Productivity Commission Inquiry on First Home Ownership

Victorian Government Response to Discussion Draft

February 2004

Executive Summary

The Victorian Government welcomes the Productivity Commission's First Home Ownership Inquiry *Discussion Draft* report, and the opportunity to provide comments as part of the Commission's public inquiry process.

As outlined in the Government's original submission to this Inquiry, improving housing affordability and access is a key focus of the Victorian Government. Nevertheless, the co-ordination of multi-level Government contributions is important in promoting housing affordability and access. Commonwealth Government support for State initiatives is vital in this respect. Accordingly, the Victorian Government is ***concerned that the Commission has not adequately addressed the appropriate role of the Commonwealth***. For example, the development of regional areas and the funding of infrastructure are two areas where the Commonwealth's current contribution is lacking.

The Victorian Government is striving to improve housing affordability and access across *all* forms of tenure. For those on low-incomes, social housing and rental housing are particularly important. It is disappointing, therefore, that ***the Commission has failed to adequately address issues surrounding the Commonwealth State Housing Agreement (CSHA) and Commonwealth Rent Assistance***.

The Commission has recognised that the Commonwealth's taxation regime and the current system of Commonwealth-State financial relations have implications for the affordability of first home ownership in Australia. For its part, ***from 1 July 2004, Victoria will be the first State to abolish mortgage duty – a change to the taxation system that will assist first home buyers.*** However, the Victorian Government's capacity to absorb the financial impact of major changes to State property taxes on housing transfers are constrained by its financial arrangements with the Commonwealth. ***The Commonwealth's role in tax reform is potentially more significant.*** The Commission has recognised that capital gains and negative gearing arrangements have fuelled investor activity in housing markets during the price upswing.

The Victorian Government is pleased that the Commission has supported its call for the First Home Owner Grant to be better targeted to first home owners in need of financial assistance. To achieve this, the Victorian Government believes that the grant should only be available to first time buyers purchasing properties worth up to $500 000.

On the supply side, Victoria has taken initiatives to expand the supply of housing in a cost-effective manner. The Commission's *Discussion Draft* indicated the value of the *Melbourne 2030* strategy, but questioned the impact of its Urban Growth Boundary (UGB). The UGB has been introduced to ensure a sustainable future for Melbourne, and the Government has ensured that its impact on land prices will be minimal by announcing a commitment to maintaining 15 years' supply, and demonstrating this commitment with a substantial adjustment of the UGB where supplies were shown to be inadequate. An annual review process will assess whether further adjustments to the UGB are necessary.

As far as planning and approval processes for residential land are concerned, the Commission's recognition that Victoria is implementing best practice systems following the *Better Decisions Faster* review is welcome, and the Victorian Government looks forward to the Commission's recommendations about how these best practice methods can best be promoted.

The Victorian Government is of the view that ***regional policy can play an important role in improving housing affordability***. Affordable housing in the regions provides an opportunity to alleviate price pressures in metropolitan areas. The Commission's failure to consider opportunities in regional housing markets has resulted in only a partial analysis in the range of options to help first home buyers enter the housing market.

Structure of this Response

This response is structured as follows:

- An overview of the importance of considering housing affordability across all forms of tenures is provided in Section 1.
- Section 2 addresses the role of taxation in the affordability of home ownership.
- The Victorian Government's proposals for modifying the First Home Owner Grant are presented in Section 3.
- Given that cheaper and accessible housing finance has been an important driver of increased demand and rising house prices, Section 4 considers the appropriate regulation of mortgage brokers.
- Planning and supply issues are discussed in Section 5, with an examination of Melbourne's Urban Growth Boundary.
- Section 6 looks at infrastructure provision, and focuses on the Commonwealth's responsibilities in this area.
- Finally, the importance of regional policy in promoting housing affordability is reiterated in Section 7.

1. The importance of housing affordability across all tenures

The Victorian Government is concerned that the Commission's *Discussion Draft* report considers housing affordability only in the context of first home ownership. The Commission needs to work its terms of reference to look broadly at housing affordability issues across all forms of housing tenure.

First homebuyers do not only move from the parental home directly into first home ownership. Rather, many households use private rental accommodation (or public or subsidised social housing) either by choice or as a bridging form of tenure prior to achieving home ownership. Therefore, the costs of private or subsidised rental affect an individual's ability to save and, ultimately, his/her ability to purchase a home.

The Victorian Government believes the Commission's final recommendations should focus on policy settings impacting on housing affordability across *all* tenures.

