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**The Henry
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Submission to the House of Representatives Standing Committee on Tax and Revenue's inquiry into Housing Affordability and Supply

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September 2021

Summary

- There are more, bigger, better, dwellings per capita in Australia in 2021 compared to any point in history.
- Multiple government inquiries at all levels over the past two decades have ostensibly sought to find the cause of house prices hidden in the pages of local zoning laws.
- Dwellings are assets and are priced based on financial market conditions.
- Density (dwellings per unit of land) and the rate of supply (new dwellings per period of time) are conceptually different but often confused in housing supply discussions.
- This submission argues that market housing supply has exceeded household demand. State planning systems have flexibly accommodated new supply while regulating the location of different types of dwellings.
- Compared to household incomes and rents, the cost of buying a home (measured by mortgage payments) in 2021 is historically cheap. This is due to lower interest rates and is why intercensal homeownership is expected to rise in the 2021. However, asset price adjustments will mean that this situation will not persist.
- Taxes on property are efficient and fair and do not add to housing costs but rather subtract from property values.
- Affordable housing is cheap housing. Cheaper housing means lower rents and prices. Any "affordability" policy that reduces market prices will remove billions in landlord revenues each year, transferring that value to tenants, and trillions in housing asset values, with that value transferred to future buyers.
- Fostering parallel non-market housing systems, just as public healthcare provides a non-market medical system, can be an effective way to improve housing affordability.
- There are no local, international, or historical examples of planning reforms leading to cheaper housing. Indeed, a Productivity Commission review concluded "given the small size of net additions to housing in any year relative to the size of the stock, improvements to land release or planning approval procedures, while desirable, could not have greatly alleviated the price pressures of the past few years." (p154)

Terms of Reference

The House of Representatives Standing Committee on Tax and Revenue will inquire into and report on the contribution of tax and regulation on housing affordability and supply, that is:

- Examine the impact of current taxes, charges and regulatory settings at a Federal, State and Local Government level on housing supply;
- Identify and assess the factors that promote or impede responsive housing supply at the Federal, State and Local Government level; and
- Examine the effectiveness of initiatives to improve housing supply in other jurisdictions and their appropriateness in an Australian context.

Background

The current inquiry replicates many previous inquiries over decades into the potential link between planning and housing affordability, such as:

- Menzies Research Centre: Prime Ministerial Taskforce on Home Ownership 2003
- Productivity Commission's First Home Ownership Report 2004 and Performance Benchmarking of Planning, Zoning and Development Assessments 2011
- Senate Select Committee report on Housing Affordability in Australia 2008
- Western Australia's Affordable Housing Strategy 2010-2020
- NHSC: State of Supply Reports (2008, 2010, 2011, 2012, 2013 onwards)
- COAG Review of Capital City Strategic Planning Systems Report 2011 and report on Housing Supply and Affordability Reform 2012
- Senate Inquiry into Affordable Housing, 2014-2015
- Parliamentary Inquiry into Home Ownership 2015

Many reports from think tanks like the Grattan Institute, the McKell Institute, AHURI, and others, have assessed the performance of Australia's housing system. Tens of thousands of workhours alongside tens of millions of dollars of salaries and fees have been spent on these reports.

This is also true outside of Australia. After multiple reviews in the past decade, the United Kingdom is currently seeking solutions to rising dwelling asset prices in its planning system. Researchers there are looking to Australia and the United States as examples of effective planning systems. Many parts of the United States are looking at the flexibility of the United Kingdom's planning system as the answer to their high housing asset prices—a puzzling circularity indicating that perhaps the answer to high house prices is elsewhere.

The reality is that Australia has more, bigger, better, dwellings per capita than any point in history (407 dwellings per 1,000 people).¹

This submission therefore concentrates on explaining the correct analytical framework for understanding housing markets and their incentive to supply new housing. At the very least, this document can stand as a reference anyone with an interest in changing Australia's housing system. It also espouses an approach to affordable housing that mirrors the effective approach taken to make healthcare affordable to all, by creating non-market systems in parallel to the market system.

¹ Murray, C.K. 2021. The Australian housing supply myth. Australian Planner. Volume 57(1). 1-12.
<https://doi.org/10.1080/07293682.2021.1920991>

What is the economic price of housing?

The first piece of conceptual clarity involves the price of housing. Are housing rents, assets prices, or both, a reflection of the economic price of housing?

The answer is simple. The economic price of a product is value of consumption sacrificed for it. In this standard economic framework, the price to occupy housing is therefore the rental price. If you did not rent housing, you could have spent the rental money on other consumer goods and services.

What makes housing rental somewhat different to the market for manufactured goods is that the rental price should be expected to track household incomes, irrespective of supply. This is because optimal allocation of budgets between alternative consumption goods usually arises when a fixed share of the budget is spent on each different good.² Figure 1 shows that reality matches this theoretical prediction, with Australian renter households spending the same 20% share of their income on rent in 2018 as they did in 1998.

For owners with a mortgage, annual housing costs (such as interest, council rates and body corporate fees) are also relatively constant. Both metrics do show some cyclical variation, perhaps reflecting temporary supply or demand shocks. Rising private rents from 2009 to 2013 coincided with lower housing construction after the financial crisis and booming immigration. The market has since adjusted through new supply to return this metric to its long-run average.

