

Submission to the Senate Inquiry into Affordable Housing

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Thank you for the opportunity to submit a response to the Senate Inquiry into Affordable Housing.

This submission considers the impact of government policy on the affordability of housing in Australia and in particular addresses the following terms of reference:

- (a) The role of all levels of government in facilitating affordable home ownership and affordable private rental, including:
 - (i) The effect of policies designed to encourage home ownership and residential property investment
 - (ii) The taxes and levies imposed by the Commonwealth, state, territory and local governments
 - (iii) The effect of policies designed to increase housing supply, and
 - (v) The regulatory structures governing the roles of financial institutions and superannuation funds in the home lending and property sectors.

The submission intends to provide a high level overview of some of the key policies contributing towards high house prices and offers a series of recommendations for government action.

Introduction

Australia is in the midst of a housing affordability crisis, with house prices (and more specifically land prices) amongst the highest in the developed world despite the country possessing more land per capita than any other developed nation. This is an outcome that has been engineered over the past twenty-five years by countless government policies that encourage speculation in housing and restrict the supply of new properties.

High house prices are often viewed as a positive based upon the illusory “wealth effect” created by rising prices and are generally considered to be reflective of a healthy and booming economy. However, the underlying reality is that these price gains are largely driven by debt which at some stage needs to be repaid along with the interest accrued. This is fine while the economy is growing and house prices are rising but when economic conditions stagnate, the harsh reality sets in that we are a country saddled with staggering levels of private debt and very little productive capacity outside of mining.

High land prices have a considerable inflationary impact on our economy (and yet land prices are not included in the CPI). When property prices rise, workers demand higher wages to meet spiralling living costs and businesses increase the price of goods and services to meet rising overheads causing a vicious cycle of ever increasing prices. Our products become more expensive relative to those made overseas, which causes the demand for our exports to fall and when price conscious locals favour cheaper imported goods over locally made products, it becomes very difficult for our companies to compete. We are only now seeing the visible results of this with several large companies including Holden, Ford and Toyota recently pulling the plug on their Australian manufacturing operations. To compound matters, high land prices discourage people from pursuing entrepreneurial activities and creating new jobs to pick up the slack, as both the cost of living and cost of purchasing or renting space for their business makes it difficult to endure the cash flow bleed during the start-up phase. More money funnelled into an unproductive asset such as housing also means less money available for spending in other areas of the economy which further exacerbates the problem.

Whilst high land prices cause their share of problems, we need only look at the recent experience of a number of overseas countries whose property bubbles burst during the global financial crisis to see the negative repercussions of an abrupt correction leading to more affordable housing – recession, unemployment, bankruptcies etc. This is the conundrum faced by the government and unfortunately there is no easy solution. Ultimately the only way to resolve the housing issue is for house prices to correct to more affordable levels and to cleanse the economy of the significant levels of debt on household balance sheets. It is a case of accepting short term pain for a much healthier economy in the long term. We can either accept the inevitable downturn, learn from our mistakes and make the necessary reforms to ensure this doesn't happen again or we can go down the Japanese path of refusing to accept our fate and instead endure economic malaise for decades to come.

There is no doubting that politicians of both persuasions are well and truly aware of the situation and how it can be resolved. The two previous Senate inquiries into affordable housing in 2004¹ and 2008² identified many of the key issues and reforms required to address housing affordability. The problem is that politicians are also acutely aware of the negative repercussions of resolving the situation and no government wants to be responsible for this occurring on their watch. The issue is potentially the most significant for the Australian economy, yet is constantly dismissed by politicians on both sides of the fence who seek to distract the public with emotive social issues. Politicians and political parties are unfortunately largely concerned with being re-elected so there is little incentive, particularly in such a short political term of 3-4 years, to instigate any real long term reform. However I, along with many other Australians frustrated by this issue, would applaud and support any government with the courage to take the action necessary to resolve this crisis.

