

Chapter 3

The drivers of housing affordability in Australia

3.1 In seeking to explain the decline in housing affordability in Australia in recent decades, some of the evidence received by this committee focused predominantly on either supply-side or demand-side factors. Taken as a whole, however, the evidence points to an affordability problem that is driven by a complex interaction of factors. Whether the weight of these factors falls on the supply-side or demand-side, the evidence points to a substantial mismatch in supply and demand in the housing market. As DSS explained in its submission, while:

...demand for housing has increased significantly over the last 30 years, the supply of new dwellings has not responded, with average annual completions of new dwellings remaining around 150,000 since the mid-1980s.¹

3.2 This chapter provides an overview of the drivers of housing affordability in Australia, and in turn considers the need for government policies to take account of these drivers so that policy interventions are efficient and effective.

An overview of supply-side and demand-side considerations

3.3 Some witnesses told the committee that the problem of housing affordability was principally one of supply constraints. For instance, MBA argued:

...that when you really drill down to the problem that needs to be solved, it is an issue of supply or the lack thereof. That is not to say that in the short term there are not issues that perhaps arise from cyclical factors that may need some sort of attention. But our proposition is that unless governments—and I put this in the plural—address the whole issue of housing supply then unfortunately and regrettably we may have even more of these inquiries looking into housing affordability.²

3.4 The HIA also framed the issue of affordability as essentially a consequence of a 'persistent imbalance between growth in demand for housing and the slow rate at which the nation has added to the housing stock.'³ There were various reasons for this constrained supply, it submitted, including the inadequate supply of developable land (discussed in chapter seven), the impost of taxes and charges on new housing (discussed in chapter six) and delays in providing supporting infrastructure for new

1 Department of Social Services, *Submission 198*, p. 4.

2 Mr Wilhelm Harnisch, Chief Executive Officer, Master Builders Australia Ltd, *Proof Committee Hansard*, 30 July 2014, p. 34.

3 Housing Industry Association, *Submission 178*, p. 3.

developments.⁴ The HIA argued that the combination of constrained housing supply and a rapidly growing population had:

...resulted in a systemic deterioration in housing affordability. This has meant that households across a wide range of Australia's housing continuum are now facing increasingly restricted housing choices. It has now been 10 years since a reasonably tight historical linkage between population growth and new housing supply disconnected. The current cyclical recovery in new home building will provide a partial and temporary reprieve, but we do face a structural undersupply of adequate affordable and readily available shelter. The housing challenge, be it for first homebuyer accessibility or those with the most restricted choices along the housing continuum, has one root cause—that is a lack of readily available housing supply.⁵

3.5 According to the HIA, over the past 20 years Australia has, on average, added around 156,000 new houses per annum to existing stock. Yet, it continued, under the most conservative estimates Australia will need to add about 180,000 per annum between now and 2050 in order to 'successfully house our growing and ageing population. The difference is very wide and it is growing by the day.'⁶ The HIA submitted that the:

...long term failure of new housing supply to keep pace with the growth in demand manifests itself in a considerable constraint on the housing choices available to Australians. Households experience lower levels of housing affordability when their housing choices are restricted. Restriction to the point of exclusion is evident in the case of Australia's homeless, while a severe restriction is evident in the under-provision of low income public and social housing. Restrictions also exist in the private rental market, especially for low and lower-middle income renters, but also for low/middle income owner-occupiers.⁷

3.6 The HIA noted that despite strong population growth over the period 2004 to 2013, largely resulting from net overseas migration, the annual number of new homes commenced had declined in seven out of the ten years. Moreover, the HIA noted that since the economic recession of the early 1990s, new home building in Australia has experienced three episodes of recession—in 1996–97, 2001 and 2009, with a fourth episode narrowly avoided in 2012. While welcoming a recent improvement in new home building activity, the HIA maintained that under current policy settings this improvement 'will be insufficient to see Australia attain building levels commensurate

4 Mr Graham Wolfe, Chief Executive, Industry Policy and Media Relations, Housing Industry Association, *Proof Committee Hansard*, 30 July 2014, pp. 44–45.