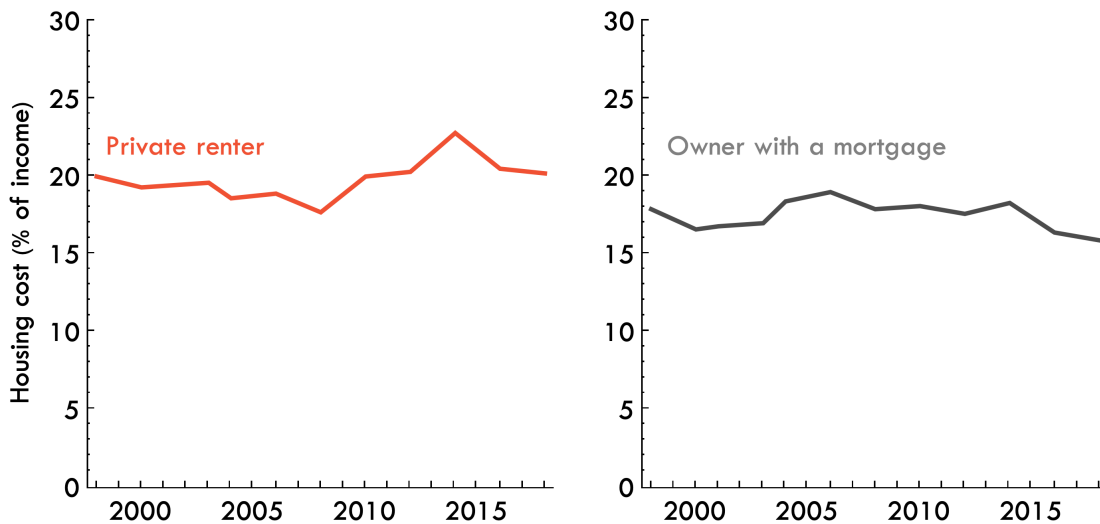


Figure 1: Share of income spent on housing in Australia³

² Most utility-maximising approaches to consumer choice generate the “fixed budget share” result. This means that if the price of housing per square metre rises, household still spend the same fixed share of the budget on housing but choose smaller homes (less space per person) and when prices fall, they occupy larger homes in superior locations until they have spent that share of income on housing.

³ ABS. 2019. 4130.0 Housing occupancy and costs, 2017-18. Australian Bureau of Statistics. <https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/2017-18>

Rent money from a bank or rent a dwelling from a landlord?

If the economic price of housing is the rental price, what does the price of dwelling assets represent? Strictly, this price represents the market assessment of the value of an asset that generates a return in the form of

- a) rental occupancy, and
- b) capital gains.

Both investor buyers and owner occupiers get the same returns (although with different tax treatments). An investor gets the rents as a cash payment, and an owner-occupier gets it in the form of occupation (avoiding paying a cash rent).

Variations in the price of dwelling assets that occur independently of variations in rents are therefore reflective of changes in asset market factors, such as interest rates, expectations of capital gains, and the tax treatment of returns to housing.

One of the major asset pricing factors is the prevailing mortgage interest rate. In a market like housing where bank financing of a high proportion of the asset price is available, this greatly affects asset pricing (compared to say, sharemarkets, where high leverage is not available at low interest rates and where commercial competition creates higher company risks).

Table 1 shows a hypothetical example of a dwelling that rents for \$20,000 per year and has \$6,000 per year in rates and maintenance costs that are paid by owners but not renters. Ignoring expectations of capital gains for the moment, the \$14,000 saved by owning compared to renting can be used to fund a loan so that a household can switch from being a renter and becoming an owner. That \$14,000 will pay the interest on very different loans depending on the prevailing mortgage interest rate.

Three interest rates and resulting loan sizes that generate a \$14,000 interest cost are shown in Table 1. At an 8% mortgage rate, a loan of \$175,000 costs \$14,000 per year in interest. However, at 2% interest rate, a loan of \$700,000 generates \$14,000 of interest—a four times larger loan.

Table 1: An example of an equilibrium condition in housing asset markets

Annual costs	Rent	Buy
Rent	\$20,000	\$0
Rates/maintenance	\$0	\$6,000
Interest on loan (borrowing 100% of the asset price)	\$0	\$14,000
Total economic cost	\$20,000	\$20,000
Asset price that equalises economic cost at different interest rates	8%	\$175,000
	4%	\$350,000
	2%	\$700,000

This comparison of renting and buying in pure economic cost terms (ignoring loan repayments and changes in asset prices)⁴ shows just how large the role of interest rates is on determining market prices.

The situation is slightly more complex than this. Dwelling asset owners also get an economic return from capital gains. The value of this expected gain is also incorporated into the price at different points in the property cycle.

In Figure 2 the logic shown of equalising the economic price for buying or renting (as per Table 1) is applied to Australian households over time. The red line shows the price where the interest payment (on 100% of the price) is equal to 25% of household income at the time of the purchase. The grey dashed line shows the actual mean dwelling price, which is usually above this “loan interest equals rent” price. The dashed black line is the equilibrium asset price of dwellings had interest rates stay fixed at the 11.5% level they were in 1981 at the start of this analysis.

This chart shows two things. First, dwelling prices are typically higher than is justified on the cost of replacing rent with interest payments (arrows mark periods where this is apparent). This is due to expectation of capital gains, which are also incorporated into prices.

Second, in the absence of interest rate reductions since 1981, dwelling asset prices would be \$325,000 on average today rather than the current \$754,000 (a 57% reduction).

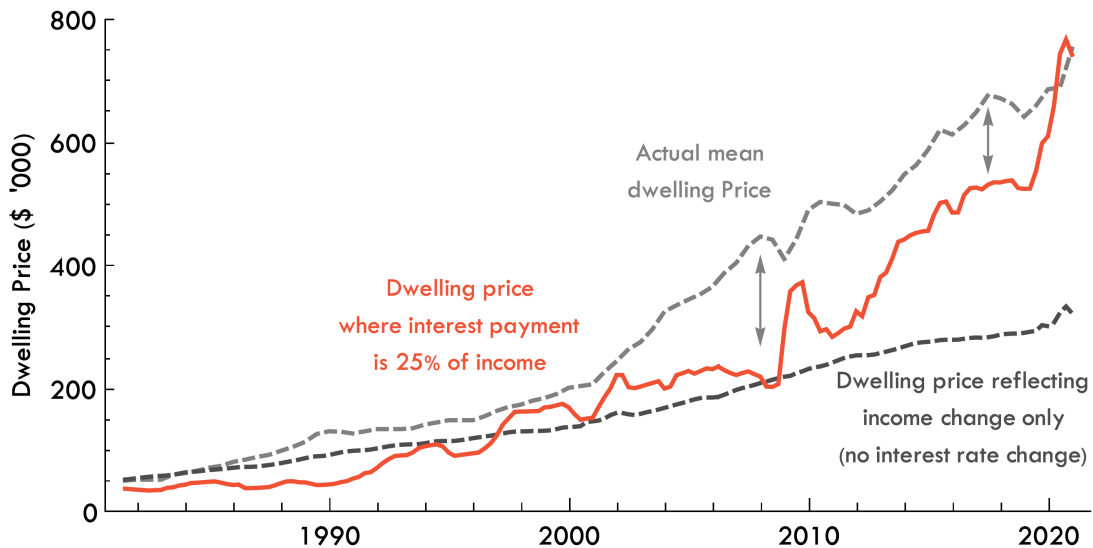


Figure 2: Dwelling asset prices where mortgage interest rate payments are a fixed share of income (red)

Note that this 57% lower price at higher interest rates would be equally affordable in terms of the economic cost of housing. The key concept here is that dwelling asset prices are not good metrics of housing affordability or the economic cost of dwellings.

