

# Affordable Housing in Australia

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Submission to the Senate Economic References Committee

by  
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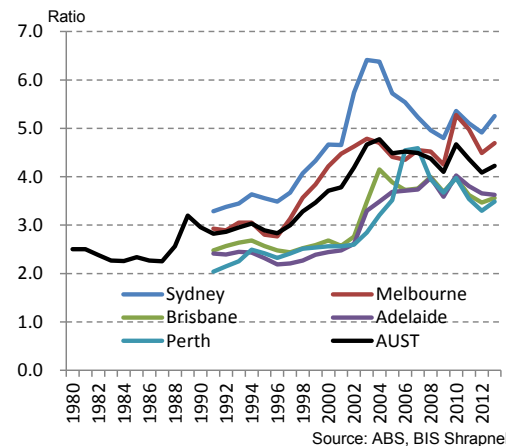
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## 1. Introduction

1.1 The high cost of housing in Australia is well documented, with Australian cities performing poorly in international comparisons such as The Economist House Price Index and Fitch's Global Housing & Mortgage Outlook, amongst others. The national ratio of dwelling prices to disposable household income has increased from 2.5 times the annual household income in 1980 to 4.2 times that in 2013 as shown in chart 1, which neatly summarises the deterioration in housing affordability.

1.2 Whilst there are many secular factors that contribute to rising house prices and deteriorating affordability, such as financial market deregulation increasing households' capacity to borrow and households' investment in improving existing dwellings, there are also a number of mitigating secular trends such as falling average dwelling sizes and an increasing incidence of dual-income households. Notwithstanding these structural and social changes, in this submission we argue that ongoing economic rigidities are key and that the primary factor underlying the deteriorating affordability of housing in Australia has been **the inability of supply to keep pace with the underlying demand for new dwellings**, and the resulting emergence of a significant national undersupply.

