

Issues and Policy Options

Submission to the Senate Economic References Committee on Affordable Housing

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Attached are two short papers addressing key policy challenges directly relating to the terms of reference outlined for this inquiry:

- A. Housing affordability, especially for households in the bottom half of the household income distribution and
- B. The taxation treatment of housing

Each attachment provides a brief overview of the concerns which informed the policy proposals, identifies key issues to be addressed and lists a table of policy options related to each of these issues. More detailed material and evidence underpinning the proposals is available in the references listed at the end of this submission.

These proposals are based on a lifetime of academic research on housing issues in Australia. However, they temper academic purity with a dose of political reality. The material in them provided the basis for a briefing note submitted by the National Housing Supply Council to the then minister for housing in late 2012. The National Housing Supply Council was established in 2008 to assist the Australian Government improve housing supply and affordability for home buyers and renters. It was disbanded in late 2013. While the Council's contribution in identifying what it saw as the key policy challenges in the housing sector is acknowledged, this submission is made in a personal capacity.

Attachment A:

Issues & policy options for affordability & affordable housing supply

Background – affordability and affordable housing challenges in the 21st Century

Structural changes in the housing market have reduced access to owner-occupation for moderate income first home buyers and resulted in high levels of rental stress amongst lower income households in the private rental market. Addressing the challenge of ensuring access to affordable housing for everyone requires an understanding of the pressures in the housing market that have contributed to these adverse outcomes.

Note that this brief overview focuses on underlying structural factors rather than on cyclical factors that exacerbate or ameliorate structural trends from time to time.

For most of the past century, Australia's housing system has been dominated by private provision of housing. Post-war housing policies supported the growth of home ownership as the tenure of choice (and as a form of insurance that provide protection from poverty in retirement) and public housing provided a long term, affordable alternative for lower income households. Private rental housing was primarily a transitional tenure for young and mobile households.

This traditional foundation has been challenged by a number of structural trends. From the mid-1980s until the series of global crises that began in 2007, global trends fuelled housing demand. Real household incomes increased; disinflation meant that nominal interest rates fell and borrowing capacity increased; deregulation and financial innovation meant that finance was more readily available. These demand pressures have been exacerbated in Australia by population growth and by increased longevity. Increased demand, together with a sluggish dwelling supply response, contributed to dwelling prices rising ahead of household incomes and reduced access to home ownership for first home buyers.

Rising prices have contributed substantially to the wealth of home owners and this has reinforced the demand for larger and better located homes. This, in turn, has added to difficulties faced by first home buyers (and, consequently by renters). For over a decade, supply has failed to keep pace with increased demand. Any lack of confidence by Australian households in the Australian economy, depresses effective demand, but also aggravates supply shortfalls. In the longer term, if no intervention is undertaken to improve supply, underlying demand pressures are likely to keep aggregate house prices at levels that remain unaffordable for low and moderate income households and rents are likely to continue to increase.

Although the aggregate home ownership rate in Australia has remained relatively stable at around 70% for the past 50 or so years, this can be attributed primarily to the effect of the ageing of a population that gained access to home ownership before the structural factors outlined above limited first time home purchase to moderate to high income households (often two-earner households) or those willing or able to live in less accessible locations. Between 1981 and 2006, home ownership rates for households aged between 25 and 34 years old declined by 10 percentage points and by seven percentage points for those between 35 and 44 years old. ABS survey data from 2009-10 suggest this trend has continued with age-specific home ownership rates falling a further 5 percentage points for each of these key age groups since 2006.

Over the same period, the stock of social housing (covering public, community and affordable housing) has declined in absolute terms so that the total stock by 2006 was less than it was in 1986. Policy initiatives since 2007 (notably those implemented to stimulate economic activity to counter the effects of the Global Financial Crisis) temporarily halted the decline in the absolute size of the social housing stock but fell well short of halting the decline in the relative share of

social housing in Australia's housing stock. The combination of a decrease in home ownership amongst younger households (whether because of affordability constraints or lifestyle preferences) and the decline in social housing stock has created additional demand pressures on the private rental market, felt most severely at the lower end of the market. By 2010 the shortfall of private rental dwellings affordable and available for households in the bottom two quintiles of the income distribution was over 500,000 dwellings.

