
SUBMISSION BY THE

Housing Industry Association

to the

# Productivity Commission

on the

# Inquiry into Public Infrastructure

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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 40,000 builders, contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.

# 1 Introduction

## 1.1 About the Housing Industry Association

The Housing Industry Association (HIA) is the voice of the residential building sector, and represents some 40,000 members throughout Australia. The residential building industry includes both cottage construction and multi-unit apartment buildings. HIA's membership includes builders, trade contractors, design professionals, kitchen and bathroom specialists, manufacturers and suppliers.

The residential building industry is one of Australia's most dynamic, innovative and highly efficient service industries and is also a key driver of the Australian economy.

Over the past twelve months, construction employment grew by 1.4 per cent. This was slightly slower than the overall employment growth in the economy of 1.7 per cent.

The residential building industry has a wide reach into manufacturing, supply, and retail sectors. The aggregate industry value to the Australian economy is over $150 billion per annum, with over 1 million employees, tens of thousands of small businesses, and over 200,000 sub-contractors heavily reliant on the industry for their livelihood.

## 1.2 Significance of the Inquiry to Residential Building

The 'Issues Paper' released by the Productivity Commission defines three types of infrastructure being:

- Economic Infrastructure.
- Nationally Significant Infrastructure.
- Major Infrastructure Projects.

The first category, *Economic Infrastructure* is of most concern for HIA. This best defines the type of infrastructure needed to support residential building, both greenfield and infill development.

The economic infrastructure relating to residential home building is a fundamental component of new housing supply and is equally as important to Australia's economy as larger infrastructure projects in terms of productivity, growth, employment, and more so in terms of welfare, shelter and community.

Without the provision of appropriate infrastructure, major residential construction projects are at risk of not going ahead. These types of projects are substantial job creating opportunities in their own right, as well as generating significant economic activity in the broader economy.

Residential building is also an important precursor of other major development and infrastructure projects, providing shelter for growing communities.

HIA also notes the distinction drawn between *Economic* and *Social* Infrastructure, the latter of which would appear to be not included for consideration. Should the Productivity Commission make recommendations to the government on means to both provide alternative and innovative funding mechanisms for the provision of infrastructure and to improve its delivery, HIA considers that the application of these measures should not be limited to solely economic infrastructure.

# 2 Residential Infrastructure

## 2.1 Importance of New Home Building

Australia must build a considerably higher level of new homes each year than has been achieved in recent decades, to house a growing population. Australia needs to build at the very minimum 180,000 dwellings per annum over coming decades.

Over the last 20 years new housing supply has averaged around 155,500 dwellings.

Achieving a minimum new supply of 180,000 dwellings per annum would generate a number of positive outcomes for Australia, including:

- the adequate housing of Australia's growing population;
- improving housing affordability;
- creating an environment where housing supply could take pressure off federal and state government budgets, for example, through greater potential for ageing in place for Australia's population and reducing demand for social housing; and,
- encouraging stronger economic growth outcomes than would otherwise be realised due to the substantial reach the new home building sector has into the broader economy.

While cyclical recoveries in new home building can periodically boost overall supply, an annual build rate in excess of 180,000 dwellings per annum cannot be achieved and maintained under Australia's current taxation and regulatory environment because the costs are too high.

Research also shows how construction activity has wider economic effects. It is estimated that for every $1 increase in construction activity, GDP rises by $4.75 with obvious positive implications for employment at the economy wide level. It has also been estimated that for every 1 per cent increase in Total Factor Productivity in residential construction, GDP will increase by $2.36 billion.[1]

The impact of economic infrastructure delivery on the rate of housing supply is significant. In the current setting, the delays and upfront costs for funding economic infrastructure has been an impediment to housing supply in every state and territory.

## 2.2 Taxation Burden on New Home Building

In 2011 HIA commissioned an independent report into taxation on new housing from the Centre for International Economics (CIE). Information on all the taxes that contribute to the final price of a new home were collated, with figures then verified with a large number of residential building businesses.

When all taxes are included (direct and indirect), the taxation on a new house in Sydney is an estimated 44% of the purchase price, for Melbourne the figure is 38% and for Brisbane the figure is 36%. These figures have since been replicated in a further study conducted by CIE, which focused on smaller capital cities and regional centres.

Yet the burden of tax falling on the housing sector is considerably higher than the average for all other sectors. New housing in particular is inequitably taxed, accounting for around 1.2 per cent of value added in the economy while actually contributing 2.8 per cent of government taxation revenues.