This asset pricing issue is closely related to the use of monetary policy to stabilise the macroeconomy, as central banks and economic textbooks make clear.⁵ This is one reason dwelling asset prices are rising globally in 2021. Until a new macro-stability regime takes hold, a divergence of dwelling asset prices from rents and incomes may continue.

⁴ The repayment of the loan is a balance sheet reallocation, reducing a loan liability by exactly the amount it increases home equity. It is therefore not an economic cost to housing occupancy.

⁵ Bank of England. 2021. How does the housing market affect the economy?
<https://www.bankofengland.co.uk/KnowledgeBank/how-does-the-housing-market-affect-the-economy>

Homeownership

Australia was not always a nation of homeowners. Prior to the Second World War homeownership was below 55%, as shown in Figure 3. In the 19th century that rate was even lower, with estimates of homeownership in the major capitals of around 44% during the 1880s.⁶ Homeownership in Australia began to grow the 1950s, with the peak level of 71.4% in 1966. The latest census in 2016 had homeownership at 65.4% of households.

One social benefit of homeownership is that it is a way for households to “opt out” of paying the economic price for housing and being at the mercy of market forces and changing local conditions. Another is the security of tenure relative to Australia rental tenure, which compared to peer wealthy nations, provides little certainty long term or control over maintenance decisions.

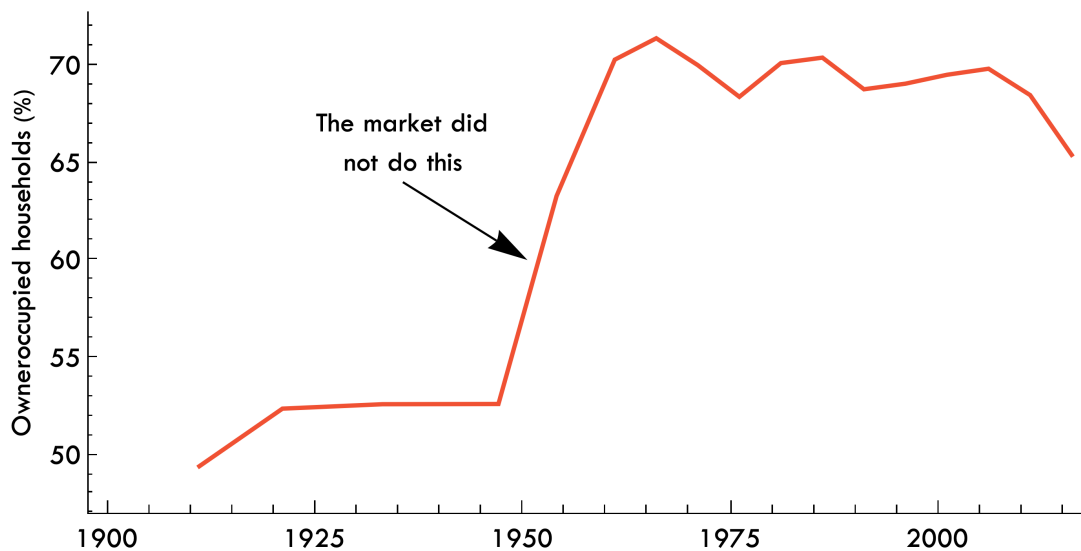


Figure 3: Australian long term homeownership rate⁷

Government inquires and reviews over the past two decades have focused on homeownership. Despite this policy attention, between the 2006 and 2016 homeownership fell from 69.8% to 65.4%.

To reverse this decline in homeownership requires that, on balance, investor landlords are sellers of housing and renters are buyers. Any policy that increases the reward to investors for selling property (or punishes retaining ownership) and increases the payoff for renters to become homeowners will help increase homeownership rates.

Historically these incentives were achieved from a variety of heavy-handed interventions in the housing system, such as

- rent controls that persisted post-war and incentivised landlords to sell,
- public finance for first home buyers building new homes, and
- large scale public housing with tenant purchase programs that attracted renters.

⁶ See commentary by Graeme Davison in Bluett, R. 2017. Australia's home ownership obsession: A brief history of how it came to be. ABC Radio National. <https://www.abc.net.au/news/2017-08-23/why-australians-are-obsessed-with-owning-property/8830976>

⁷ ABS. Housing tenure data in the Census. Australia Bureau of Statistics. <https://www.abs.gov.au/census/find-census-data>

One popular policy to increase homeownership has been cash subsidies to first time buyers. However, even the popular 2009 first home buyers grant was insufficient to arrest the entrenched 21st century trend of declining homeownership. One reason is that these subsidy scheme attract many new buyers and their effect of increasing prices became an incentive for landlords to retain ownership. The policy incentivised renters to become buyers, but also landlords to not sell. This dynamic is why the value of such subsidies mostly ends up in higher dwelling asset prices.⁸

In 2018, market conditions evolved to create a major shift in the composition of first home buyers and investors in the dwelling asset market. Prices nationally peaked in the December quarter 2017 and fell 8.6% by the June quarter 2019.⁹

One factor was a rising gap between the interest rate available to investor buyers compared to owner-occupiers. Figure 4 shows that mortgage lending interest rates for investors had a 5% cost premium (as a proportion of the interest rate) over owner-occupier mortgages in 2016, which grew quickly to 10-15% in 2017. This may have been partly the result of complaints and actions that led to the establishment of the Financial Services Royal Commission, which ultimately uncovered a destabilising appetite for high-risk lending.¹⁰ Whatever the reason, investor buyers have for four years faced a new financial disadvantage compared to owner-occupiers.