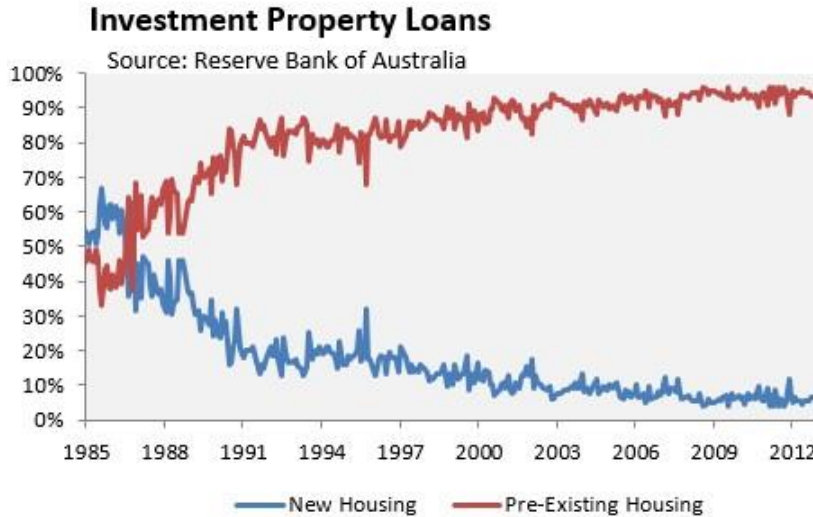
¹ First Home Ownership Report, Productivity Commission Inquiry, 2004

² A Good House is hard to find Report, Senate Select Committee on Housing Affordability in Australia, 2008

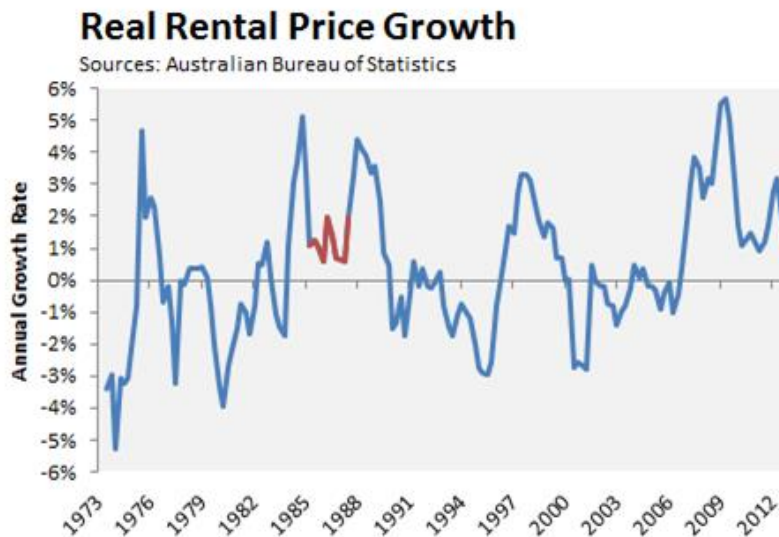
Government Policies Contributing to High House Prices

1.1 Negative gearing

The key objective of negative gearing is to increase the supply of properties by encouraging the construction of new dwellings but the reality is that over 90% of negatively geared investment loans are now used to buy existing dwellings so the policy is clearly failing. Negative gearing favours investors over owner-occupiers and only serves to compound the issue of affordability by increasing the demand for existing properties and encouraging investors to speculate on further house price increases. Furthermore, it costs the Federal Government an estimated \$5 billion a year in lost tax revenue.



The abolition of negative gearing is regularly promoted as a solution to high house prices but has been continually ignored by governments of both persuasions. Commentators with a vested interest will argue that it will result in an increase in rents as investors would sell off their properties reducing the supply of rental properties, however this ignores the fact that if a significant number of rental properties were to hit the market, prices would become more affordable and a number of renters would opt to become owner-occupiers so whilst the rental supply may shrink, so would the pool of renters. They will also point out the increase in rents in the mid-1980s when the Keating Government briefly quarantined negative gearing on new transactions to rental income only, however the 1980s was a period of generally high inflation and real rental price growth was actually relatively subdued during this period (as illustrated below). For this argument to hold any validity, rents should have increased across the country but the reality was that between July 1985 and September 1987, rent increases were actually isolated to Sydney (6.2%), Perth (10.7%) and Melbourne (1.1%) with rents actually falling in Brisbane (-7.6%), Adelaide (-2.0%), Darwin (-8.1%) and Hobart (-1.5%).



