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John Hawkins
Committee Secretary
Senate Select Committee on Housing Affordability
in Australia
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

31 March 2008

Dear Mr Hawkins

Submission: Senate Select Committee on Housing Affordability in Australia

The Urban Research Centre is a new venture of the University of Western Sydney. The Centre aspires to be an international leader in research and teaching initiatives involving cities and urban management.

The Urban Research Centre welcomes the opportunity to comment on this important topic. Our submission details the implications of both demand and supply side factors in creating barriers to home ownership in Australia. In particular, we address issues relating to:

(a) the taxes and levies imposed by state and territory governments;
(b) the rate of release of new land by state and territory governments;
(c) proposed assistance for first home owners by state, territory and the Commonwealth governments and their effectiveness in the absence of increased supply;
(d) the role of all levels of government in facilitating affordable home ownership;
(f) the role of financial institutions in home lending.

We trust that this inquiry will further the debate about the barriers to home ownership and government policies to address this issue.

Yours faithfully

Phillip O'Neill
Director
Urban Research Centre

(a) the taxes and levies imposed by state and territory governments

In NSW we have seen a gradual increase in the level of charges that have been levied on the development of new dwellings. Some of these taxes have been directly levied by state government instrumentalities whilst others have been levied by local governments through powers under the Environmental Planning and Assessment Act.

The price impact of these charges is unclear. The exact fraction of the tax that is passed forward or passed back will depend on the state of the housing market (Evans-Cowley and Lawhon 2003). The issue, then, is how to fund necessary infrastructure in new housing growth areas while not adding to price rises for home buyers. A consistent national approach to funding urban infrastructure would remove some of the political debate surrounding levies. Such an approach should include certainty as to the source of funding with a clear and consistent apportionment across the realms of federal, state and local jurisdictions. We also note the recommendation of the Productivity Commission (2004:177, recommendation 7.1) that the rate of infrastructure levies should be based on the principles of necessity, efficiency and equity to ensure that they reflect the costs of supply.

(b) the rate of release of new land by state and territory governments

The increase in the cost of land has been an important factor in increasing the cost of housing in recent times. The argument that a strong growth in urban land supply would be able to decrease housing affordability problems seems, on the face of it, a sensible claim. After all, it is a basic tenet of economics that increasing supply will lead to a reduction in price pressures. However, there are a number of reasons why increasing the supply of land does not function in this way in the housing market:

1. The importance of demand in influencing housing prices

While supply is an important element in the price of housing, it is often overwhelmed by demand for housing. This is because the supply of housing is relatively inelastic over the short term.

In Australia, Ellis (2006), from the Reserve Bank of Australia, demonstrated how a fall in inflation and interest margins similar to that experienced in Australia over the 1990s increased individual homebuyers' capacity to purchase housing by as much as 60 per cent and that this surge in demand across the market was unable to be addressed by a supply response. According to Ellis (2006:7-8),

> *Even the most flexible and least regulated construction sector would struggle to lift its output from something equal to a few percentage points of the dwelling stock [existing housing stock plus whatever building and renovation work is done over a given period] to accommodate a surge in demand of 50 per cent or more…It is therefore inevitable that housing prices would rise in the face of such a surge in demand.*

Given this conclusion, Ellis (2006:27) took the view that extra land supply at the fringe would not have been able to counter the house price increases,

> *It is simply physically infeasible for new supply to expand enough to have accommodated the expansion in households' capacity to pay. Instead there have necessarily been large increases in the cost of housing and land.*

International research has also investigated the relationship between demand and housing prices. Grigson (1986) argued that as new-build supply makes up only a small proportion of total housing supply, prices are more likely to be determined by demand forces, not supply. Nelson et al (2002) and Bramley et al (1995) concluded that the relative elasticity of demand has the greatest influence of any other factor, including planning, on house prices, especially within metropolitan regions.

2. the complexities of the land development process

Much of the political debate talks about the issue of land supply in very coarse terms. However, urban land needs to be differentiated into a number of categories including:

1. Land which could potentially be zoned for residential development
2. Land which is zoned for residential development which is owned by original owners (e.g. farmers)
3. Land which is zoned for residential development which is owned by developers but is not yet subdivided
4. Land which is zoned for residential development which is owned by developers and subdivided which is not yet for sale
5. Land which is zoned for residential development which is owned by developers and subdivided which is for sale as either as land or house and land package

The release of land for development is often portrayed as an unproblematic process. In reality, it takes between 7 and 12 years for land to become available for housing on the market as it passes through the various steps identified above. This lag in the time between when land is released and when it actually becomes available on the market means there is little likelihood of a direct correlation between current demand and supply.