Of particular concern for the future is the high incidence of affordability problems amongst older low income renters - a group that is projected to increase in the next two decades as a result of the cohort effects of those currently excluded from home ownership - ongoing access constraints to this tenure and a declining relative share of social rental housing.

Policy options

The policy options in the table below focus on:

1. addressing problems faced by vulnerable and marginal first home buyers;
2. improving affordability in the rental market and addressing the decline in the availability of affordable rental housing; and
3. reversing the decline in social housing.

Although there is potential for considerable overlap in the options that focus on these problems, a consistent theme that underpins the options proposed is the simultaneous need for:

- supply side initiatives to increase the supply of affordable housing, both for home owners (whether these are first home buyers currently unable to access home ownership or established owners wishing to trade-down to more appropriate dwellings) and for those in the rental market;
- regulatory or planning changes to facilitate the provision and delivery of affordable housing; and
- demand side assistance for disadvantaged households, targeted in a way that will not create undue pressure on prices or rents.

A number of the options listed require relatively urgent attention because relevant processes are already in train (for example, the future of the National Affordable Housing Agreement), because the value of existing initiatives may be diluted if the momentum that has been established is not sustained (for example, that developed as a result of National Rental Affordability Scheme (NRAS) and the Nation Building Economic Stimulus Plan (NBESP) social housing initiative), or because the present state of the housing market provides an opportunity that is more likely to be politically feasible or even an economic imperative (for example, restructuring land taxes to stabilise State finances and encourage private investment in rental housing).

It is also evident that the idea of Australia as a home-owning nation is under some threat. Unless it is addressed soon, the rate of home ownership will fall appreciably as the population ages. While a declining rate of home ownership might not be perceived as a negative in its own right, it will almost certainly place additional demand pressure on the private rental market, increase rents substantially and place additional pressure on the already overwhelmed social housing system.

None of the options proposed below is easy – most require substantial resource commitments and all require patience, persistence and long-term, coordinated planning to deliver successful outcomes.

Issues	Policy options
1. Problem of access for FHBs	
1.1 Increase access for marginal FHBs	<p>1.1a Facilitate increased supply of affordable housing (eg planning regulations such as inclusionary zoning as in SA)</p> <p>1.1b Assist access for marginal purchasers (eg by targeting FHOOG by income and price point and limiting to new dwellings and providing transitional access to mortgage finance such as through KeyStart in WA)</p> <p>1.1c Expand role of hybrid tenures (eg such as shared equity programs as in WA, land rent scheme in ACT, indigenous co-ownership models or community land trust models as in US)</p>
1.2 Protect vulnerable purchasers from excessive stress	1.2a Develop appropriate safety net measures for vulnerable owners (eg along lines proposed in UK JRF Housing Market Taskforce report)
1.3 Reduce upward pressure on house prices	<p>1.3a Reduce demand pressures from established households by reducing existing tax incentives (eg CGT and land tax exemptions for owner-occupiers; asymmetry encouraging negative gearing for investors)</p> <p>1.3b Reduce cost pressures on new dwellings (eg by funding infrastructure from broad based taxes; by reducing obstacles to development in both greenfield and infill sites)</p> <p>1.3c Reduce land price gradients (adding to price pressures in established areas) by improving transport infrastructure, encouraging regional development</p> <p>1.3d Require housing impact statements to be developed for all major government portfolios to link housing to broader agendas</p>
2. Declining availability of affordable rental housing	
2.1 increase supply of affordable rental housing	<p>2.1a Continue NRAS (to build up confidence in key stakeholders providing and financing construction); provide subsidised access to well-located public land for Not for Profit (NFP) providers of affordable housing; build in incentives to ensure State contributions are mandatory; encourage appropriate planning regulations (as 1.1a above)</p> <p>2.1b Initiate and/or support establishment of a financial intermediary and products to encourage institutional investment and ensure affordable housing providers have access to (affordable) finance (to initiate new stock and to protect stock from sale after expiry of NRAS incentives after 10 years)</p>