Recommendations could include a review of Commonwealth policy settings that might have most impact on addressing the housing needs of low-income groups, and proposals to better target the First Home Owner Grant (FHOG) scheme towards low-income households. (The modification of the FHOG is considered in Section 3 below.)

The Commission itself suggests in the *Discussion Draft* that demand assistance to first homebuyers will have an inflationary impact on house prices, but that there is a public benefit in such assistance notwithstanding. The report states that "there is a question as to whether current subsidies to first homebuyers, including through [FHOG], might not yield a higher return to the community if spent in other ways, including promoting more affordable (rental) housing for low income earners…" (p. xxvi). That is, the Commission implies the need to consider affordability more generally, and that the Commonwealth should take a broader perspective on tenure as regards relevant policy settings.

As a first step, Victoria proposes consideration by the Commonwealth of other means to assist low-income households to enter home ownership, or be supported in affordable public or private rental housing. In this regard, consideration could also be given to expanding existing forms of housing subsidy through Commonwealth Rent Assistance (RA) and the Commonwealth State Housing Agreement (CSHA).

The Commission has failed to address one of the Victorian Government's primary housing affordability concerns in relation to the supply and cost of suitable rental accommodation for low-income people. As a matter of policy, the cost of public rental is constrained to no more than 25 per cent of tenants' income to preserve affordability. However, despite additional housing effort by the Victorian Government, real funding reductions under the CSHA have prevented public housing supply keeping pace with growth in the eligible population. This imbalance needs to be addressed through Commonwealth action.

Similarly, low-income private renters' access to RA does not guarantee affordability, and nearly a quarter of Victorian recipients pay more than 30 per cent of their income in rent. The Victorian Government believes the Commonwealth should therefore review the impact and adequacy of RA parameters.

Recent State initiatives

A substantial range of initiatives implemented by the Victorian Government are directed towards the achievement of long-term sustainability and growth in housing for low-income households. Accordingly, the Victorian Government is proceeding with implementation of a *Strategy for Growth in Housing for Low Income Victorians*, in keeping with its commitment to the development and implementation of strategies to provide better housing services, and to deliver growth in the supply of housing, for low income Victorians. In the 2003-04 State Budget, the Government committed $70 million over four years for this and related purposes.

In December 2003, the Victorian Government also announced the allocation of an additional $40 million beyond CSHA requirements and previously announced budget commitments to improve the supply of public housing throughout Victoria. These initiatives complement the Government's commitment to the 2003-2008 CSHA.

By these and other means, the Victorian Government continues to support housing for low-income Victorians through stronger partnerships between Government, non-government and private sectors in planning, funding and delivery of affordable housing, and a commitment to seek greater levels of private investment, and social and financial equity, in housing supply.

2. Role of taxation

The Commission has suggested that land transfer duty be replaced by less distorting taxes. Nonetheless, the Victorian Government agrees with the Commission's finding that removing stamp duties could not be expected to have a large effect on housing affordability.

Currently, Victoria collects taxes in the broad areas of payroll tax, taxes on property, gambling taxes, taxes on insurance, motor vehicle taxes, and licences and levies. Land transfer duty revenue was $2.1 billion or 23 per cent of general government taxation revenue in 2002-03. This compares with revenue of $2.6 billion and $0.7 billion from payroll tax and land tax, respectively, in the same year.

While the Commission has suggested replacing land transfer duty with an expanded land tax or payroll tax, these are not feasible options. A tripling of land tax or a near doubling of payroll taxes would be needed to replace land transfer duty. Increases of this magnitude are likely to have significant direct and indirect economic and social effects.

Victoria's alternative revenue-raising options are limited by the burden placed on Victoria under the current Commonwealth-State financial arrangements, with Victoria subsidising other States by over $1 billion in 2003-04.

The Commission also suggested the growth component of GST revenue as an alternative to land transfer duty. However, under the current Commonwealth-State financial arrangements, any GST benefits to Victoria will not be sufficiently large to fund the elimination of land transfer duty for some considerable time. While the provision of GST revenue to the states may eventually provide a more secure revenue source, the estimated growth in the GST revenue is still likely to be less than the growing demand for state government spending in key service areas. The decrease in GST grants is driven by demographic changes, as population ageing is likely to drive compositional changes in the consumption of goods and services. In particular, older people typically consume relatively more health services, which are GST exempt. As baby boomers increasingly draw on health services, and these services take up a higher share of their overall spending, GST revenue is likely to fall as a share of total consumer spending, thereby causing GST revenue to be less of a growth tax than previously believed.