As well as the time taken, the land supply process entails the involvement of a number of different actors. Some authors have suggested consideration of the traditional supply and demand theory is not enough to account for the activities of these actors. In particular, land holders and developers may engage in speculative or land banking behaviour that is not predicted by traditional economic theory. Gillen and Fisher (2002) contend that it is the behaviour of developers and landowners, driven by expectations of future trends in housing demand that determines land prices. Pryce (1999) suggested the land supply curve may tend to bend backwards at higher price levels because of builders and land owners speculation at times when the housing market cycle is peaking that the value of vacant land will rise at a faster rate in the future than present prices. When this occurs, land owners do not sell their land and there is an incentive for developers not to build houses. Therefore, land supply may fall even when current prices are rising.

The NSW Department of Planning’s Metropolitan Development Program Update (2007), highlights how bottlenecks can occur as a results of the behaviour of actors – they highlight the issue of land holders (at category two) holding out for a higher price. This is a particular issue in the Sydney market because of the number of small holdings (10 hectares or less) in the urban release areas.

3. the importance of scale

This is not to say that increasing land supply will not have an impact on housing prices. Rather, we believe that to examine the importance of supply on house prices, analysis has to be done at the level of the “housing market”, defined as a geographical area in which demand and supply operate independently of other regions.

For example, a study in Auckland (Motu 2007) found that whilst demand was important, supply responses could have important local price impacts. The Productivity Commission (2004) reached a similar conclusion.

Monk and Whitehead (1999) compared the experience of three regions within Cambridgeshire over a ten year period (1981-1991) to consider the effect of planning on house prices. The areas were chosen because of the differing levels of demand for housing in these areas as well as differences in planning processes. They concluded that the level of land released does influence the price of land. However, due to housing market segmentation, increased land release in one area with lower levels of demand (at least during downturns in the housing market cycle) did not fully compensate for land supply restrictions in another area. As a result, constraint in one area pushed up prices in the other areas under analysis.

Taken together, these factors suggest there is no straight forward causal relationship between land supply, land prices and house prices. The implication is that land releases to alleviate demand pressures within specific, local housing markets may be an effective way of improving housing affordability when they are carefully targeted.

(c) proposed assistance for first home owners by state, territory and the Commonwealth governments and their effectiveness in the absence of increased supply

There is empirical evidence that in strong metropolitan housing markets, demand side assistance, without supply side assistance, can act to exacerbate house price inflation. Demand side assistance should be targeted to redress specific anomalies in the housing market, especially those involving equity issues. Consideration should be given to making this assistance tenure form neutral, i.e. not dependent on home ownership as the preferred tenure form.

(d) the role of all levels of government in facilitating affordable home ownership

The housing affordability crisis provides the government with the opportunity to examine the issue of housing affordability from a variety of perspectives, other than by the promotion of home ownership as the nation’s preferred form of home occupancy. There are many circumstances in which encouraging low-income households, for instance, into home ownership is irresponsible given an inability to service a mortgage.

Governments should give attention to improvements in both public and private rental markets and render some the status as life-long tenure options. The private rental market is typically seen in Australia as a tenure of transition. Yet making rental conditions more amenable not only improves housing opportunities for a variety of Australian household types, it also takes pressure off the home ownership sector. Accompanying such a change, consideration should be given to a widespread review of Australian landlord and tenant legislation as well as considering support for the establishment of other intermediary tenure forms, as discussed below in (f).

(f) the role of financial institutions in home lending

Since the deregulation of the financial system in the 1980s, there have been significant developments in the Australian housing finance market, including: changes in credit standards since the mid 1980s (including higher loan to valuation ratios, relaxation of debt serviceability criteria); increased competition in the sector through the entry of non-deposit-taking mortgage originators (funded by securitisation) in the early 1990s; the growth in broker-originated lending beginning in the late 1990s; the creation of new housing loan products (including no deposit loans, home equity loans, interest only loans) and the expansion in the number of higher risk loan products (such as low documentation and sub prime loans and equity withdrawal loans). These changes have encouraged lenders to make more finance available to a wider range of potential borrowers than previously, hence expanding the supply of mortgage loans.

The Reserve Bank's (2003) Submission to the Federal Government's Inquiry on First Home Ownership concluded that the primary reason for the increase in the cost of housing was the expansion in the supply of credit as well as people's improved capacity and propensity to borrow.

One of our concerns with the developments in the mortgage lending market is that the most complex, sophisticated loan products are being marketed to those people who are often in vulnerable socio-economic circumstances and are the least likely to be able to make adequate assessments of their value.

One of the projects currently being undertaken by the Urban Research Centre explores the links between the growth of mortgage distress and default to the new ways mortgage finance has been packaged and marketed to low-income households. The target area for the study is Western Sydney, identified by a number of agencies as the region with the highest concentrations of mortgage arrears and defaults.