5 Dr Harley Dale, Chief Economist, Housing Industry Association, *Proof Committee Hansard*, 30 July 2014, p. 43.

6 Dr Harley Dale, Chief Economist, Housing Industry Association, *Proof Committee Hansard*, 30 July 2014, pp. 43–44.

7 Housing Industry Association, *Submission 178*, p. 3.

with the requirements of providing an adequate and affordable level of housing to a growing and ageing population'.⁸

3.7 The HIA emphasised the interconnectedness of the different types of housing supply, and explained how shortages in one area flowed through to others. That is, inadequate supply in one type of tenure (purchase, rental, community or public housing) has a cascading effect, creating pressures across the housing continuum.⁹

3.8 BIS Shrapnel also suggested 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'.¹⁰ The UDIA made essentially the same point, telling the committee:

We simply do not build enough new homes and have not done so for a number of years. In the face of rapidly increasing demand, this undersupply of new housing has led to rapidly increasing prices and declining affordability.¹¹

3.9 High population growth resulting from immigration was identified by a number of witnesses as a key driver of growing demand for housing. The Department of Immigration noted that Net Overseas Migration (the net gain or loss of population through migration to and from Australia) 'can fluctuate considerably from year to year, but has exceeded the natural increase in the population since 2005'.¹² The Department noted that the likely continuation of strong population growth would continue to increase demand pressures on housing supply. At the same time, Australia's skilled migration policy would:

...go some way to reducing skill blockages and labour shortages which can impede housing construction, and therefore can contribute positively to improving housing affordability.¹³

3.10 The UDIA submitted that while population growth offered Australia many benefits, governments needed to provide for the growing population with improved processes for land release, house construction and infrastructure creation. Their collective failure to do so, UDIA argued, has:

8 Housing Industry Association, *Submission 178*, p. 3.

9 Dr Harley Dale, Chief Economist, Housing Industry Association, *Proof Committee Hansard*, 30 July 2014, p. 43.

10 BIS Shrapnel, *Submission 16*, p. 1.

11 Mr Liam Foley, Policy Officer, Urban Development Institute of Australia, *Proof Committee Hansard*, 30 July 2014, p. 66; Urban Development Institute of Australia, *Submission 190*, p. 9.

12 Department of Immigration and Border Protection, *Submission 113*, p. 2. The submission was made in March 2014, and considered Net Overseas Migration through to 2012–13.

13 Department of Immigration and Border Protection, *Submission 113*, p. 2.

...meant that the supply of new housing has struggled to keep up with increasing demand, and both rents and house prices have risen dramatically as a result.¹⁴

3.11 The REIA told the committee that at a recent roundtable it had convened with industry leaders, housing supply was identified as the main factor that needed to be addressed to improve affordability.¹⁵ At that roundtable, the then Minister for Social Services, the Hon Kevin Andrews MP, noted that the shortfall in housing supply was projected to rise from 228,000 dwellings in 2011, to nearly 370,000 dwellings by 2016 and 663,000 dwellings by 2031.¹⁶

3.12 The RBA explained that Australia's urban structure created particular constraints on the ability of supply to respond to demand. Australia's urban population, it noted:

...is unusually concentrated in two large cities, and these and the other large cities have unusually low population densities compared with cities in other developed countries with similar population sizes. It is more costly to build additional housing supply in a limited number of locations; land prices could be expected to be lower if there are more undeveloped locations competing for buyers.¹⁷

3.13 Professor Terry Burke contended that the housing supply shortage in Australia was in part due to the nature of the Australian construction industry. Most countries, he explained, have speculative construction industries, where builders add stock in anticipation there will be buyers for it. However, Australia has a contract building system in which a consumer needs to commission new construction. As a result, it was hard to have an oversupply in Australia, but quite possible to have an undersupply.¹⁸

3.14 Prosper Australia disputed the idea that an undersupply of housing was driving price increases. Prosper Australia researcher, Mr Phillip Soos, told the committee that since the 'price boom' had begun in 1996, Australia had built one new dwelling per 1.9 new people, not far from the long-term post-war average of one new dwelling per 2 new people and well below the average household formation of

14 Urban Development Institute of Australia, *Submission 190*, p. 9.

15 Ms Amanda Lynch, Chief Executive Officer, Real Estate Institute of Australia, *Proof Committee Hansard*, 30 July 2014, p. 72.

16 The Hon Kevin Andrews MP, 'Opening remarks to the Real Estate Institute of Australia Housing Affordability Roundtable', 26 March 2014, <http://www.formerministers.dss.gov.au/15342/opening-remarks-to-the-real-estate-institute-of-australia-housing-affordability-roundtable/>.

