Submission to the Select Committee on Housing Affordability in Australia

Dr Brett F Edgerton (B.Sc., Ph.D.)
www.geocities.com/homes4aussies

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Summary

Australia is in the grip of a Housing Affordability Crisis with the impacts felt most acutely by working families. Rising interest rates are not a major factor in the crisis. The extremely high price of houses is the most critical factor. The RBA has clearly stated that high house prices do not benefit Australians in aggregate. They benefit high income Australians whilst low income Australians suffer. The cause of the high prices is multi-factorial. One major factor has been the taxation concessions to property investors – negative gearing, capital gains concessions, and now leveraged investment in property within self-managed superannuation funds – which act to price first home buyers out of the market and cause escalating rents. The Commonwealth government plans to retain these concessions which will maintain a high level of investor demand for established housing. As the current Crisis shows, these concessions do not lead to increases in housing stock.

In the absence of increased supply, the likely consequence of the current financial climate and proposed policy settings, and with the investor taxation concessions continuing, the proposed First Home Savers Accounts will worsen the Housing Affordability Crisis. Short of massive funding by Commonwealth and State governments to directly build more public housing, the only effective solution is the permanent removal of these distorting taxation concessions from established housing and their application for a period only to newly constructed housing. This will channel investor demand away from increasing prices on established housing to the construction of new rental housing.

Bull markets in all assets are accompanied by less than ethical practices of some participants. Few industries have benefit more from the residential property bull market than the realestate industry. The ACCC needs to closely examine the role of the realestate industry in the escalation of housing purchase and rental prices to provide confidence to Australian working families that realestate industry members have not been involved in price gauging or collusion in setting prices. Moreover, competition policy must be extended to the realestate industry. The two functions of the realestate industry – sales and rentals – should be split so that they must compete with each other in the provision of housing to Australians. This would be of significant benefit to Australian working families.

Introduction

Over recent decades, housing has become increasingly regarded as an investment commodity, a source of wealth, rather than one our most basic needs, shelter and an absolute prerequisite for personal security and feeling of inclusion in our society. Indeed, affordability of housing has been one of the greatest factors in the establishment and entrenchment of a two-tiered Australian society where those that acquired property prior to the late 1990s, and who have drawn wisely and conservatively on its increasing value, are now well off, whilst others are increasingly priced out of property ownership and resigned to a permanent "underclass of renters".

Everybody that has lived in Australia over the last decade knows this to be fact. It barely requires substantiation. I will simply point to the proliferation of media programming relating to property investing, books suggesting that untold wealth can be obtained by investing in Australian property (e.g. books promoting the acquisition of X properties in X years), and frequent advertising by property advisers in various media (Figure 1).

Similarly, that Australia has a Housing Affordability Crisis – after a decade and a half of unbroken economic growth and an enormous run-up in personal debt, much of which went toward housing "investment" – is accepted fact within our society. This inquiry, in itself, is proof of that. Moreover, many national and international reports have highlighted that Australian house prices, as a ratio of purchase price to average wages, are one of the highest, if not the highest, in the western world. These reports are from leading national and international organisations including the Reserve Bank of Australia, The International Monetary Fund, Demographia, and The Housing Industry Association/Commonwealth Bank, amongst others.

This Select Committee is sure to have read many thousands of words. So I will attempt not to add unnecessarily to that by reiterating the findings of the above reports. I will simply draw attention to one critical report – by the Head of Economics at our own Reserve Bank of Australia, Anthony Richards – "Some Observations on the Cost of Housing in Australia". The author and the RBA are to be commended for their thorough and frank assessment.

There are several absolutely critical statements in this report:

1) The RBA unambiguously states that rising house prices have not been to the advantage of Australians in aggregate, but that higher income Australians have benefited whilst lower income Australians have "suffered"!
2) The RBA also conclusively shows that the Housing Affordability Crisis is a function of the very high purchase prices rather than interest rate rises.
3) A graph (reproduced herein as Figure 2) is included to demonstrate that "Australia's median house price to income ratio is quite high by international standards" – and I would add that we actually have the highest ratio of all of the countries shown including UK, US, Ireland, New Zealand and Canada.
4) The RBA developed a new measure of affordability which showed that between 1998/99 and 2006/07 the proportion of dwellings which the median young

Australian household could afford to purchase dropped by 50%, at which point it was 33% below the longer-run average. (Also note that affordability has continued to worsen since 2006/07.)

5) The RBA acknowledged that "aspects of the tax system" boosted demand for housing.

The Housing Affordability Crisis does not sit comfortably with our own generally accepted view of Australia as a proudly egalitarian society. Either, that image of ourselves must change to reflect modern reality – that we are a society in aggregate comfortable being divided into two-tiers, the "haves" and the "have-nots" – or we must implement policy designed to provide equal opportunity for all Australians. Equal opportunity to affordable housing is one of the most critical requirements in a cohesive society.