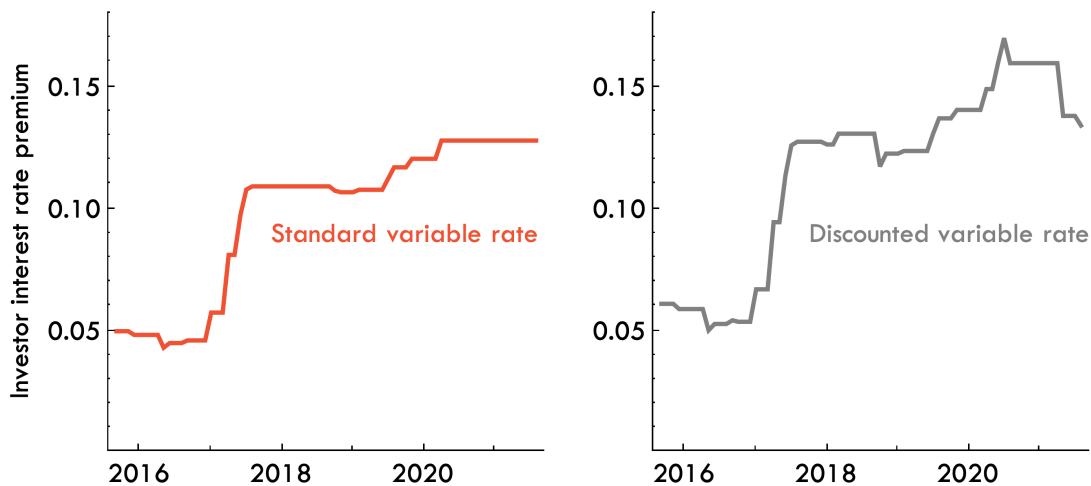


Figure 4: Rising interest rate premium paid by investor borrows (proportion of owner-occupier rate)¹¹

Combined with various other factors—including declining prices during 2019 and the HomeBuilder grant for new home construction introduced in early 2020—the result has been a shift in mortgage lending towards owner-occupiers and first home buyers. Figure 5 shows that from its peak of 45% mortgage lending in 2015, investor lending fell to 23% in 2020, while first home buyer lending rose from 14% to 26% over the same period.

⁸ Coates, B., and B. Nolan. Submission to Inquiry into the National Housing Finance and Investment Corporation Amendment Bill 2019 September 2019. Grattan Institute. <https://grattan.edu.au/wp-content/uploads/2019/09/Submission-to-Inquiry-into-the-National-Housing-Finance-and-Investment-Corporation-Amendment-Bill-4.pdf>

⁹ ABS. 2021. Residential Property Price Indexes: Eight Capital Cities. Australian Bureau of Statistics. <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/residential-property-price-indexes-eight-capital-cities/latest-release>

¹⁰ Hayne, K. Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry <https://financialservices.royalcommission.gov.au/Pages/default.html>

¹¹ RBA. 2021. Table F5 - Indicator lending rates. Reserve Bank of Australia <https://www.rba.gov.au/statistics/tables/>

It is unlikely that this shift will continue, as there are only a small number of households in a position to become first home buyers at any point in time. Recent conditions have allowed for first home buyers who have delayed purchases to finally enter the market and future first home buyers to bring forward their home purchase.

However, it demonstrates the key principle that homeownership rates respond to incentives that promote investor landlords selling and renters buying.

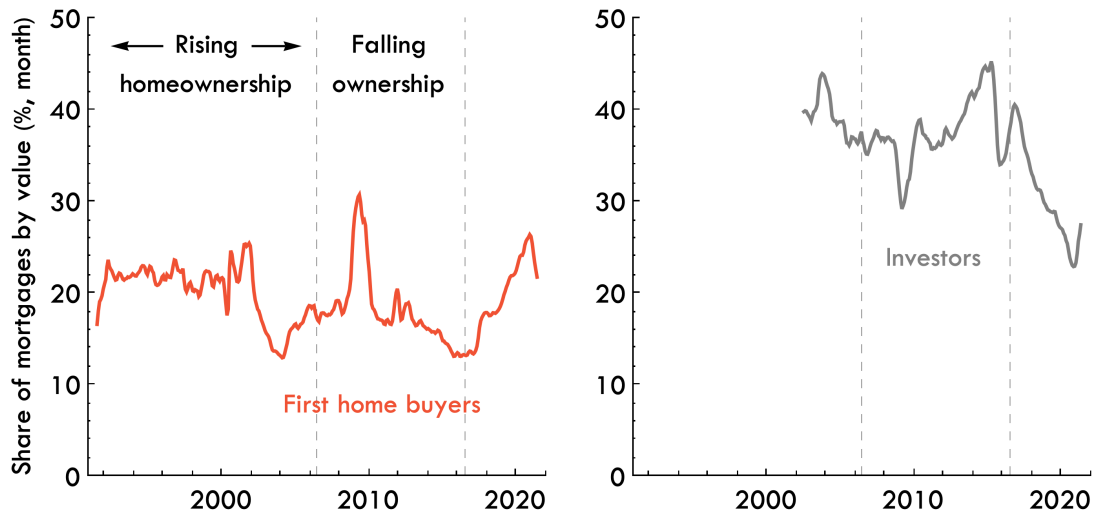


Figure 5: Share of new mortgages for investors and first home buyers¹²

Supply and the market absorption rate

The current inquiry, and many previous ones, have focussed on the rate of new housing supply as a potential underlying factor in the determination of dwelling asset prices.

However, the physical number of dwellings and the willingness to pay to occupy them generates a price reflected in housing rents (the economic price). Only through changes in rents can supply affect dwelling asset prices.

Figure 6 illustrates the divergence between rents and dwelling asset prices in Sydney and Melbourne in the past two decades. Since 2000, Sydney dwelling asset prices have risen 121% in real terms, and housing rents 16% in real terms (i.e. relative to the price of other consumer goods and services). The comparable figures for Melbourne are that dwelling asset prices increased 157% and housing rents by 8%.

The gap between the economic price of housing and the asset prices of dwellings can only be explained by other asset pricing factors, such as interest rates, expectation of capital gain, or potentially by changes to the tax treatment of asset returns.¹³

Perhaps, though, dwelling rents could still be lower if the rate of new housing construction was higher, and this would still flow into prices proportionally. While economic theory is clear that this would be the case, it is not clear whether there is an economic incentive for landowners to supply new housing faster, regardless of planning regulations.

¹² ABS. 2021. 5601 – Lending Indicators. Australian Bureau of Statistics.

<https://www.abs.gov.au/statistics/economy/finance/lending-indicators/mar-2021>

¹³ Asset price can be conceptualised as $\text{asset price} = (\text{gross income} - \text{costs}) / (\text{interest rate} - \text{growth expectations})$.