17 Reserve Bank of Australia, *Submission 14*, p. 8.

18 Professor Terry Burke, private capacity, *Proof Committee Hansard*, 9 September 2014, pp. 14–15.

2.7 people per household.¹⁹ Mr Soos pointed to the recent booms and busts in housing markets in the United States and various European nations, where claimed housing supply shortages during boom periods had subsequently proven non-existent:

During the boom it is difficult to see that supply, especially when the vested interests—anywhere from the real estate institutes to the banks to the government—all get together in a chorus saying that there is a shortage. In Ireland and Spain they had strong immigration rates, approaching two to three per cent, as we have had in Australia in the last half a decade, but those markets still went down-under, because if immigration had an effect on prices you would see it in rents as well. Rents have remained mostly flat over the last decade or so.²⁰

3.15 According to Prosper Australia, price inflation is not caused by supply shortages, but rather by debt-fuelled speculative demand driven by the preferential tax treatment of land.²¹

3.16 Contrary to the evidence presented by Prosper Australia, the HIA told the committee that over the past decade rents in Australia have increased by about 55 per cent, which is roughly in proportion to the 62 per cent growth in residential property prices. On this basis, the HIA rejected the idea that strong price growth in residential property prices has been due to speculative demand:

Rental prices reflect the value of housing services rather than any entitlement to future growth. Strong concurrent growth in home prices and rental prices is consistent with the demand for housing services exceeding the supply.²²

3.17 Against Prosper Australia's suggestion that housing supply relative to population growth was more or less trending near to the historical average, Mr Eslake observed that from the end of World War II until the early 1990s, housing stock increased at a much faster rate than population growth. The growth in housing stock, Mr Eslake wrote, slowed in the decade from 1991 to 2001 (18.3 per cent), but still outstripped population growth (11.5 per cent). However, in the decade from 2001 to 2011, population growth (15.9 per cent) actually outstripped housing stock growth (15.2 per cent), the first time this had occurred in the post-war era. The failure of housing stock growth to keep pace with population growth had occurred despite

19 Mr Philip Soos, Researcher, Prosper Australia, *Proof Committee Hansard*, 9 September 2014, p. 7.

20 Mr Philip Soos, Researcher, Prosper Australia, *Proof Committee Hansard*, 9 September 2014, p. 7.

21 Prosper Australia did, however, suggest that while there was no shortage of housing supply, there was a shortage of supply of affordable housing. This apparent contradiction could be explained, it argued, by the fact that prices were not based on fundamentals like rents, income, GDP and inflation, but on debt speculation. Mr Philip Soos, Researcher, Prosper Australia, *Proof Committee Hansard*, 9 September 2014, p. 9.

22 Housing Industry Association, *Submission 178*, p. 5.

demographic trends that, according to Mr Eslake, would have warranted a reverse scenario (that is, housing stock growth exceeding population growth) if supply was properly responsive to demand. These trends included:

- average family sizes declined between the early 1960s and the early 1990s, implying that more dwellings are required to accommodate the same number of people;
- family breakdowns have meant that more dwellings are required to accommodate the same number of people; and
- population ageing has resulted in more people living alone, again increasing the number of dwellings required to accommodate the same number of people.²³

3.18 A number of witnesses argued that declining housing affordability could not be viewed simply as a function of supply constraints. As noted later in this chapter, Dr Winter recommended that government housing assistance and subsidies should be directed towards increasing housing supply. However, he also noted that supply was not the only consideration, and pointed to research showing that Sydney prices had experienced strong growth despite a significant rise in dwelling completions:

City dwelling completions doubled from 14,000 to 28,000, so that is a doubling of supply over that period of time, yet house prices still went up by 21 per cent. An exclusive focus on supply is not going to solve the problem. It is obviously one very important part, but it cannot be the be-all and end-all of trying to solve affordable housing problems in Australia.²⁴

3.19 A similar point was made by Mr Adam Mills, Senior Strategic Planner for the City of Melbourne. According to Mr Mills, the City of Melbourne:

...is seeing unprecedented levels of new housing. In 2013 the City of Melbourne was the fastest-growing local government area in Australia, with 11,000 new residents. Last year there were more than 3,000 dwellings completed, which is expected to increase to over 5,000 this year and then up to 8,000 new dwellings in 2015. This is against the historic average of around 2,000 dwellings, so it is significant. Yet this increased supply in the central city is not improving housing affordability. In fact, affordability is worsening.²⁵

Financial deregulation and disinflation as drivers of housing price growth

3.20 In its submission, the RBA observed that in the decade or so up to 2003, Australian house prices had increased by about two-thirds relative to income. This

23 Mr Saul Eslake, *Submission 2*, pp. 3–5.

24 Dr Ian Winter, Executive Director, Australian Housing and Urban Research Institute Limited, *Proof Committee Hansard*, 9 September 2014, p. 14.