Recommendations to change or remove taxes can only be sensibly made in the context of feasible alternative sources of revenue. Otherwise, the lost revenue will lead to a reduction in the provision of public services. States are key service delivery providers in areas such as education, health, community safety and public housing.

Where it can, the Victorian Government is introducing changes to the State's taxation system, which will assist first home buyers. From 1 July 2004, Victoria will be the first State to abolish duty on mortgages. It is estimated that over 400,000 individuals and businesses will benefit from this abolition, and the buyer of a median priced house in Melbourne will save over $1,400 as a result of the change. Furthermore, it is now estimated that the total benefit to all participants in the market will be in the region of $220 million per annum.

The *Discussion Draft* notes that negative gearing rules, high marginal income tax rates and the reduction in capital gains tax for assets held by individuals have increased the attractiveness of investing in residential property during the recent upswing in house prices. However, the Commission has failed to acknowledge that current Commonwealth policies do not provide incentives for investment in affordable housing specifically.

It is incomplete analysis for the Commission to identify that the Commonwealth's taxation system has had a significant impact on, and indeed distorts, the housing market in a number of ways, and then to argue that any examination of the tax system is beyond the scope of the current Inquiry. The Commission should take a holistic view of the housing sector and, at the very least, provide a qualitative assessment of the likely impact on first home ownership of Commonwealth taxes and options for addressing any distortions.

Recognition of even broader considerations is helpful if reform options are to be fully assessed. For example, the Victorian Government's capacity to absorb the financial impact of major changes to State property taxes on housing transfers are significantly affected by current system of Commonwealth-State financial relations – and this has not prevented the Commission from considering the issues and stating its views.

3. Modifying the First Home Owner Grant

The Victorian Government is pleased that the Commission has supported its call for the better targeting of the First Home Owner Grant (FHOG) to first home buyers in need of financial assistance.

The current eligibility criteria – established by the Commonwealth Government – allow wealthy first home buyers to access the grant to buy expensive dwellings. Indeed, in

Victoria, there have been almost 80 instances of the grant being used to purchase homes worth more than $1 million.

As the Commission acknowledges, there are administrative difficulties inherent in means testing the grant (e.g., based on the income of the purchaser). To better target the FHOG, the Victorian Government believes that the grant should only be available to first time buyers purchasing properties worth up to $500 000.

Such an approach would be simple to administer. It would also target the funds towards lower income home purchasers because of the strong link between the price paid for a property and the purchaser's income level. (This is because most Australians rely on a home loan to purchase their first dwelling, and borrowing capacity is directly linked to income.)

4. Availability of finance: Regulation of mortgage brokers

As stated by the Commission, the current housing boom has highlighted the need for appropriate regulation of lending practices and property investment advice. The mortgage broking industry has experienced significant growth in recent years. Mortgage brokers offer advice on products that will have similar implications for advice offered by financial advisers, but brokers are not subject to the rigorous conduct and disclosure requirements applicable to financial advisers under the Corporations Act.

Brokers routinely provide advice about the relative merits of credit products and make recommendations to consumers. Mortgage brokers are often the main (if not the sole) channel of communication between the consumer and the credit provider. The need to provide consumers with robust protection in connection with the marketing and sale of financial services is well established. Such protection is limited for mortgage brokers, despite the extent of the financial commitment represented when a person assumes a mortgage.

Further, the national Consumer Credit Code, as it applies to consumer credit, requires full disclosure of interest, fees and charges to overcome information asymmetry. Mortgage brokers can receive up-front and trailing commissions, as well as 'soft' commissions such as conference sponsorship and travel. They are required to disclose some, but not necessarily all, fees and charges.

Currently, the Commonwealth licenses persons offering advice on investments while states regulate mortgage brokers. The states are seeking a national solution to the regulation of finance brokers through the Ministerial Council on Consumer Affairs. However, the cooperation of the Commonwealth Government to work with the States in developing regulatory proposals for finance and mortgage brokers would facilitate national consistency and limit the potential cost to business.

5. Planning and supply issues

The Victorian Government supports the Commission's view that the "supply of land is inherently constrained from responding quickly to sudden demand pressures" of the type experienced in the last few years. In this context, it is important to note the Commission's finding that aggregate supply appears to be less constrained in Melbourne than other cities.