There is a role for financial institutions in preventing the potential impacts of lending to homeowners unable to manage mortgage and ownership commitments; these risks can be summarised as higher risk of foreclosure and the overestimation of an already heated market. Innovative programs and structures in the United States in particular, have combined lending with broader social obligations to generate hybrid ownership forms able to develop and manage affordable ownership via partnerships between homeowners and dedicated third parties. These have, firstly, physically provided stock so prevented upward pressure on the market; secondly, enabled access to lower income households without increasing their financial exposure; thirdly, built the skills and equity of those households; and, fourthly, retained both the subsidy base and the affordability of the stock across title transfers.

This highlights several key issues regarding the future role of financial institutions in home lending in Australia. Clearly, there is a need for more socially and economically responsible lending mechanisms in Australia. It is imperative that future lending mechanisms not only enhance access to the market, but also provide dedicated stock, work with households to develop homeowner skills and critically, retain any subsidy base and affordability criteria in perpetuity. In the United States, such programs have been underwritten by government funding and dedicated revolving loan funds and are proving able to withstand the emerging sub-prime crisis.

The Role of Shared Equity Ownership in Generating Housing Affordability in Perpetuity

To date Australia's experiments with shared equity refer to shared *borrowing and lending* arrangements involving a state or financial partner, with little attention placed on the ongoing terms of ownership or the retention of affordability across title transfers such as resale or inheritance. Such schemes have demonstrated a degree of success in increasing initial access to housing stock, but do little to hold that stock as affordable housing for future homeowners. In this way, these schemes offer a leg-up for those homeowners lucky enough to access the scheme, but *only* those homeowners, with the subsidy lost to the private homeowner within a generation. This represents an inefficient use of that public subsidy, which can and should be structurally retained. To this end, there exists several potential mechanisms for securing affordability in perpetuity via shared equity *ownership*, which balance individual and broader community rights to affordability and equity through ongoing relationships between the resident and a partner organisation dedicated to the retention and management of affordable housing.

Australia currently has a relatively limited range of tenure options open to its citizens. Sweden and the United States in particular, have diverse housing systems that include a range of ownership forms readily able to safeguard affordability and retain public subsidies. These include deed-restricted homes, limited-equity co-operatives and community land trusts. These are collectively referred to as "shared equity homeownership" (Davis 2007), but differ greatly to the forms of shared equity currently being rolled out in Australia. Davis (2007) documents 10 strengths of shared equity homeownership schemes:

- expanding access to homeownership
- preserving access to homeownership
- enhancing security of tenure
- stabilising residential neighbourhoods
- creating personal wealth
- preserving community wealth
- building social capital
- expanding civic engagement
- enabling personal mobility
- promoting development and diversity

Clearly these are reasonable aims for a just and equitable society. It is therefore worth exploring the characteristics of these models to assess the opportunities these present for Australian housing systems.

Key characteristics of shared equity homeownership models:

1. <u>Deed-restricted homes</u>

These represent an expansion of inclusionary planning regimes or current mandatory affordable housing requirements from rent into ownership. Currently in Australia, housing dedicated to affordable housing provision, whether through voluntary planning agreements or LEPs, is generally deed-restricted to be held by an affordable housing provider - usually a community housing provider. The housing is then rented to targeted households at specified, capped rent levels. In the USA, such deed restrictions have expanded to include home ownership, such that various regulatory bonuses are offered to private developers to generate housing units subsequently made available for affordable purchase by eligible households. Most of the traditional rights of ownership are held by the homeowner, except for the right to absentee ownership or the ability to sell without the application of affordability eligibility criteria. These restrictions are held in place by the partner organisation responsible for development and management, which in Australia would most logically be a community housing provider or analogous entity.

The retention of housing stock affordability over time is a key issue confronting this model: most restrictions currently expire after less than 30 years, representing a medium-term solution at best. Evidence from the US shows it is imperative that long-term affordability requirements be instated and independently monitored and enforced; where this is happening, affordability is being generated in perpetuity. The benefit of deed-restricted ownership is its relative simplicity and familiarity and its ability to dovetail with existing planning agendas and processes. These elements are documented as the key reasons for the existing and predicting ongoing expansion of this form of affordable ownership in the US.

2. Limited-equity co-operatives (LECs)

In cooperative housing, residents are members and shareholders of a non-profit co-operative corporation holding title to the housing, with ownership of that share granting a right to reside in a housing unit. In market-based cooperatives, share values increase in line with surrounding property prices, but the pooling of resources into the cooperative make initial purchase easier. In limited-equity cooperatives, shareholders are entitled to a limited equity gain on their corporate share at resale; this gain is indexed according to a pre-determined formula which may correlate to CPI or a percentage of surrounding market gain. This ensures that the affordability of the share is retained over time. Housing cooperatives are unique in that residents are shareholders in the corporation owning their home and as such, have ultimate control over the corporation's assets and operations and over the enforcement of restrictions placed on title and occupancy. The terms of occupancy are secured via a lease between the homeowner and the co-operative. In Sweden, market-based and limited-equity cooperatives house over 500 000 individuals, representing 15% of the housing market.