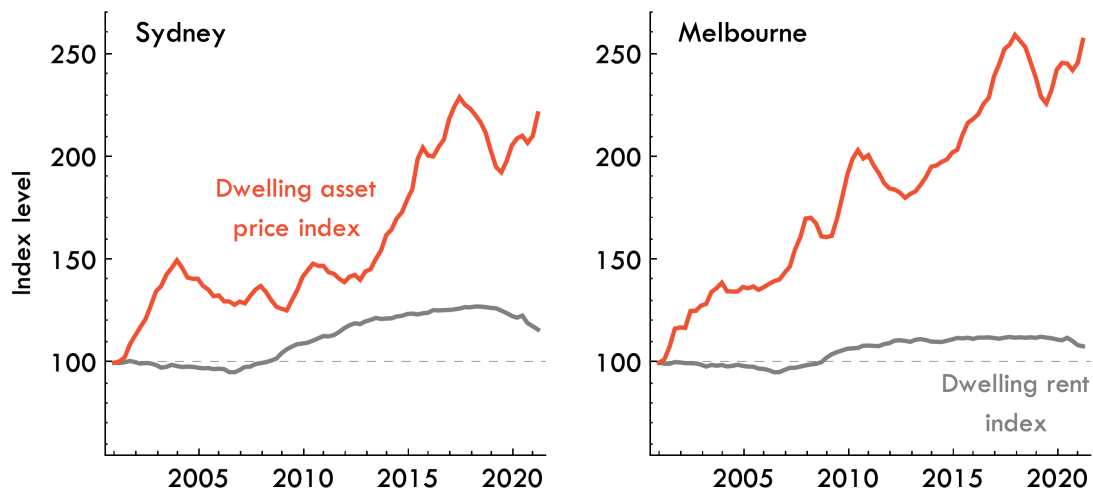


Figure 6: Divergence of real (non-housing CPI deflated) dwelling rent and asset price indexes¹⁴

Planning regulates the location of different dwelling types, not the rate at which they are built. Private landowners decide when and how fast to develop, and that rate of new dwelling supply is known as the market absorption rate.

Dwelling development is an asset reallocation decision, not a production quantity decision. However most economic analysis assumes that dwelling investment is output quantity decision with fixed capital assets (as per short-run supply-demand theory). Choices to develop new housing are tied to asset market factors, not production cost factors, such as construction costs.

Undeveloped land is an asset on a landowner's balance sheet like any other asset, earning a return in the form of capital gain. The cash needed to fund dwelling construction is also an asset. Only if swapping an "undeveloped land asset plus cash asset" for a "dwelling asset" increases total returns in will development be undertaken.

Figure 7 visualises this asset return incentive for developing housing. On the left are the two "asset stacks" involved in building a new dwelling. Before development, the site is an undeveloped land asset, and the cash required for construction is a cash asset. The total value of these two assets is equal to the value of a developed dwelling. If dwelling prices rise, the value of undeveloped land also rises until this value plus the cost of development equals the dwelling asset value. This is why the market price of undeveloped land usually grows and provides a return even in the absence of development.

On the right panel of Figure 7 is a representation of the economic return over time for the two alternative "asset stacks". The economic return is the slope of the growth in the total value of all returns from the asset. The return to the combined "cash and undeveloped land" asset comes from rising land value and the interest on cash. For the developed dwelling asset, the economic return is on the form of net rental income and capital gains. Only if the return from a dwelling asset exceeds the return from the "cash and undeveloped land" asset will development be undertaken. In this hypothetical situation, the return from dwelling assets is less than the return from the "cash and undeveloped land" asset.

This asset return requirement is why housing development can appear constrained at first glance. Many sites will remain undeveloped even though the price of housing assets exceeds development costs. But the constraint is an economic one, not a regulatory one.

¹⁴ ABS. 2021. Consumer price index and Residential Property price index. Australian Bureau of Statistics. <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release> and <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/residential-property-price-indexes-eight-capital-cities/latest-release>
Dwelling rent is the CPI rent index.

Furthermore, even when the asset returns are greater from new housing development there is a limit on the rate at which these new dwellings will be sold into the market. Since new housing is almost exclusively a build-to-order business, sales come before construction. This asset market's appetite for buying new dwellings will determine the overall rate of new supply, the absorption rate, regardless of planning regulations.

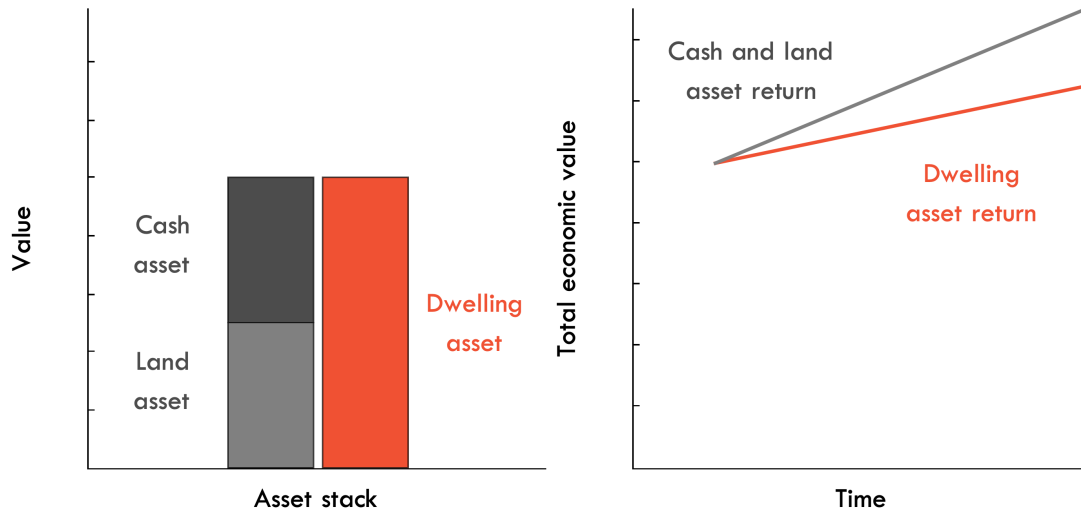


Figure 7: Conceptual representation of the economic incentive to swap assets to develop new dwellings

The limiting factor on the absorption rate is the degree to which new sales affect the growth rate of the market price. Selling faster (more sales per period) reduces the growth rate on local prices, lowering the price for future sales. The size of this effect depends on the rate of growth of market demand and the market “thickness” in terms of how many buyers are willing to pay the current market price.¹⁵

Planning regulations determine allowable densities at different locations but do not regulate the speed at which development is taken up across the market. A site with higher density (more dwellings per land area) will still have the same optimal rate of supply in the same market conditions (sales per period of time) as one with lower density.