The Commission's concern about the impact of planning policies (such as urban growth boundaries) on land supply is understandable but, in the Victorian case, fails to acknowledge the clearly stated Government position on maintaining an adequate (15 year) supply of broadhectare land. The role of the Urban Growth Boundary (UGB) is to manage the direction of growth into sustainable corridors, while permanently protecting green wedges and other areas that are unsuitable or not able to be cost efficiently serviced for urban development.

The *Discussion Draft* states that there are “indications” that prices for broadhectare land within the UGB increased sharply just after the boundary was announced. However, the Government’s own research has indicated that this increase was the result of a combination of factors, not least of which was the rapid rate of land take-up associated with very high levels of housing demand and greater competition from large, interstate land development firms attracted to Melbourne’s comparatively robust and profitable housing market.

The Commission noted the Urban Development Institute of Australia (UDIA)’s view that the increase in broadhectare prices paid by developers reflected the industry’s uncertainty about the new policies in Melbourne. It is important to point out that recent decisions and actions have now clearly demonstrated the Victorian Government’s commitment to maintain a continuing 15 years’ supply. Following completion of the initial annual Urban Development Program cycle, the Government made a substantial adjustment to the UGB in Hume and south east Melbourne to make substantial additional land available for residential and industrial development. The Government is also giving a high priority to completing growth area plans for all metropolitan growth areas. The completion of the growth area reviews will provide much enhanced certainty regarding the form and extent of future urban development to the industry, councils and the community.

The Urban Development Program has been strongly supported by the UDIA and Housing Industry Association. It is now established as the primary mechanism for accurately determining the status of land stocks and assessing the need to make adjustments to zonings or the UGB to provide for future urban development needs. The successful implementation of the Urban Development Program and provision of unrestricted access to the data collected under this initiative (via the Department of Sustainability and Environment’s Land Channel web site) has greatly improved the industry’s understanding of current land supply across Melbourne and reduced the potential for uninformed decision making by individual developers.

6. Commonwealth funding of infrastructure

Proper planning and timely provision of infrastructure is critical to the orderly and efficient release of broadhectare land for new housing. This minimises the cost of infrastructure to both the developer/end purchaser and to Government. In Victoria, coordinated infrastructure planning has been strengthened under the *Melbourne 2030* strategy, which emphasises the role of the *Growth Area Plans* and *Committees for Smart Growth* in the planning and sequencing of infrastructure provision in growth areas. These initiatives, together with the *Compact City Key Direction*, will ensure that efficiencies can be realised and existing investment maximised while supporting new communities with the infrastructure they require.

In Victoria, the Urban Development Program undertakes a rolling annual review of land take-up and future development activity, reporting to Government on any changes in the timing of demand for infrastructure. It also identifies potential infrastructure constraints to future land supply and enables infrastructure providers to determine budget priorities.

In discussing the funding of infrastructure in its *Discussion Draft*, the Commission suggests improvements in the process of levying developer charges to finance the infrastructure relating to new housing developments. The Commission highlights the importance of coordination between State Government, local government and utilities, but the Victoria Government remains concerned that the role of Commonwealth in contributing to infrastructure needs has not been addressed by the Commission.

The ability of the States to fund the provision of critical infrastructure is constrained by current Commonwealth-State financial arrangements, which means greater reliance needs to be placed on the Commonwealth Government in financing major infrastructure projects. This is particularly the case in relation to urban transport needs and reducing congestion of the nation's largest cities.

The recent announcement by the Commonwealth Government that it will extend its *Roads to Recovery* programme is an acknowledgement of its responsibilities for the funding of transport infrastructure, and is welcomed by Victoria (although around one-third of this funding is subject to a process and criteria that are yet to be defined). Over the past decade, Victoria's share of national funding has been falling – a situation exacerbated in 2003 by the Commonwealth's refusal to honour its commitment of funding for the Mitcham-Frankston Freeway, or to re-allocate this funding to other major road schemes in Victoria. Under current arrangements, Victorians pay 25 per cent of the Commonwealth's fuel taxes, account for a similar share of the nation's population, yet receive only around 15 per cent of national road funding.

Sustainability of the urban transport system will be more difficult to achieve with forecast travel and freight growth, and the associated congestion impacts, which will have implications for general economic growth. The Victorian Government, through its *Melbourne 2030* Strategy, is supporting: (i) real travel choice and reduce inequalities in access to opportunities and essential services; (ii) more sustainable travel patterns with reduced environmental impacts; (iii) better use of resources by using infrastructure efficiently; and (iv) improve productivity in the movement of freight and high occupancy vehicles.