[1] Centre for International Economics, Construction and the wider economy, an equilibrium analysis (2013).

The average tax burden on the new housing sector is estimated at 31 per cent of the value of output compared with an economy-wide average of 24.4 per cent. This percentage for new housing makes it the second most heavily taxed large industrial sector in the Australian economy.

These taxes include excessive infrastructure charges and are an example of a range of the hidden burden that not only adds to housing costs, but are also a wasteful use of resources, imposing deadweight losses on the economy.

A significant component of these taxes relates to upfront charges for infrastructure delivery at both a state and local government level. The bulk of infrastructure targeted by these taxes is by definition, economic infrastructure.

## 2.3 Provision of Infrastructure for Residential Building

Levies and charges applied to development to fund infrastructure significantly affect housing affordability. Further, an up-front charge against development is the least efficient manner in which infrastructure costs may be recovered and they are an ineffective means of funding long-lived community assets.

Development specific infrastructure - which provides essential access and service provision and without which the development could not proceed - is considered to be a core requirement for housing development and should be provided in a timely manner to facilitate affordable development.

It has been the position of HIA for some time that infrastructure items within the boundaries of the development should rightly be provided by the developer as part of the cost of development.

However, broader infrastructure that benefits the entire community - which we consider to be economic infrastructure for the purposes of this inquiry – should not be funded by new home buyers.

## 2.4 Current Funding Model

New home buyers are increasingly required to bear the excessive cost component of housing infrastructure, costs that permeate across housing stock and add to our housing affordability problems. However, local councils and state governments cannot afford the cost either, which has been the key driver of the increasing movement towards a user-pays housing infrastructure model over the last 15 years.

The cost of economic infrastructure adds substantially to the construction costs for new home developments. These are ultimately borne by the new home's first purchaser. The higher cost of new homes due to infrastructure costs also has detrimental effects on affordability in the established homes sector of the market, leading inevitably to a significant increase in mortgage repayments and indebtedness for all home buyers.

Economic infrastructure for housing adds to the economy's long term capital stock and provides wider benefits than just to the initial purchasers of the relevant homes. For example, the instigation of infrastructure in new developments will mean that the cost of infrastructure for any further housing construction in adjacent areas is likely to be significantly lower.

Similarly, the users of broader community infrastructure will never be solely those who pay these levies. Governments themselves surely recognise the economic growth benefits that more housing brings to their communities.

Other types of infrastructure currently paid for by home builders (like roads) are likely to have particularly high positive externalities. This is because they may provide considerable benefits to those not necessarily resident in the new dwellings.

The efficient provision of housing-related economic infrastructure is equally as important as the efficient provision of larger infrastructure projects. The Henry Tax Review found that of the vast array of taxes paid by the new home building sector, around half were highly inefficient, including excessive infrastructure charges.

The quantum of these inefficient taxes ranges from $45,300 on a new apartment building in Melbourne to $141,500 on a new house in Sydney.

A reduction in inefficient taxes in the sector that improved productivity by 1 per cent would increase national GDP by an estimated $780 million so that for every dollar of extra activity it created in residential housing, it would expand national GDP by an estimated $2.26. These estimates relate to a situation of full employment, which Australia is not currently experiencing. In a situation of less than full employment the new home building and wider economic gains would be greater still.

With the move towards direct charging of developers/new residents, there is inequitable treatment of new and existing residents. Even if new residents are charged a fair share of the capital cost (that is, the estimate reflects actual usage), the remainder of the cost of the facility, which benefits existing residents is usually funded by the council out of general rate revenue or grants from higher levels of government.

In cases where rates of new residents are not selectively reduced, there will be subsequent double dipping by councils, as the new residents are levied at the same rate as existing residents, despite the fact that they have already contributed towards the capital costs of the facility.

Any up-front contribution to the delivery of long-lived, income-generating community and trunk infrastructure is not supported by HIA. Up-front contributions create affordability barriers for home seekers by shifting the burden of borrowing for infrastructure delivery away from large corporatized local authorities on to the mortgages of the home owner.

Up-front infrastructure charges are not a cost that can simply be transferred on to the ultimate owner of a development. Development operates in a competitive market: the major competitor to development in the residential market is established property. The established market sets a price point against which new development must compete.