Housing developers optimise both density and the rate of sales. Large housing developers landbank, holding undeveloped sites off market to ensure they match the rate of sales that maximises their total return on assets. In a 2020 study that reviewed the annual reports of Australia’s top twelve listed residential property developers landbanks constituted 13 years of supply at current rates.¹⁶ In these reports companies are obliged to be honest with investors (unlike when they comment to the media). Development companies reported that their landbanks were managed as assets, not inventories, targeting a rate of supply that maximised the value of these existing land holdings. This supports the analysis in this submission whereby asset-market factors determine the housing market absorption rate, not production cost factors.

¹⁵ See a full explanation of the market absorption rate in Murray, C.K. 2021. A housing supply absorption rate equation. The Journal of Real Estate Finance and Economics. <https://doi.org/10.1007/s11146-020-09815-z>

¹⁶ See Murray, C.K. 2020. Time is money: How landbanking constrains housing supply. Journal of Housing Economics. Volume 49. 1051-1377. <https://doi.org/10.1016/j.jhe.2020.101708>

The United Kingdom's most recent 2018 Letwin review considered this same puzzle and concluded that the market demand for buying new dwellings at the current prices limits the rate of new homebuilding.¹⁷ Surveys of housing developers also support this conclusion.¹⁸

Even in rental markets there is a limit on the rate at which the market will supply new housing. In one of Australia's first large build-to-rent estate, Smith Collective on the Gold Coast (the former 2018 Commonwealth Games athlete's village), the 1,251 already-constructed dwellings haven't taken over three years to be fully leased to renter households, despite record low rental vacancy on the Gold Coast. The asset managers have explained that "the precinct has been on a staged release strategy to not flood the rental market".¹⁹ Holding hundreds of dwellings vacant for many years maximised their overall return

Unfortunately, there is widespread confusion within the economic discipline about the market absorption rate. The time dimension, so important to asset allocation decisions, is usually ignored, resulting in the following shortcomings:

1. The planning system is assumed to be a constraint on the total stock of dwellings at any point in time rather than a geographic regulation on dwelling types
2. Incentives to supply are assumed to be reflected in dwelling asset price levels and not relative asset rates of return
3. Land price patterns are interpreted as being the result of physical constraints on the rate of redevelopment²⁰

The data on planning approvals shows just how flexible the system is across Australia in enabling the desires of market participants to vary the rate of supply. The New South Wales approvals in Figure 8 show both cyclicity and the increasing throughput of the planning system via Complying Development Certificates (CDCs) over the past decade. While still the minority share of applications in the planning system, the pattern here is that more developments are complying and fewer going through contestable DA processes, streamlining the regulatory checks on market dwelling development choices.

The cyclicity of market choices to develop new dwellings is apparent in Figure 9. Queensland data is available on the number of new dwellings contained in planning approvals, with new lot registrations being the result of approved and completed new dwelling development. The patterns are especially varied over the market cycle. The maximum rate of new detached housing lot registrations can vary by more than 100%, and for attached dwellings by 184%. The ability for the planning system to accommodate enormous variation in throughput from the market for new housing demonstrates that it is not a binding constraint on the rate of new dwelling supply.

To reiterate how much new housing has recently been built in Australia we can compare the 2008 forecasts of population growth and housing need from the then National Housing Supply Council (NHSC) with what happened in the subsequent decade.

¹⁷ Letwin, O. L. 2018. Independent Review of Build Out Rates. Ministry of Housing, Communities and Local Government.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/718878/Build_Out_Review_Draft_Analysis.pdf

¹⁸ Adams, D., Leishman C., & Moore, C. 2009. Why not build faster? Explaining the speed at which British house-builders develop new homes for owner-occupation. *Town Planning Review*. Volume 80.

¹⁹ Personal communication. January 2021.

²⁰ One popular approach compares the average and marginal prices of detached dwelling lots, following from the method first used in Glaeser, E. and J. Gyourko. 2003. The Impact of Building Restrictions on Housing Affordability. *Federal Reserve Bank of New York Policy Review*, 9(2), 21–39. However, this method does not reveal any information about supply or planning, as has been repeatedly noted in the academic literature, such as recently in Murray, C.K. 2020. Marginal and average prices of land lots should not be equal: A critique of Glaeser and Gyourko's method for identifying residential price effects of town planning regulations. *Environment and Planning A: Economy and Space*. Volume 53. 191-209