Chart 1: Dwelling price to disposable household income ratio

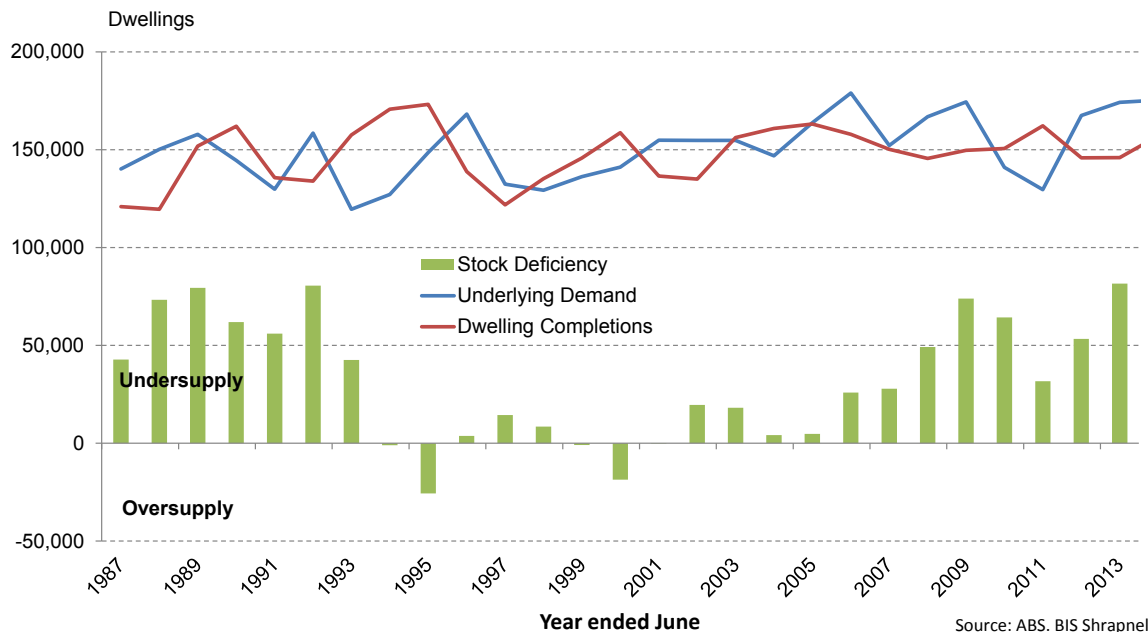


## 2. Australian housing unaffordability linked to dwelling undersupply

- 2.1 Chart 2 presents BIS Shrapnel's estimate of **national undersupply**. It is far from uniform across the country, with varying rates of population growth and differing state policies determining the stock balance in each state. New South Wales, Queensland, Western Australia and to a lesser degree the Northern Territory all exhibit the most significant stock deficiencies at present. South Australia and Tasmania have been able to avoid the emergence of a sizeable deficiency thanks to weaker population growth, whilst in Victoria and the A.C.T. new dwelling supply has recently proven more responsive to underlying demand.
- 2.2 Although it takes more than a significant dwelling undersupply to promote strong dwelling price growth, such a mismatch between supply and demand is a deemed necessary precondition. With such an underlying deficiency present, a period of low interest rates and strong confidence can then encourage dwelling prices to grow ahead of income and see affordability deteriorate as a consequence.
- 2.3 If supply were to respond speedily, poor affordability would be less prevalent. As chart 2 highlights however, when underlying demand picks up during periods of high population growth, dwelling supply does not always respond quickly. This reflects various roadblocks on the supply side of the market.
- 2.4 When new dwelling supply is unresponsive to an increase in demand the mismatch often results in higher prices instead of higher investment in new housing. Sanchez & Johansson (2011) refer to this as the 'responsiveness of new dwelling supply to prices' and identify the US as displaying the most price elastic housing supply of the selected OECD countries investigated, which in turn contributes to the much lower and steadier dwelling price to income ratio exhibited there (RBA, 2012). Australia's supply responsiveness lags far behind the US and acts as a contributing factor to the relative unaffordability of our housing. Therefore the aim of government policy must be to **improve this supply responsiveness** in Australia and thus enhance dwelling affordability.

- 2.5** The central thrust of our submission is that the primary aim of government policy must be to improve the responsiveness of the private sector in increasing new dwelling supply more rapidly in response to increases in demand.

**Chart 2: National demand & supply for new housing**



### 3. How can dwelling supply responsiveness be improved?

#### 3.1 Increasing the supply of developable land

- 3.1.1** Increasing the supply of developable land would serve to reduce its cost and promote new development. This need not just be **releasing new land** on the city fringes, but also by rezoning existing commercial and industrial land that may be more valuable as residential or increasing the height and density limits of sites. Implementing taxation reform to discourage 'land banking' and encourage the development of available land would also assist in increasing the supply of new dwellings. This would serve to limit future increases in the cost of land and ultimately improve the affordability of new housing.
- 3.1.2** The geographical limitations of Australia's coastal cities can sometimes pose a difficulty here. Australia has a significant capacity to **increase population density** across our cities which provides an opportunity to more efficiently use the scarce inner city and waterfront land. This would in effect increase the supply of available 'sky acreage' in the high demand and less affordable inner city locations. Melbourne's recent strength provides a good example, with the pro-development stance taken by the State and Local Governments resulting in a significant addition to new dwelling supply. This will serve to reduce the upwards pressure on house prices and rents and thus result in improved housing affordability over the medium to longer term.
- 3.1.3** Another opportunity to increase the supply of developable land is to promote the development of **regional Australia** and the non-capital cities, although the difficulties in promoting growth in regional Australia are less linked to the supply of land and affordable housing and more due to a lack of demand, with most households preferring to live in the capital cities due to the greater employment and lifestyle opportunities that they offer. However, if the economies of the major regional centres can be supported and growth encouraged this would serve to unlock a more affordable housing alternative to living in the capital cities as well as easing the pressures on the capital city housing stock by attracting demand away from these centres and diversifying the range of housing options across Australia.