In current market conditions, and competing against established house prices, up-front charges for new homes are more likely to be accommodated by reductions in margins rather than price increases, damaging the viability of residential projects to the point that they do not proceed. This stalemate continues until established house prices rise – an inevitable feature of Australian housing due to housing undersupply.

Alternative funding models for housing related economic infrastructure would mean the removal of an inefficient tax on housing which would in turn provide a significant boost in efficiency and productivity to the economy, in addition to improving new home affordability and facilitating much needed growth in housing supply.

# 3 Infrastructure Funding Models

## Overview

Recent decades have seen an increase in the user pays approach to funding physical and social infrastructure to support residential development. Development levies - particularly state based levies or their equivalent - are a barrier to housing development and contribute to the housing affordability challenge facing many Australians. The levies are highly inequitable.

There is a strong argument for public intervention in the financing and provision of housing related infrastructure. HIA has considered four approaches to reducing reliance on up-front infrastructure charges.

- ***Commonwealth Government infrastructure bonds***, which would be tax preferred, and would see the Commonwealth Government support state and local governments to build new, and to revitalise existing, infrastructure.
- ***State Government infrastructure bonds*** modelled on the lines of the US local authority municipal bonds system.
- ***Local Government infrastructure bonds*** modelled on the lines of the US local authority municipal bonds system.
- ***Tax Increment Financing (TIF)*** under which a local (or state) government authority would designate TIF areas from which future tax revenues would be used as security against which long-term loans (from the commonwealth or the states) for capital expenditure could be raised.

## Commonwealth Infrastructure Bonds

The issuing of federal government bonds to fund the residential infrastructure requirements of selected new residential developments, or to fund a proportion of the residential infrastructure required for all new residential developments, would help ensure that projects proceed and that new home buyers are not burdened with excessive charges.

State and local governments would be required to offset the reduced cost of loan raisings by lowering the level of development charges applying to new residential development, including in-fill development.

While the bonds in question would offer inducements, such as preferential taxation treatment which incur a cost to the government, the additional offering required to meet infrastructure needs would represent a very small percentage of total bond issuance. Such a bond program would be attractive to institutional and self-managed superannuation funds, although the tax treatment of borrowings may need to be considered for self-managed funds.

Bond interest and capital repayments are financed primarily through charges on the infrastructure's users, which would be regulated objectively, with any increases linked to transparent metric such as the CPI.

The range of eligible projects for support by the issuing of bonds could be aligned with the various capital city strategic plans.

Developing a market that incorporates residential infrastructure creates the opportunity to 'bring the community on board' by implementing a framework allowing the offering of bonds to the household sector as well as to institutional and wholesale investors.

## State Government Infrastructure Bonds

The municipal bond funding model that operates in the US enables governments to raise long term debt to fund investment in long lived infrastructure by issuing 'muni-bonds' in public capital markets. This enables government to fund investment in infrastructure to meet the needs of the community today and into the future. Muni-bonds are attractive to investors as the interest income they receive is exempt from federal and most state taxes.

The tax-exempt status means muni-bond issuers only need to pay an interest rate that is comparable with the after tax rate of return that an investor would receive if they invested in the bonds of private sector issuers (assuming the same credit rating of both issuers). This means muni-bond issuers can borrow funds at low interest rates compared with private sector borrowers.

A muni-bond system would be viable at a state government level in Australia, where there would be sufficient demand for muni-bond style securities from institutional investors and from Australia's expanding superannuation industry, particularly where longer term secured returns are sought. Australian muni-bonds could trade within the existing debt market which adds to the attractiveness of the proposal.

Muni-bond funding for infrastructure in residential developments in Australia would have to be conducted through a general obligation-style bond (out of general revenue), as opposed to a revenue bond (linked to the revenue generated by a specific government project). In other words, interest liability would need to be funded by the general revenue of the issuing jurisdiction as residential infrastructure such as local roads and drainage does not generate a revenue stream to fund interest payments.

## Local Government Infrastructure Bonds

Muni-bonds could also be considered at a local government level. The fact that investors do not pay tax on the income they receive from muni-bonds provides local governments with a competitive advantage in capital markets. Furthermore, local governments typically have lower rates of default compared with private sector issuers.

Local governments in Australia maintain very low levels of debt because they do not have the capacity to internally generate the revenue required to service larger debt levels. Charging property rates is effectively the only method of taxation available to local governments and the rates are based on land values. Furthermore, increasing the amount levied can be restricted by policy settings imposed by higher levels of government (e.g. rate pegging in NSW). Rate revenue makes up around 38% of council revenue with the remainder primarily funded by grants from State and Federal Government and user charges and fees.