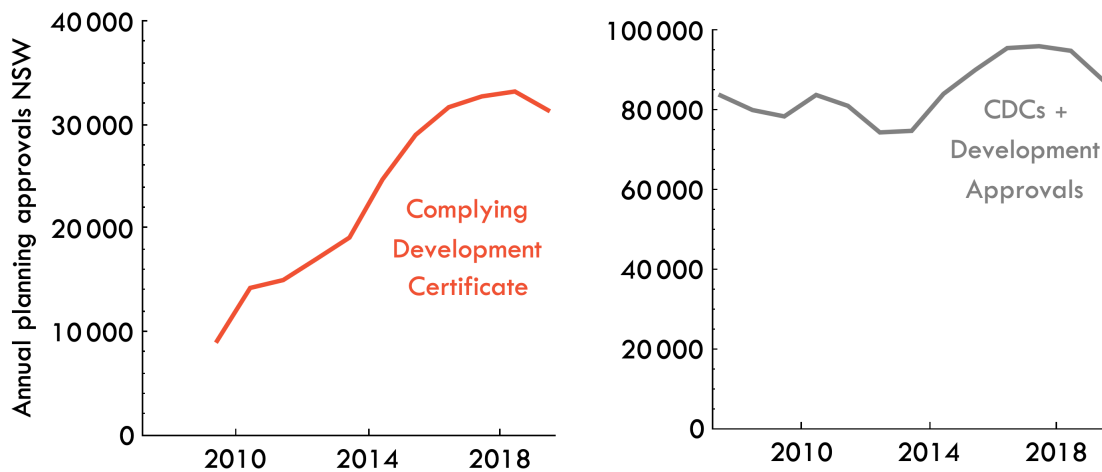


Figure 8: NSW annual planning approvals²¹

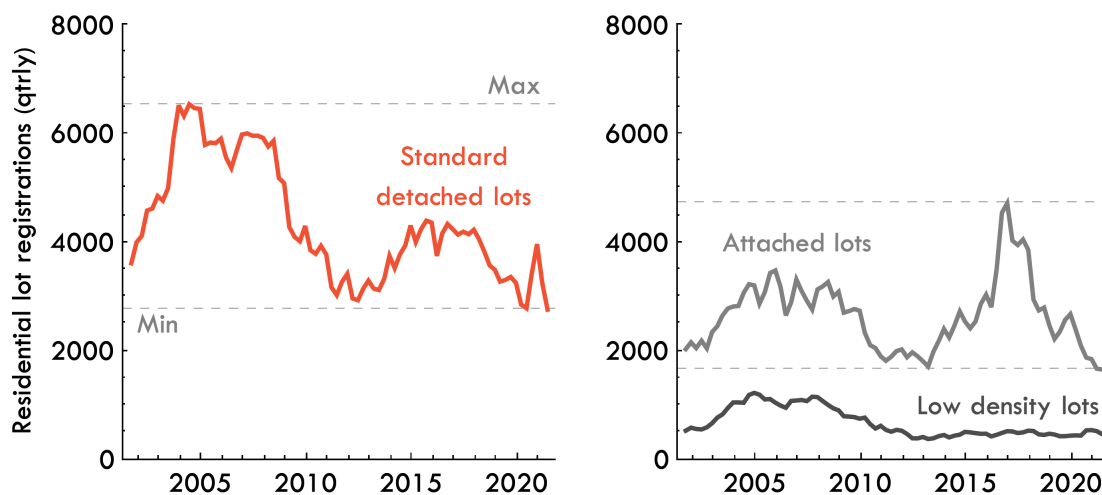


Figure 9: QLD new dwelling lot registrations²²

In Figure 10 are three NHSC projections of dwelling need based on expected population growth and changes in household composition (families, singles, couples, etc). Alongside is the observed increase in occupied households over that decade, which was lower than even the “low projection” scenario. Lastly is the actual increase in the stock of dwellings, which was far higher. The number of dwellings grew by 390,000 more than the number of households (over 30% more). These additional dwellings include second homes or holiday homes, while a small fraction may be vacant investment property. Census data confirms that dwelling construction has outpaced household growth, with unoccupied dwellings in Australia rising from 4.8% of the total stock in 2001 to 11.2% in 2016.²³

²¹ These are approvals, not dwellings. Each approval can contain multiple dwellings. NSW Government. 2021. Local Development Performance Monitoring (LDPM). <https://pp.planningportal.nsw.gov.au/local-development-performance-monitoring-ldpm>

²² Queensland Treasury. 2021. Residential land supply and development. <https://www.qgso.qld.gov.au/statistics/theme/industry-development/residential-land-supply-development/residential-development>

²³ ABS. 2021. 2006 and 2016 Census QuickStats – Dwelling structure. Australian Bureau of Statistics.

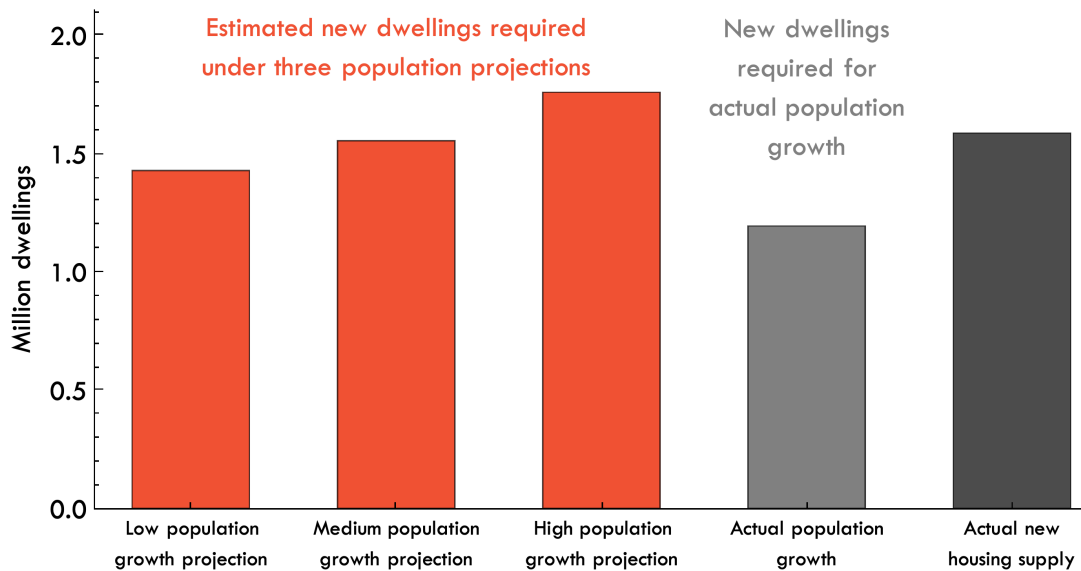


Figure 10: NHSC 2008 10-year housing demand projections compared with actual outcomes ²⁴

In all, the Australia planning system has flexibly accommodated huge variation in rate of new dwelling development when the market desired it. Asset market conditions determine how fast property owners would like to develop—they sell faster in “thick” asset markets with rising demand, and slower in “thin” markets with falling demand—which is why the pattern of housing construction is pro-cyclical. The fact that rental prices have tracked close to the consumer price index, and below their expected rate which would match household income, suggests that the supply of new dwellings in Australia has easily accommodated the population demand. In fact, the latest data would suggest that there are more, bigger, better, dwellings per capita in Australia in 2021 compared to any point in history. If supply has had any effect on the rental price of housing it has been to suppress it relative to historical periods.

Taxes on property are efficient and fair

A common claim from lobbyists in the property industry is that taxes are adding to the cost of new dwellings. These can include stamp duty, developer charges, land taxes, GST, and more.

As was previously shown, the supply of new dwellings is determined by asset market conditions, not production costs. Taxes or fees applied to asset ownership or trade reduce their market value by the value of the tax or fee and can have relatively small effects on the incentive to hold undeveloped land or trade dwelling assets.

