 page 11. This figure is useful because it shows the future outcomes for young families, removing the need to distinguish those who had bought their homes before the current boom from the total ownership. If older persons are included it distorts the ability to measure outcomes for those buying in the future.
[ii] ACOSS "Public and Community Housing: A rescue package needed 14 Oct 2002
[iii] Cath Hulse 'Rent Assistance –time for a policy review?" Just Policy March 2002 VCOSS, and Wulff, Yates with Burke LOW RENT IN AUSTRALIA DFACS Canberra 2001, for stock numbers (decline in)
[iv] Judith Yates "A
distributional analysis of the impact of direct and indirect housing assistance" AHURI Aug. 2002 at vi.
[v] Tim Colebatch in "The Age" July 8, 2003
[vi] Tim Colebatch "The Age" 9 Aug. 2003 in June 2003 $6.5 billion was spent on existing home purchase. An annual extrapolation is around $70 billion
[vii] Tim Colebatch "The Age" July 8 2003
[viii] Richard Webb "The Sunday Age" Aug 17 2003 page 8
[ix] Josh Gordon "The Age" 14 October 2003 Page 1
[x] Tim Colebatch "the Age" 8 July 2003
[xi] Gavin Wood and Matthew Forbes "Fundamental tax reform and its impacts on alternative providers of rental housing" AHURI 2001