However, if a muni-bond style funding arrangement was to work in Australia at a local government level there would need to be significant reform to local government arrangements and it would need to be cost effective for the issuers.

## Tax Increment Financing (TIF)

Tax Increment Financing (TIF) is widely used for urban renewal funding and delivery in North America. TIF is a 'value capture' model whereby a portion of the increase in the value of property that is created in an urban renewal area is used to repay the cost of investing in public infrastructure up-front. The TIF model as it is applied in the US temporarily diverts increases in tax revenue attributable to a TIF project (referred to as the 'tax increment') to pay for the infrastructure improvement of that specific project.

The property tax revenue increase is used to repay government-issued bonds or privately secured loans which have been used to pay for the infrastructure up-front. Bond holders and investors receive a stable and long term investment (often incorporating favourable tax treatment) and the cost to communities of upgraded infrastructure is spread over a long period of time, generally 25 to 30 years.

A PriceWaterHouseCoopers study of the applications of the TIF model in Australia conducted in 2008 concluded that there were no insurmountable risks or barriers to implementing TIF in Australia. The key characteristics of TIF include;

- Infrastructure and service improvements are planned within a defined area.
- TIF improvements are designed to attract private developers to invest in specific projects in the district, thereby leveraging public investment.
- Tax revenue increases resulting from the improvements pay for the improvements, so no new taxes are created.
- TIF revenue can only be used in the TIF District for pre-determined improvements;
- TIF funding is intended to work with other existing public and private funding sources to attract new investment to the District.
- Once the cost of the improvements have been fully repaid (typically over 20 to 25 years), the full tax revenue stream returns to the original taxing authority.

## Advantages of a Housing Infrastructure Bond Model

Addressing the high cost component of infrastructure in new home prices has the potential to assist in the delivery of more affordable housing.

Not only is the cost of a home reduced, but the amount of borrowing undertaken by developers, builders and first home buyers is reduced as they are not required to finance infrastructure costs upfront, providing some relief to the difficulties in accessing finance since the GFC. Further, owners only pay for infrastructure while they live in the house – it is not permanently incorporated into their personal debt.

Importantly, improved housing affordability is likely to lead to increased activity in the new – and existing – home markets, and the cost of infrastructure financing is obtained at lowest possible cost, that is, through sovereign rather than private borrowing costs.

# 4 Impediments to Infrastructure Delivery

There are a range of impediments to the timely and cost effective provision of economic infrastructure. The additional costs associated with these impediments only serve to further delay projects that would otherwise be financially viable and could create new economic activity.

## 4.1 Industrial Relations

### Fair Work Act

Changes to the industrial system over recent years have added to the complexity and cost of doing business, in particular for large projects such as infill/ medium and high density residential developments, and importantly, the infrastructure supporting residential construction.

The Fair Work Act 2009 set out to create "a national workplace relations system that is fair to working people, flexible for business and promotes productivity and economic growth". However, the Act's reregulation of the labour market has not resulted in the promised productivity, efficiency or flexibility gains. Since the Act's commencement, the experience of industry is that the Act and its related legislation have:

- swung the pendulum too far in favour of employees with respect to several aspects of the Act's operation;
- failed to modernise, simplify and streamline terms and conditions of employment, with the modern awards introducing even further complexity to the regulatory framework;
- as a consequence of the new complexities associated with the bargaining process, together with the entrenchment of the role of the unions and significant limitation of options, discouraged enterprise bargaining and hampered the ability for businesses to flexibly structure working arrangements;
- failed to deliver productivity or efficiency improvements;
- failed to assist businesses in competing in a global market;
- negatively impacted on the cost structure and business practices of small and medium businesses;
- acted as a disincentive to employ;
- resulted in more adversarial, conflict based work environments;
- undermined direct engagement strategies; and,
- made it too easy for unions to interfere in the workplace and hamper the exercise of managerial prerogative in decisions concerning labour engagement and workforce structure.

In it's 2012 submission to the review of the Fair Work Act, HIA recommended that changes to the Act include: modifying the safety net to reflect simple, flexible and fair minimum standards; providing genuine exemptions to small business from unfair dismissal claims; keeping independent contracting out of the province of industrial law including the removal of restrictions on the engagement of independent contractors in EBA's; strengthening protections for small businesses against pattern bargaining;

limiting payments made under industry specific redundancy schemes to cases of "genuine redundancy" only; and, restoring individual agreements between employers and employees, subject to a no-disadvantage test.