The Board of the co-operative is elected by members on the basis of "one member: one vote", with the Board responsible for overseeing sales and the retention of affordability such that shares are usually sold back to the Board according to the indexation formula and then on-sold to eligible households. A key issue has been the fact that the Board is ultimately comprised of individuals with a personal stake in increases in share value, which has led to the dissolution of affordability requirements in some US LECs when the indexed share price has differed from rapidly increasing market values. Consequently, many LECs are exploring hybrid models to secure affordability in perpetuity, such as combining LECs with the community land trust model discussed below, utilising deed restrictions as above, or modifying the Board structure to include "outside" directors appointed to counter the potential erasure of affordability requirements.

3. Community land trusts (CLTs)

Perhaps the most substantial intervention for generating perpetual affordability is the community land trust (CLT). In this model, residents hold title to the built property but lease the land underlying their property from the CLT, with the terms of that ground lease governing the ongoing affordability conditions of the property title. Most CLTs commit to permanent affordability that holds across title transfers, whether resale or bequeathment. At its base, the CLT is a dual-ownership model, with the CLT—a non-profit, community-based corporation—holding title to the land. The built property is usually owned by an individual homeowner, but can be a cooperative, a non-profit corporation or even a for-profit corporation. Many CLT ground leases can endure beyond the existence of the housing or the Trust, such that another non-profit or governmental agency can inherit the CLT's responsibilities and powers should the CLT dissolve. Usually, the Trust Board has a tripartite structure of leaseholders, broader community members and parties such as local government, lenders, planners or community-based organisations. This is intended to balance any short-term interests in profit gain with a broader concern for ongoing affordability. To date, CLTs have effectively combined affordable homeownership in perpetuity with other programs such as food security, youth employment, site remediation and crime prevention. This has largely been enabled through the direct involvement of residents and the broader community in the management and terms of the Trust.

Similar to the models above, absentee ownership is prohibited and subletting is subject to restrictions. Again similar to the above models, the resident is entitled to a share of the equity gain on the property via a resale formula which also gives the CLT the first right to repurchase. The CLT therefore has a primary role in regulating, processing and monitoring resales, ensuring affordability and the eligibility of buyers. Critically, the CLT also has the ability to step in and forestall foreclosure should the owner default on their mortgage. The resilience of CLTs has been highlighted in the emerging US sub-prime mortgage crisis: of the several hundred homes held on CLT land in 2007, CLT interventions in dozens of households to prevent default meant that only 2 went to foreclosure (Abromowitz and Greenstein 2008). To date CLTs in the US have been supported through philanthropy, state funding and the Institute for Community Economics, which provides resources and training and maintains a dedicated revolving loan fund. A dedicated resource and advocacy team, Burlington Associates, is also pivotal in the ongoing evolution of the sector. The model is also attracting increasing attention in the United Kingdom, where a dedicated research and support hub has been established in Community Finance Solutions at the University of Salford, with dedicated legal advice and operational documentation available.

Opportunities for Australian uptake of shared equity ownership: illustrations from NSW

Australia has skilled community and cooperative housing sectors which are currently somewhat hindered by a lack of national cohesion as regards legislation, funding and even form, with each state's sector(s) operating largely in isolation. Within NSW, the cooperative housing sector is subject to further internal incoherence, with disparate public rental and private equity forms. There is great interest in growing both community and cooperative housing, as evidenced by the NSW's Department of Housing growth strategy *Planning for the Future*, which plans for the development of 17 000 new affordable housing units over the next 10 years via 3 identified community housing growth providers. Similarly, a recent public symposium, *Living Cooperatively*, brought the NSW cooperative housing sector together, generating an agenda to unite the residualised and stymied public rental and the non-metropolitan private equity cooperatives and move forward as a growing, diverse and strengthened sector. Key to this however, is the long-overdue ability of the public cooperatives to control and leverage their asset base. These cooperatives have long proven themselves financially viable and HousingNSW is now entering into discussions to enable title transfer to the sector's peak body for the purposes of targeted growth and sector-based management, similar to Victoria's cooperative development via Common Equity Housing Limited.

The evident experience of the identified growth providers and the confidence being expressed in the cooperative sector, combined with substantial Federal interest and emerging funding mechanisms across governmental levels, provide a vital opportunity to establish more innovative and durable forms of securing affordability and retaining public subsidies in perpetuity. As non-profit organisations dedicated to the establishment, management and expansion of affordable and equitable housing, Australia's community and cooperative housing providers are ideal bodies to establish and manage the models established in the United States and Sweden and under development in the United Kingdom.

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