- 3.1.4** Increased investment in transport infrastructure would assist in creating better linkages between the capital cities and regional Australia. By reducing travel times and transport costs to regional Australia the advantage of a capital city lifestyle over regional living would be lessened. It would help to make commuting to work in the capital cities more viable and thus help reduce the pressure on capital city housing stock. The same logic can also be applied to the outer suburbs of the capital cities. Technological advancements will also help 'reduce the distance' between regional and metropolitan Australia and should be leveraged by government to enhance the attractiveness of the regional lifestyle via investment in telecommunications infrastructure (such as the NBN) to take advantage of new opportunities.
- 3.1.5** Achieving such growth in regional Australia presents a daunting task, but the initial focus should be on providing employment opportunities in regional centres to encourage population growth and assist the local economies there in reaching a 'critical mass' that will promote further holistic growth. Government (both Federal and State) contributions to infrastructure (both social and economic) would assist in reducing the advantage of capital city living over the regional alternative, whilst locating particular government service headquarters in regional areas would provide employment, with Canberra providing a positive example of a similar growth strategy. Such a strategy would need to be well targeted and build on a region's existing competitive advantages. Capturing existing momentum by targeting particular growth sectors in specific regions with the potential for strong growth would help ensure the success of the program in the most efficient manner; for example: encouraging lifestyle demand in areas popular amongst retirees, or supporting the tourism sector to take advantage of increasing Asian tourism.
- 3.2** *Reducing the costs and red tape associated with property development*
- 3.2.1** A more direct policy response to improve dwelling supply responsiveness is to work with the property development industry to reduce the **regulatory requirements** associated with new developments. This must necessarily strike a balance between encouraging development and maintaining good planning practices but opportunities exist to ease the regulatory burden. Reducing the time taken to obtain a building permit would significantly improve the responsiveness of supply. Limiting developer contribution charges would encourage development whilst reducing the ultimate cost paid by the purchaser. These provide only a few of the more obvious examples and the barriers vary by state, but they highlight the fact that reducing constraints on developers will ultimately flow through to a greater and more affordable supply of new housing for the public, whilst also encouraging economic activity.
- 3.2.2** The cost of the required **infrastructure** associated with new development is another restrictive cost, with the burden for infrastructure which will often benefit the entire community falling disproportionately on the developer and thus new residents. A shift in focus could result in a more equitable sharing of infrastructure costs across all who benefit from them. There exists a role for government to play in funding and providing the necessary infrastructure here and the right balance must be struck between developers and government as to who foots the bill. This would help reduce developer contribution costs and thus help limit the ultimate cost of new housing development.
- 3.2.3** Example: The new Growth Areas Infrastructure Contribution (GAIC) Works In Kind (WIK) guidelines introduced by the Victorian Government are an example of a policy aiming to assist developers in avoiding infrastructure levies. The program allows developers to deliver the necessary infrastructure earlier instead of paying the cash levy. It is hoped that by allowing new housing and infrastructure to be delivered in tandem this will provide a more efficient way of planning and delivering growth infrastructure, but it remains to be seen how effective the new policy will be in reducing the costs of development.

### 3.3 Reducing uncertainty over planning regimes

- 3.3.1** Governments and their planning policies are a major influence on the volume and mix of building activity over time, state governments in particular. For instance, they either facilitate or hinder development depending on whether they operate an efficient application assessment system and governments affect builders via the more nebulous channel of uncertainty - which can derive from erratic approvals decisions, volatile project submission costs, or equivocation by legislators.
- 3.3.2** Planning agencies are charged with adequately providing for rising populations, taking steps to address land availability, identifying suburbs with potential, addressing the broader infrastructure needed for economic expansion, and so on. Their impact is not always easy to see because it only becomes visible over the medium term. They are sometimes thrown off course by competing community voices, and much can depend on details found at the level of implementation.
- 3.3.3** The prevailing **planning landscape varies markedly between the states**. At times the effect on building activity of state and planning authorities is relatively neutral, while at other times they can distort construction market patterns and opportunities to a significant degree. Uneven legislation between states adds to compliance costs, hampering factor mobility and restricting competition.
- 3.3.4** A situation of planning uncertainty is also unhelpful. New South Wales provides a current case study of this. In July 2011 the new O'Farrell government launched a comprehensive review of the planning regime. This resulted in a Green Paper, released in July 2012, which was followed in April 2013 by a White Paper entitled *A New Planning System for NSW*. The resulting system admirably seeks a streamlined approval track, called code assessment, designed primarily for growth areas. Under this code councils, in consultation with their communities, would be able to choose where streamlined assessment should apply by default, in advance. Legislation for the new planning system has passed the Legislative Assembly, albeit with significant amendments, but then when it came to be debated in the Legislative Council in November, the government chose to withdraw the Planning Bill. The effect is that things have been left hanging in limbo as we head into 2014. With the reform process currently on hold, supply may not reach its full potential.
- 3.3.5** Clearly **uncertainty over the planning provisions** in various jurisdictions will act as a constraint on dwelling supply. This area provides an opportunity for federal policy to work with State Governments to encourage 'best practice' planning practices that will promote new dwelling supply.