The Commonwealth Government can and should make a greater contribution than it has to date because of the significance of efficient transport to the national economy, and the fact that productivity dividends translate into higher Commonwealth revenues.

Proposals have already been advanced to the Commonwealth Government via the Victorian Submission to the House of Representatives Standing Committee on Environment and Heritage Inquiry into *Sustainable Cities 2025*. These are summarised in Box 6.1.

The Commonwealth is also failing to undertake its fair share of financing infrastructure associated with regional development initiatives. It has been left mainly to the States to address the infrastructure needs of regional areas, and the Victorian Government repeats its calls for the establishment of a Commonwealth Regional Investment Development Fund to augment funding already provided by the States. (The Victorian Government is playing its part – for example, through the recent renewal of its Regional Infrastructure Development Fund, with a commitment of a further $180 million over the next five years.)

Box 6.1: *Sustainable Cities 2025* – Summary of Victorian Government Proposals

a. Improved infrastructure has the potential to enhance productivity, and hence economic growth, which provides substantial benefits to the Commonwealth in increased tax revenue. The emphasis of such investment should be on improving the performance, efficiency and sustainability of metropolitan transport systems (irrespective of mode or types of solutions). Improvements to metropolitan public transport should be within the scope of Commonwealth programs.

b. Freight and passenger rail services interact along metropolitan and regional corridors. Public transport makes a significant contribution to the management of congestion which improves freight efficiency and addresses social needs. Solutions to improve transport efficiency need to recognise the role of public transport, particularly where the growth in travel is most intense.

c. The Commonwealth, working with the States and the National Transport Commission, can target improvements in the environmental impacts and energy consumption of commercial vehicles. The Commonwealth could also ensure that its policies do not promote inefficiencies. Some anomalies include: Fringe Benefit Tax breaks for executives driving at least 15,000 km per year but no comparable financial incentive for travel by public transport; lower import costs associated with off-road (4WD) vehicles that have higher fuel consumption and greater urban safety and environmental impacts than cars.

d. The Commonwealth could take a lead role in working with the States to ensure the development of nationally consistent criteria for assessing and prioritising investment projects. It could support development of nationally consistent principles in relation to road pricing and increase the application of Intelligent Transport Systems (ITS) to achieve urban sustainability outcomes.

7. Regional policy

In its original submission to the Inquiry, the Victorian Government emphasised the important role of regional policy in promoting housing affordability. By developing regional centres, and encouraging population growth outside the major cities, regional policy can ease the pressure on metropolitan house prices.

By ignoring the opportunities available in regional housing markets, the Commission's *Draft Discussion* report has omitted consideration of an important option to help first home buyers enter the housing market. Median house prices in regional Victoria remain 40 per cent lower than in Melbourne. Increasing numbers of consumers are already choosing to purchase homes in certain regional centres, and commute to work in the city, find employment locally, or re-settle after self-funded retirement. Without exploring this market response to increased housing prices in metropolitan areas, the Commission is only partially considering a very complex issue.

By supporting the Victorian Government in the development of regional centres and the promotion of population growth in rural and regional areas, the Commonwealth Government can ease pressure on metropolitan house prices and provide an additional stimulus for the regional housing sector.

A commitment by the Commonwealth is needed to further develop regional centres to take pressure off metropolitan house prices. The Commonwealth can encourage growth in regional areas – including housing – through a number of regional initiatives, including increased funding of more higher education places for students in regional areas, and encouraging skilled overseas, interstate and other migrants into regional areas to stimulate demand and boost local and statewide economic growth. The recent immigration initiatives favouring those intending to locate in regional areas is welcomed.

The attraction of first home buyers to rural and regional Victoria provides other significant regional, state and national benefits, including:

- stimulating additional regional economic development;
- developing a critical mass to maintain and improve services in regional areas;
- addressing skilled shortages that are prevalent in regional areas;
- stimulating investment and employment opportunities;
- increasing the regional demand for secondary and tertiary education; and
- creating more diverse and vibrant local communities including stimulating community and family orientated activities.

A clear and accurate analysis of the impediments to first home ownership by the Productivity Commission should include a geographical and spatial dimension to properly understand the impediments and, more importantly, the opportunities available in regional Victoria and other regional areas around Australia.

8. Concluding Remarks

The Commission has an historic opportunity to make an invaluable contribution to understanding the complex issues affecting housing affordability. However, it should not constrain its analysis to first home ownership. The Commission would fail to meet its Terms of Reference if it ignored the issues raised by the Victorian Government surrounding all forms of tenure and the role of regional development in promoting housing affordability.