<p>2.2 improve affordability outcomes for low income renters</p>	<p>2.2a Adopt Henry review recommendations regarding Commonwealth Rent Assistance (CRA; see also 3.1b)</p> <p>2.2b Protect public housing assets and ensure public housing is financially viable (eg by restoring annual funding through NAHA as co-investment)</p>
<p>2.3 reduce upward pressure on rents</p>	<p>2.3a Increase competition to the private rental market through increased supply of social and affordable rental housing (see 3.1 options, below)</p>
<p>3. Declining supply of social housing</p>	
<p>3.1 place social housing on a financially sustainable footing</p>	<p>3.1a Provide a guaranteed growth fund within NAHA (see 2.2b above)</p> <p>3.1b Require surplus funds and proceeds of public housing asset sales to be reinvested in social housing (or extend national regulation to public housing to ensure publicly funded community housing assets are retained in the social sector)</p> <p>3.1c Adopt Henry review recommendation by making CRA tenure neutral (extend entitlement to public tenants) and provide support services subsidy for high needs tenants (as option 2.2a above)</p>
<p>3.2 enhance pathways within and through social housing</p>	<p>3.2a Increase choice and mobility within social housing system (eg by integration of State Housing Authority and community housing registers as in Qld)</p> <p>3.2b Facilitate movement out of social housing (eg by increasing range of tenancy support programs such as the rental pathways scheme in WA)</p>

Attachment B

Issues and policy options for taxation reform

Background – the extent of housing taxation

The key taxes that are relevant to housing in the Australian tax system are, at a federal level, (individual) income and consumption (GST) taxes and, at a State or local level, transactions (stamp duties) and wealth (land tax and rates) taxes.

Stamp duty on transactions can discourage turnover, influence housing decisions and inhibit mobility. Land taxes favour owner-occupied over investment housing and can both encourage investment in properties where land is a small proportion of total value (such as apartments) and discourage large scale investors. The asset test on pensions can create “lock-in” effects that may discourage sales of housing.

While the effect of these specific taxes or exemptions can be considerable, they fall into insignificance when compared with the much greater concessions that apply through the income tax system. Other than recognition of the potentially distortionary and destabilising effects of an asymmetric tax system that treats gains and deductions differently, the AFTS Report made no observations about the potential impact of the income tax system on the housing system. Estimates of the extent of the various taxes and tax exemptions vary considerably depending on how these are defined but all (including official Treasury estimates) clearly point to the overwhelming dominance of tax expenditures over taxes with the capital gains tax exemption being the most significant of these.

This preferential treatment of housing has the potential to create inefficiencies in the housing market by encouraging excess consumption of and investment in owner-occupied housing and by distorting tenure choices. Debt-financed investment in housing, particularly for higher income households, is encouraged by the current tax treatment of rental housing which encourages households to negatively gear (recognised in the AFTS report as amongst the greatest tax-induced biases to the savings choices of households). This benefit is offset by the operation of state based land taxes which generally apply to the cumulative value of investment holdings and which are unnecessarily high because of the narrowness of the residential land tax base (as a result of exemption of the vast bulk of investment - that undertaken by owner-occupiers - from the land tax base).

An even greater concession to owner-occupied housing, however, arises because it is fully exempt from capital gains tax. It is also exempt from taxation on imputed rent (equal to value of rent saved from owning a home) but, against this, interest expenses and maintenance costs are not deductible. In its 2012 Tax Expenditure Statement, Treasury estimated tax concessions to owner-occupiers from the CGT exemption alone amounted to more than \$35b and were the largest of all tax expenditures estimated, accounting for approximately one third of total tax expenditures. In the absence of any form of income or land taxes on the family home, households are encouraged to build up significant holdings of their wealth in owner-occupied housing.

Distributional analyses of these concessions highlight the extent to which older, higher income households with high housing wealth benefit disproportionately compared with younger, lower income households who are most in need of assistance. The somewhat lower benefits for older, lower income households are reinforced by the exemption of the family home from asset testing for the age pension (higher income households are less affected because they will be excluded by the income test). This provides an incentive for households potentially eligible for the pension to maintain a high proportion of their wealth in the family home in the same way as tax incentives encourage older higher income households to do the same.

Policy options

The policy options in the table below focus on improving housing supply and affordability by:

1. reducing incentives that contribute to reduced affordability because they increase pressures on demand for housing, including speculative demand, without directly stimulating supply; and
2. increasing incentives for investment in affordable rental housing.