25 Mr Adam Mills, Senior Strategic Planning, City of Melbourne, *Proof Committee Hansard*, 9 September 2014, p. 29.

increase, it explained, was primarily the result of a secular shift resulting from disinflation and financial deregulation:

[T]he primary driver of this large increase in housing prices relative to income was the secular decline in average interest rates brought about by the decline in inflation in the 1990, together with some increase in borrowing capacity enabled by financial deregulation.²⁶

3.21 The RBA stressed, however, that housing price growth should not be conflated with declining affordability. To the extent Australian borrowers were better able to service larger loans with the same repayment, affordability could not be said to have worsened. This was the case, it argued, even if house price growth had outpaced household income growth.²⁷

3.22 Moreover, it was reasonable to suppose, the RBA told the committee, that the structural shift in housing prices in the decade prior to 2003 was unlikely to recur, even if prices had recently started to rise out of ratio to household income growth:

Both the shift to low inflation and the comprehensive deregulation of the financial system are things that happen only once. In broad terms, the adjustment of the housing market to this new environment seems to have been completed by around the middle of last decade. Since then, the ratio of housing prices to incomes has been relatively stable but, for reasons I have already alluded to and which I will come back to, it has been rising recently and is now at the upper end of its recent range.²⁸

3.23 DSS also noted that since the introduction of financial deregulation in the mid-1980s, Australians have had greater access to capital for both consumption and investment. This had in turn flowed through to house price growth:

[T]his increased access to capital has largely been used by households to increase their consumption of housing. The additional consumption of housing by both owner-occupiers and investors has increased significantly as official interest rates have continued to fall to record lows. This increase in 'financial' demand for housing has been supplemented by an increase in 'actual' demand for housing, driven by increases in Australia's estimated resident population by around 48 per cent since 1984 and by around 9 per cent since 2008.²⁹

26 Reserve Bank of Australia, *Submission 14*, p. 6.

27 Reserve Bank of Australia, *Submission 14*, p. 6. The RBA does allow that such growth in house prices 'may, however, have some implications for intergenerational equity if first home buyers increasingly rely on parental assistance or bequests to fund larger deposits (and thus higher prices) than they could sustain from their own resources, because such assistance may not be available to the children of renters.'

28 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 2 October 2014, pp. 1–2.

29 Department of Social Services, *Submission 198*, p. 4.

3.24 Associate Professor Yates provided a useful summary of how structural supply and demand trends had interacted to drive price increases since the 1980s. In doing so, she located these trends within a global context:

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.³⁰

The impact of foreign buyers

3.25 The effect of foreign investment in residential property was not a key concern of this inquiry, although it was raised by a handful of witnesses as a potential cause of recent house price inflation. In this regard, the committee notes Professor Andrew Beer's point that while in recent years some private investment in property appeared to be coming from offshore, and in particular China, 'there is a lot of debate about the quality of the data in terms of understanding the full size of that impact.'³¹

3.26 The committee notes that the House of Representatives Standing Committee on Economics held an inquiry on the subject and released its *Report on Foreign Investment in Residential Real Estate* in November 2014. The inquiry produced four key findings. They were that: there is a lack of accurate or timely data that tracks foreign investment in residential real estate; there had been a 'significant failure of leadership' by the Foreign Investment Review Board (FIRB), which was 'unable to provide basic compliance information to the committee about its investigations and enforcement activities'; there needs to be a greater willingness to enforce foreign investment rules in order to improve compliance; and the Australian taxpayer

30 Honorary Associate Professor Judith Yates, University of Sydney, *Submission 53*, p. 2.

31 Professor Andrew Beer, Director, Centre for Housing, Urban and Regional Planning, University of Adelaide, *Proof Committee Hansard*, 28 July 2014, p. 18.

currently 'foots the bill' for the administration of FIRB and the Foreign Investment and Trade Policy Division of Treasury. The committee made 12 recommendations following from these findings.³²