### 3.4 Mitigating risk in targeted housing provision

- 3.4.1** Risk mitigation in the wholesale housing capital market is another area where governments can play a role. Risk guarantees by the government can help minimise housing subsidy costs through efficient targeting and through the contribution of such risk management measures to attract private capital into affordable housing.
- 3.4.2** A structured debt finance approach to raising private sector capital for affordable dwelling construction, based on **public sector risk underwriting**, is one option. The role of government in this model would be similar to that played in the financing of other social infrastructure, such as schools or hospitals. A minimum income threshold would be specified and when the revenue flow is at or above this level, no government contribution is required, but whenever it drops below this threshold, government undertakes to fund the gap.
- 3.4.3** In the Australian context, the risk mitigation model was recommended by the Affordable Housing National Research Consortium (AHNRC, 2001). On the criteria of efficiency, equity and effectiveness, it was rated very highly. This model removes most of the risks of investing in affordable housing perceived by institutional investors, by transferring them to the government. The approach involves a **PPP that enables government to access institutional investment**

**dollars.** Notably, the housing bond model was shown to be highly efficient at leveraging private sector investment. Modelling indicates that the leverage ratio is around 5:1, under certain reasonable assumptions. That is, for every \$1 of taxpayers' money about \$5 of private money would be raised for affordable housing. This makes risk underwriting a vastly less expensive means of assisting affordable housing for governments than direct public sector construction of dwellings.

**3.4.4** In 2006, an Australian industry report recommended the housing bond risk underwriting approach to stimulate the supply of privately finance affordable housing (Property Council of Australia, 2006). The approach is also supported in the literature, for example by Milligan et al. (2004).

**3.4.5** The current NRAS scheme is another variation on the above theme.

Example: One risk mitigation approach is the Guaranteed Housing Bonds (GHB) model, where governments raise finance for affordable housing through the issue of a housing bond with a guaranteed minimum after-tax return. The funds can then be loaned to housing authorities, developers, or other eligible providers, at competitive rates, on the condition that the monies are used to construct affordable rental dwellings. The dwellings are then owned and managed by the approved providers. The risk guarantee can be provided in two ways: via a tax concession or through a budget outlay.

The GHB model is not unlike the Essential Function Bonds (EFBs) prevalent in the US. EFBs are housing bonds issued by local housing authorities to finance the construction of affordable housing owned by state or local housing finance agencies. As part of a broader effort to reform public housing in the US, the Quality Housing and Work Responsibility (QHWR) Act of 1998 authorised new ways to leverage capital and operating funds, and stimulated interest in bond financing mechanisms. A survey of local housing authorities discovered that since the QHWR Act, the use of EFBs surged (Apgar & Whiting, 2003).

California has a long history of housing bonds for affordable dwellings. The Department of Housing and Community Development, together with California Housing Finance Agency, administers the program which seeks to provide multifamily and special needs low-cost homes. The program began in 1988 with Proposition 77 which had an allocation of US\$150 million, and has grown to where it is today with Proposition 1C at over US\$2.8 billion. The bond plan is used to fund affordable home ownership programs. Around 50 percent of the funding helps families become or remain homeowners, including funding for the Building Equity in Neighbourhoods Program CalHome and California Homebuyers Downpayment Assistance Program.

The GHB/EFB model has the capacity to generate a large volume of private investment for affordable housing, and is simple and flexible to implement.

#### 4. Conclusion

4.1 As an independent voice we have focused on our area of expertise in this submission, as economists who analyse housing supply. We have emphasised the importance of policies focusing on the supply side of housing, which we feel has been neglected in favour of policies focusing on promoting demand. Below summarises the broad areas of focus we feel should be front of mind when drafting policy targeted at improving housing affordability across Australia.

Broad areas of policy focus:

- Focusing on policy promoting supply as opposed to promoting demand
- Reducing the regulatory burden and costs associated with development
- Increasing the supply of developable land
- Promote growth in regional centres
- Improve & streamline planning processes, whilst reducing uncertainty
- Mitigating private sector risk in targeted housing provision.