Tax policies directly affecting the cost of supply (including infrastructure charges), land supply and transfer policies (such as CRA and FHOG) are not covered here.

A consistent theme underpinning the options proposed below is the need to simultaneously:

- improve the efficiency of the current tax system as it affects housing
- reduce the impact of the tax/transfer system on dwelling prices
- improve the distributional impact of the current housing tax system

While the preferential treatment of owner-occupied housing has perversely contributed to the escalation of house prices and thus to the greater difficulties faced by many people in realizing their aspirations to home ownership, the political difficulties entailed in proposing any changes to the CGT-free status of owner-occupied housing are nearly insuperable.

A brief overview of the issues raised by the current tax transfer system was provided above. More details can be found in the background paper - *Architecture of Australia's Tax and Transfer System* - prepared for the 2009 review of Australia's Future Tax System (AFTS).

Issues	Policy options
1. High house prices	
1.1 Reduce demand for housing	<p>1.1a Reduce incentives for speculative investment in housing (eg by reducing asymmetric treatment of capital gains and interest deductions as proposed in Henry review and by quarantining losses)</p> <p>1.1b Reduce incentives for owner-occupiers to over-invest in housing (eg by removing exemptions from capital gains and land taxes)</p> <p>1.1c Facilitate downsizing (eg by reducing stamp duties for households moving to a cheaper dwelling and/or removing owner-occupied housing exemption from assets test; eg by replacing stamp duties with land taxes as introduced in the ACT)</p>
2. Lack of investment in affordable rental housing	
2.1 increase supply of affordable rental housing	<p>2.1a Reduce burden of land tax on residential investment (eg by broadening base to include owner-occupied housing and lowering rate)</p> <p>2.1b Remove disincentive for large scale investment in rental housing (eg by applying land tax on an individual property basis rather than on cumulative value as proposed in Henry review)</p> <p>2.1c Increase incentives to invest in low cost rental housing (eg by committing to continuation of NRAS to build on current momentum and institutionalise growth of the community housing sector).</p>

Selected additional material (copies available to the Inquiry on request)

Overview of housing market issues and evidence:

Yates, J. (2011) "Housing in Australia in the 2000s: Too Late on the Agenda", in Gerard, H. and Kearns, J. (eds) *The Australian Economy in the 2000s*, Reserve Bank of Australia, Conference Volume 2011, pp261-296

Australia's housing affordability problem

Yates, J. (2008) "Australia's Housing Affordability Crisis", *Australian Economic Review*, 41(2):200-214

Taxation issues

Yates (2010) "Housing and Tax: The Triumph of Politics Over Economics", in Evans, C., Krever, R. and Mellor, P. (eds) *Australia's Future Tax System: The Prospects After Henry*, Sydney: Thomson Reuters, pp233-265.

Home ownership issues

Yates, J. (2012) "Housing policies and wealth inequality" in Tomlinson, H. (ed) *Australia's Unintended Cities: Housing Markets, Policies and their Urban Outcomes*, Melbourne: CSIRO Publishing

Yates, J. and Bradbury, B. (2010) "Home ownership as a (crumbling) fourth pillar of social insurance in Australia", *Journal of Housing and the Built Environment*, v25(2): 193-211

Role of government, policy issues and policy development

Yates, J. (2013) "Evaluating social and affordable housing reform in Australia: Lessons to be learned from history", *International Journal of Housing Policy*, 13(2):111-133

Milligan, V., Yates, J., Weisel, I. and Pawson, H. (2013) "Financing rental housing through institutional investment", *AHURI Final Report No. 202*.

Yates, J. (2012) "Housing Subsidies" in Clapham, D., Clark, W. and Gibb, K. (eds) *The SAGE Handbook of Housing Studies*. Sage: London, pp 397-418

Yates, J. and Milligan, V. (2012) "Policies that Support Access and Affordability of Housing", in Smith, S. (ed) *International Encyclopedia of Housing and Home*, chapter 255, Oxford: Elsevier.

Lawson, J., Milligan, V. and Yates, J. (2012) "Housing Supply Bonds—a suitable instrument to channel investment towards affordable housing in Australia?", *AHURI Final Report no. 188*