1.2 First Home Owners Grants / Boosts

First home owner incentives were initially introduced to offset the introduction of the GST and are designed to assist first home buyers in entering the market. The reality is that they merely inflate the cost of housing and bring forward demand by encouraging aspiring owners with insufficient savings to enter the market. The value of the grant is also generally leveraged which means that prices are increased by more than the value of the grant with the benefits accruing directly to the vendor.

1.3 Stamp Duty

Stamp duty is a significant cost to home buyers and many state governments have failed to adjust their stamp duty thresholds to keep pace with house prices which has led to a substantial increase in the average rate of stamp duty on a median priced house. Stamp duties are also inefficient and discourage people from moving to more appropriate housing types as their circumstances change. For example, younger people may be incentivised to purchase dwellings larger than they require rather than trading their way up as circumstances dictate and baby boomers may be discouraged from downsizing to smaller dwellings in retirement thus preventing these houses from being freed up for new families.

1.4 Lax Lending Standards

Undoubtedly the largest contributor to high house prices is the availability of credit. Deregulation of the financial industry in the 1980s caused an explosion of credit and competition in the sector, which has ultimately resulted in decreased lending standards (e.g. low doc and no doc loans), higher LVRs, interest only loans and longer repayment periods as financial institutions seek continual growth. These all contribute to increasing the amount of money that potential buyers can borrow to purchase a property putting upward pressure on the cost of housing. Looking at LVRs for example, a person with a \$50,000 deposit could pay \$1 million at an LVR of 95% but just \$250,000 at an LVR of 80%. A limitation on LVRs would place a restraint on the prices people can pay thus keeping prices under control and eliminating future susceptibility to significant price increases. Similarly with loan terms, someone with the capacity to make \$30,000 per annum in repayments could borrow \$273,237 over 15 years or \$399,951 over 40 years. A limitation of 15 years should be implemented and interest only loans (which are essentially perpetual loans) should be banned for home and investment property purchases.

1.5 Allowing people to borrow within their superannuation funds to purchase property

A recent government initiative that again only serves to increase prices. Superannuation is designed to reduce the government's aged pension obligations and is supposed to be a safety net for people in retirement, not a speculative investment vehicle. Allowing people to borrow within a self-managed superannuation fund significantly increases the amount of money available to invest in property and like the majority of other government policies, favours existing homeowners, particularly wealthy older Australians (most of whom would already own property). The other concern with this policy is that it introduces an enormous systemic risk to our aged pension system. If the property market declines and people are forced to sell at below purchase cost, a large number of people could see their superannuation wiped out and will rely on government pensions. Given we are heading into a demographic tsunami of retirements amongst the baby boomer cohort, any hit to superannuation will be borne by the taxpaying younger generations who are already struggling with the exorbitant cost of living (particularly housing).

1.6 Immigration policies

Policies to increase immigration without matching policies to increase supply add further upwards pressure to an already significantly overpriced housing market.

1.7 Relaxed foreign investment laws

Of greater concern than immigration was the decision to relax foreign investment laws. Whilst the government will try to assure the general public that foreign investors are limited to new builds and the policy is designed to increase supply, there are several problems with this. There are countless reports that these purchases are not being appropriately policed by the Foreign Investment Review Board (FIRB) and that purchases of existing dwellings are occurring unnoticed and it is also well known that many Chinese buyers are leaving their new apartments empty, which essentially does nothing to increase supply. It has been reported ad nauseam in recent times that wealthy Chinese investors are regularly outbidding locals, which further restricts our young buyers from getting into the market. One has to question why, when our country is already in the midst of a housing affordability crisis, we would open our doors to a flood of investors from a country with more millionaires than our entire population and who are

in the midst of their own colossal property bubble with prices in some cities such as Beijing as high as 34 times the median income?

1.8 Urban growth boundary restrictions

Urban growth boundary restrictions limit the supply of new properties and therefore act to increase prices. Whilst I am a believer in greater urban infill, I also believe that governments at all levels could do more to supply affordable housing in fringe locations and ensure that these suburbs are serviced by adequate transport and other infrastructure.