Ensuring policy interventions responses are effective

3.27 While witnesses tended to focus on either supply-side or demand-side drivers of housing costs, many acknowledged that housing affordability could not be rightly characterised as a 'supply-side problem' or a 'demand-side problem'. Similarly, several witnesses reminded the committee that the drivers of poor affordability were not uniform across the country. Rather, as AHURI put it, the 'causes and nature of Australia's affordable housing problems are complex, diverse and interact differently in different parts of Australia'.³³

3.28 Given the complexity of the causes of the housing price growth, it follows that a policy response that focuses simply on supply or demand will be found wanting. As Professor Beer told the committee, housing affordability:

...is a multiple challenge and something that should not be underestimated. It needs multiple solutions operating in all dimensions of the housing supply and demand equation. Solutions that focus only on demand will be inadequate and solutions that focus only on supply will be inadequate.³⁴

3.29 Similarly, the RBA told the committee that trying to cast housing affordability as a supply-side or demand-side problem missed the point. Instead, as Dr Edey explained, it was necessary to understand that:

...housing prices and affordability are affected by the interaction of both supply and demand factors. The factors that I have mentioned so far—household incomes, the cost and availability of finance—primarily affect the demand side of the market. In the short to medium term it is those sorts of factors that will tend to have the predominant influence on housing price movements. The reason for that is that the supply side of the market is dominated by a large existing stock of dwellings and new supply takes time to come on stream. In the longer term, however, supply factors are critically important. It is the supply response that determines the extent to which additional demand results in higher prices over time. Our submission highlights that Australia faces a number of longstanding challenges in this area. These include regulatory and zoning constraints, inherent geographical barriers and the cost structure of the building industry. There

32 House of Representatives Standing Committee on Economics, *Report on Foreign Investment in Residential Real Estate* (November 2014).

33 Australian Housing and Urban Research Institute, *Submission 93*, p. iii.

34 Professor Andrew Beer, Director, Centre for Housing, Urban and Regional Planning, University of Adelaide, *Proof Committee Hansard*, 28 July 2014, p. 10.

are also obstacles to affordable housing created by Australia's unusually low density urban structure, although this is gradually changing.³⁵

3.30 Dr Edey noted that the RBA was not seeking to offer policy prescriptions to improve housing supply. However, he nonetheless made the general point that:

...we cannot improve housing affordability simply by adding to demand. Targeted assistance can certainly help particular groups, such as first home buyers, but without a supply side response any generalised increase in demand will just be capitalised into prices. An important emphasis in our submission is that due attention needs to be given to supply side factors in any policy response to perceived problems of affordability.³⁶

3.31 A number of witnesses argued that poorly considered housing policies not only fail to achieve their objectives, but risk compounding the problems they were intended to address. This was particularly true if policies simply served to stimulate demand in supply-constrained markets, or inhibited otherwise efficient market-driven supply responses to housing needs. As the CFRC explained, governments have traditionally intervened in the housing market to:

...improve allocative and productive efficiency by addressing market failures, to enhance equity and to contribute to macroeconomic stability and growth. Ideally, such intervention enhances people's housing opportunities and ensures equitable access to housing.

Badly-designed housing interventions, however, can have substantial negative effects. Assistance that increases demand for housing is unproductive if it is capitalised into dwelling prices because of sluggish supply responses in housing markets. Supply side subsidies may crowd out private investment that would otherwise have occurred or may displace those who are already disadvantaged in housing markets.³⁷

3.32 In its submission, DSS went to the heart of what government housing policy should be directed toward: in the end, it concluded, housing affordability would only be improved through a structural reduction in demand for housing, or an increase in supply. To this end, the best way governments could improve housing affordability was to 'seek to alter the framework within which the housing market operates, rather than through direct interventions in the operation of the market'.³⁸

35 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 2 October 2014, p. 2.

36 Dr Malcolm Edey, Assistant Governor, Financial System, Reserve Bank of Australia, *Proof Committee Hansard*, 2 October 2014, p. 2.

37 City Futures Research Centre, UNSW, *Submission 152*, p. 4.

38 Department of Social Services, *Submission 198*, pp. 3–4.

Committee view

3.33 The committee acknowledges the complexity and urgency of housing affordability in Australia, and does not believe the issue is rightly categorised as either a 'supply-side problem' or a 'demand-side problem'. With this in mind, it is clearly evident that supply is currently not keeping pace with demand in the housing market. In this context, policy interventions that add to demand without addressing or at least accounting for supply-side constraints risk inflating housing prices and compounding affordability problems.