## Industrial Action and the ABCC

The 2002 Cole Royal Commission detailed systemic lawlessness in the Australian building industry including illegal strikes, pattern bargaining, right of entry infringements and the coercion of non-unionised subcontractors. Although the ABCC has played an effective role in addressing this endemic culture of industrial lawlessness, its work is far from finished and it is important that a strong industrial framework is again put in place as a deterrent to such behaviour.

The absence of a strong industry watchdog has contributed to increasing the costs of building and developing associated infrastructure, ultimately adding to the cost of housing.

In 2003, Econtech prepared a study for the then Department of Employment and Workplace Relations (DEWR) that analysed the cost differences for the same standard building tasks between commercial buildings and domestic residential buildings. Using Rawlinson's quantity surveyor data, Econtech found that building tasks such as laying a concrete slab, building a brick wall, painting and carpentry work cost an average of 10 per cent more for commercial buildings than domestic residential housing. This difference was mainly attributed to differences in work practices between the commercial and domestic residential building sectors.

In 2007 a further report was commissioned by the ABCC which confirmed that the introduction of that agency coupled with other legislative reforms had improved work practices and lifted productivity in the commercial building industry. One measurement of its success was the narrowing of the cost gap between commercial and residential construction.

The Econtech report (now trading as Independent Economics) has been periodically updated including most recently on 26 August 2013 in a report commissioned by Master Builders Australia.

The updated report's findings include:

- In the absence of the ABCC during the Fair Work Building Commission (FWBC) era there have been significant losses in productivity. Consumers have been $5.5billion worse off, with higher construction costs reducing demand for new construction, including a 1.1% fall for residential construction.
- Because the building industry specific nature of regulation has been almost completely removed, it is reasonable to expect most or all of the productivity gains achieved during the Taskforce/ABCC era will be lost.
- According to Econtech, consumers will better off by $7.5 billion on an annual basis if the ABCC is reinstated.
- Even though detached housing is not within the jurisdiction of the ABCC, the residential building sector as a whole will still experience a productivity gain of 1.5% if the ABCC is reinstated.

HIA has welcomed the Building and Construction Industry (Improving Productivity) Bill 2013 and the Building and Construction Industry (Consequential and Transitional Provisions) Bill 2013 and urges all sides of federal politics to support it.

HIA particularly notes the inclusion of stronger penalties for unlawful action, the new offence of unlawful picketing and the inclusion of “offsite prefabrication” to the definition of building work in the Bill.

## 4.2 Red Tape

Unnecessary red and green tape across the building and construction sector – and in the delivery of associated infrastructure – results in time delays, inefficiencies and ultimately higher costs.

A significant example of red tape impacting on the sector is the contractor reporting requirements, which were introduced by the Commonwealth Government in 2012. These regulations require businesses in the building and construction industry to prepare and lodge an annual report providing the names, details and payments made to all contractors they have engaged.

HIA supports the government’s desire to deal with those businesses engaging in tax evasion and supports efforts to improve both voluntary and compulsory compliance with taxation obligations. However, this new regulatory framework imposes significant additional administrative and accounting costs onto principal contractors. Coupled with existing Business Activity Statement (BAS) reporting obligations, it adds a further compliance burden on business.

## 4.3 Planning

## Zoning and Land Release

The inability to identify cost effective means of funding and financing for housing related economic infrastructure has been an impediment to timely zoning and land release for new residential development.

The delays in funding and delivery of major infrastructure to service new land with water, sewer, electricity and telecommunications is often cited as a reason to defer consideration of zoning for new land releases.

The processes involved in the coordination of new land releases, both greenfield and infill, is significantly weighted to the ability of the utility providers to construct appropriate infrastructure. Simplistically, if water is not available within a 2-3 year timeframe due solely to the funding required to construct large scale trunk infrastructure, then approval for rezoning will not be granted.

In other cases, residential developers can identify their own means of funding for infrastructure ‘ahead of schedule’ if this facilitates early zoning of land. However leap-frogging of development is rarely permitted due to the arbitrary limits enforced by utility providers.

Given the economic benefit that flows from residential development, these types of impediments needs to be addressed as part of the Inquiry with a view to ensure that where a residential development could occur but for the costs associated with infrastructure delivery, that innovative funding options can be used to unlock the potential benefits.