1.9 Making developers pay the cost of infrastructure in new estates

The shift towards developers paying for infrastructure in new estates rather than local councils has had a significant impact on the price of land, which has flowed through to the cost of existing properties, pushing prices up across the board. Developers obviously build these infrastructure costs into their prices meaning buyers need to pay significantly more upfront, money that will generally be borrowed and cost them significantly more in interest over time. Given the flow-on effect into existing house prices, every property buyer is essentially paying this extra amount in perpetuity and this is ultimately ending up in the banks' coffers through interest charged on the loans. It would make a lot more sense for councils to absorb this cost through some form of development bond and have residents repay the cost through council rates.

1.10 The exclusion of land price from the Consumer Price Index

How is it that the price of land – the largest expense in most people's lifetime – is not included in the Consumer Price Index (CPI), which is designed to reflect the cost of living and is used by the Reserve Bank of Australia (RBA) to set monetary policy in this country? The failure to include land in the CPI has masked significant inflation in the overall economy over the past 20 years. We have been led to believe that inflation has been running at 2-3% per annum during this period, yet the cost of land (which is the key driver of the increasing cost of housing) was increasing through the 2000s by upwards of 20% per annum. If land was included in the CPI, inflation would have been much higher and the RBA would have needed to increase interest rates accordingly to keep lending under control, which would have acted as a stabiliser for house prices.

1.11 Means Testing for the Aged Pension

The principal place of residence (PPOR) is currently not included in the means test for the aged pension but if a pensioner were to downsize and free up cash by buying a smaller residence, their aged pension entitlements would be impacted which, in conjunction with incurring transaction costs such as stamp duty, is discouraging many from seeking more appropriate accommodation for their needs and freeing up larger homes for new families. The simplest solution to this issue is to include the PPOR in means testing for the aged pension to encourage the elderly to downsize and free up cash.

List of Recommendations

- 2.1** Abolish negative gearing of property against other income. This would preferably be applied immediately and to all property, but if it must remain it should only apply to new builds to encourage an increase in supply, which is the underlying intention of the policy.
- 2.2** Remove all first home buyer incentives. If they must remain they should only be geared towards new builds to increase supply.
- 2.3** Eliminate stamp duty and replace with a broad-based land tax. This would assist in reducing the cost of housing, encourage greater mobility amongst homeowners, remove a significant impediment to people moving to more appropriate housing that reflects their needs and provide the State governments with a more consistent and reliable revenue stream.
- 2.4** Increase regulation of the financial industry: (1) Make it compulsory for buyers to have a 20% cash deposit (and possibly higher on second homes) and (2) Ban interest only loans on long term investment in property and limit home loan terms to a maximum of 15 years.
- 2.5** Repeal the legislation allowing SMSFs to borrow to invest in property and absolutely at all costs avoid introducing legislation allowing first home buyers to access superannuation.
- 2.6** Slow down the rate of immigration.
- 2.7** Impose a ban on foreign investment in residential real estate.
- 2.8** Relax the urban growth boundaries and consider the development of new cities between Melbourne, Sydney and Brisbane connected with super-fast rail.
- 2.9** Make ratepayers in new suburbs pay for infrastructure costs over time through council rates rather than capitalising the cost in land prices by charging developers. Consider introducing development bonds for new estates and infrastructure upgrades with proceeds collected by councils and investment in the bonds available to superannuation funds and the general public.
- 2.10** Land price should be included as a considerable component of the CPI.
- 2.11** Include the PPOR in means testing for the aged pension.

Conclusion

Considering the number of government policies identified above that encourage higher prices, it is difficult to believe that the issue is truly being taken seriously. Based on the past two Senate Inquiries into affordable housing, I fear this is yet another window-dressing exercise to give the illusion that something is being done about the issue with no real action taken. The necessary reforms have been there for all to see for a number of years but continue to be ignored by both parties. More disturbingly, the reforms that have been enacted regarding housing in recent years appear to have been designed to further spur demand and keep inflating the market (e.g. the First Home Owners Boost, allowing borrowing within superannuation funds to invest in property, relaxing foreign investment laws etc.). The reality is that previous governments of both denominations have done everything in their power to keep house prices inflated.

Politicians in this country need to realise that they are doing themselves a disservice by making short term populist decisions. The general public is crying out for a government that is willing to demonstrate real leadership – one with a powerful long term vision and the courage to execute that vision. I urge those in power to demonstrate the courage and conviction to do what is right for the long term future of Australians and not take the easy option yet again.