UDIA Victoria recently included the following items in an analysis of the tax share of new dwelling prices to claim that these taxes are adding to housing asset prices. ²⁵

- Recurrent property-owning taxes—land tax and council rates
- Taxes on property transactions—Stamp duty (including any foreign buyer surcharge)

²⁴ NHSC. 2008. State of Supply Report. National Housing Supply Council. Actual demand is the increase in households from December 2007 to December 2017, the closest dates with reliable estimates, and actual supply is the increase in private dwellings over the same ten-year period from ABS. 2018. 4130.0 - Housing Occupancy and Costs, 2017-18. Australian Bureau of Statistics. <https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/latest-release>

²⁵ UDIA. 2020. The hidden cost of housing: The relationship between housing affordability and development taxes, charges and levies. Urban Development Institute of Australia, Victorian Division. <https://udiavic.com.au/wp-content/uploads/2020/07/Hidden-Cost-of-Housing-FINAL.pdf>

- Fees on converting property uses— Infrastructure charges (including Growth Area Contributions) and Special levies (open space levy, Metropolitan planning levy)
- Value added taxes—GST
- Non-taxes user fees—Utility charges

Besides the fact that utility charges are not taxes but service costs, there are two main conceptual issues with this approach that the UDIA Victoria case exemplifies. First, recurrent taxes on property ownership are not taxes on the production of new dwellings. Land tax and council rates are paid regardless of development. Developing a site and selling dwellings is a way to avoid paying these taxes, and indeed a higher rate of land tax should incentivise faster development.²⁶

Second, taxes on dwelling asset transactions do not add to the price but get subtracted from it. An asset that comes with an additional tax liability, like stamp duty, or developer charges, will be priced to take that into account. For example, if a company issued two classes of shares, one with a purchase fee, and one with no fee, the market will price the share with fees less than the other class of shares by exactly the cost of the fee. The same applies in land and dwelling asset markets.

The empirical evidence overwhelmingly supports this view. When stamp duty is reduced, buyers pay a higher price to sellers because they no longer must pay a part of the price to the state government.²⁷ When developer charges fall, the price of new dwelling assets stays fixed, but the value of undeveloped land rises because owners of that land now have a reduced fee liability attached to development.²⁸ Taxes on asset trades, like stamp duty, do reduce dwelling asset turnover, but in doing so can also stabilise the market by making trades more costly. Indeed, many of the economic arguments against stamp duty are weak or wrong. For example, standard macroeconomic theory promotes using state budgets to stabilise the economy, rather than choosing tax policy to stabilise budgets, which is a common argument in favour of removing stamp duty on property transactions.²⁹

In general, taxing property ownership and transactions is one of the most efficient ways to tax because the economic incidence primarily falls on the value of asset ownership. Tax policy can change property prices—higher taxes are factored into lower dwelling asset prices—this does not change the overall cost of dwelling asset ownership. Land taxes can affect the rate of new supply by making it more expensive to own undeveloped (or under-developed) land assets, and hence tip the asset return choice in favour of developing these land assets.

Non-market housing

Places that make housing affordable do so by minimising market exchanges and promoting non-market alternative ways to access housing. Australia has a great working example of this policy approach in the healthcare system. The problem of unequal access to healthcare was solved by creating non-market ways to access healthcare in parallel to market provision. Those who need access to healthcare can access it in a way that avoids the market if they need.

Public options in housing typically come in the form of

²⁶ Murray, C.K. and Hermans, J. 2021. Land value is a progressive and efficient tax base: Evidence from Victoria. Australia Tax Forum. <https://www.taxinstitute.com.au/tiausttaxforum/land-value-is-a-progressive-and-efficient-property-tax-base-evidence-from-victoria>

²⁷ Davidoff, I., & Leigh, A. (2013). How do stamp duties affect the housing market?. Economic Record. Volume 89(286), 396-410. <https://doi.org/10.1111/1475-4932.12056>

²⁸ Murray, C.K. 2018. Developers pay developer charges. Cities. Volume 74, 1-6. <https://doi.org/10.1016/j.cities.2017.10.019>

²⁹ <https://theconversation.com/stamp-duty-fever-the-bad-economics-behind-swapping-stamp-duty-for-land-tax-106841>

- Public housing construction and ownership with rents tied to income levels
- Public housing construction for sale at a regulated price to qualifying buyers
- Public subsidies to the private sector to build and rent housing at below market prices to qualifying tenants

The world's best example of providing non-market housing options in parallel to the private market is Singapore. Its large-scale public housing construction program began in the 1960s and has since built around 90% of all existing dwellings.³⁰ Each citizen qualifies to buy one dwelling at a time from the Housing Development Board at a price set to match construction cost. Citizens are also eligible for a mortgage from a public agency at a small margin above the prevailing central bank cash rate.³¹ This housing system shares the wealth in Singapore to all in the form of subsidised housing and can be cost neutral for the public agencies. This housing system is why Singapore has the best quality and largest dwellings in the region.

Policy ideas and conclusions

Private landowners will not supply new dwellings cheaper or faster because they want to maximise their economic returns, not minimise them. Relying on the private land market to supply cheap housing goes against market incentives. This means that any policy recipe for cheaper housing requires non-market systems for housing provision.

Like the affordability of healthcare was vastly improved with a public option, so too has the affordability of housing been vastly improved at different times and locations by public financial support of non-market systems. Since a bigger and better quality housing stock is almost always an economic positive, any housing policy intended to achieve cheaper housing access should also be directed towards directly promoting new dwelling construction.

For example, a public housing supplier could be established to build new dwellings and sell them at a price reflecting development cost only (i.e. net of land costs) to qualifying citizen non-homeowners. During the ramp up of the program queuing can be dealt with through lottery mechanisms for allocations. Ideally incentives will be built-in to the agency to increase their rate of supply until queuing is reduced. This non-market housing system idea is based heavily on Singapore's successful program, which operates in parallel to private property markets, and has sustained extraordinarily high homeownership rates and broad access to property wealth for all citizens.

Non-market rental options can involve direct public ownership of rental homes, as in traditional public housing, or subsidy support for private housing providers who rent to tenants at regulated prices. Ideally these subsidies would only apply to newly constructed dwellings. Although they are not recommended as programs to create cheaper housing, subsidies such as first home buyer grants, if enacted, should also apply to newly constructed dwellings only.

Finally, there is a major political tension in housing policy generally. Since 65% of households own their own home, and the 18% of households own investment property, any policy intervention in dwelling asset pricing has huge distributional effects. For example, if an increase in property taxes resulted in a 20% dwelling asset price reduction, that would wipe \$1.8 trillion of value from the \$9 trillion value of Australian dwellings, or roughly \$180,000 per dwelling. The political calculus is not in favour of such policies. Creating parallel non-market housing systems, as suggested here, may be a politically palatable way to create cheap and secure housing options, as they do not directly affect the market price of dwelling assets. Meanwhile, policies focussing on housing supply and planning have the appearance of doing something about housing affordability, while generating windfall giveaways to existing landowners through the planning system.

³⁰ Haila A. 2015. Urban land rent: Singapore as a property state. John Wiley & Sons.

³¹ More details are available at <https://www.hdb.gov.sg/cs/infoweb/residential>