Certainly the cause of Australia's housing affordability is multi-factorial. All of the issues covered within the Terms of Reference for this Select committee are important. In this submission I will make comments on the factors which I consider to be most urgently in need of action: the effect on the market of government intervention in the housing sector; and proposed assistance for first home owners by the Commonwealth government and their effectiveness in the absence of increased supply.

The effect on the market of government intervention in the housing sector

In the current residential property bull market, it is not uncommon to be told of property investors owning 20 or 30 houses. Certainly, property investment magazines glamorise such people as "case studies", and "advisers" and "authors" project this as something to which one should aspire. And this is precisely what advertisements highlight as Figure 1 shows.

Critically, the utility of property investment in wealth creation has been reinforced by successive Commonwealth governments implementing and retaining taxation policies – concessions – which encouraged investment and speculation in residential property. I am referring specifically to the offsetting of property investment losses against other income (negative gearing), capital gains tax concessions, and the newest form, leveraged investing via a warrant-type arrangement within a self-managed superannuation fund (with all of the tax benefits involved). Importantly, all of these concessions apply to established housing as well as newly constructed housing.

Please note carefully that the second dot point in the advertisement in Figure 1, which promotes the purchase of one property each year for six years, reads "*how to use your tax to pay for your property*".

Proponents of this system argue these taxation concessions are necessary as incentives for investors to provide more rental accommodation. Moreover, common folklore has it that in 1985 when negative gearing – the only concession in place at the time – was temporarily abolished, rents spiked as a consequence of its removal. My understanding is that view is based on information from the Real Estate Industry of Australia. This is the peek body of the industry which gains most from turnover in realestate and it has a major conflict of interest. Therefore, the analysis could not be considered robust.

To the contrary, research by Saul Eslake of the ANZ found that there was no Australia-wide spike in rents following the removal of negative gearing in the mid 1980s. There were significant rent increases in several markets, most notably Sydney and Melbourne, but these were considered due to other factors, most notably low vacancy rates. (Note those vacancy rates were higher than current levels in the same and other markets, and rents are currently surging with even more concessions in place now.)

The current Housing Affordability Crisis is a function of massive undersupply of new housing. Estimates put that undersupply at between 25,000-35,000 dwellings annually. This is after a decade and a half of unbroken economic expansion with personal credit expanding at a significant rate, much of it going toward housing. Keen (2007, "Deeper in Debt") conclusively demonstrated that the expansion of credit for housing was unproductive as most went toward paying more and more for the same housing.

The current Crisis clearly demonstrates that the taxation concessions to investors do not provide incentives to build more rental accommodation. Rather, the concessions act to provide investors with greater purchasing power over owner-occupiers, particularly first home buyers. Consequently, the tax concessions lead to a higher proportion of existing housing being owned by investors, but do not encourage the addition of further housing stock.

Moreover, the concessions in no way encourage long term investing in property – the only concession with a time frame is the CGT concession which requires the property to be owned for just one year. In so much as the tax concessions contributed to the rapidly escalating house prices over the last decade, they exacerbated the Housing Affordability Crisis by encouraging short term speculation in housing.

It is clear that these taxation concessions to investors do not play a constructive role in Australian property markets. Moreover, the concessions are distortions in markets which lead credit to be misdirected unproductively, and they act to worsen housing affordability in Australia. Unfortunately, instead of decreasing these distortions, over recent years they have been increased – the CGT concessions were implemented in 2000, and the ability to leverage into property within a self-managed superannuation fund was legislated in September 2007.

Proposed assistance for first home owners by the Commonwealth government and their effectiveness in the absence of increased supply

Firstly, I wish to state that the proposition of this term of reference, "in the absence of increased supply", I believe is correct because the supply side policies from the Commonwealth and State governments are unlikely to address the current undersupply crisis. In actual fact, with interest rates likely to be higher over than next few years than they have been in recent history, the annual undersupply level is likely to worsen.

The only proposed assistance from the Commonwealth government acting on the demand side for first home buyers is the First Home Buyers Savings Accounts (FHSA).

There are only a couple of differences between this scheme and an increase to the First Home Owners Grant. In the FHSA:

1. The first home buyer is obliged to make savings to obtain a co-contribution from the Commonwealth government; and
2. The savings are inaccessible for 4 years.

Whilst it is a good initiative to compel first home buyers to save for their deposit, and the consequent lessening of demand may act to slow house price appreciation over the next 3 years, it will simply serve to build up demand and lead to a surge in demand in late 2012 when the first participants gain access to their funds.

The RBA has very clearly stated (in Richards 2008) that "On the demand side, it is now widely accepted that policies that simply give people more money to spend on housing are likely to be capitalised into higher housing prices". I concur strongly with this view.

In the absence of increased supply, and critically, *if the other demand factors remain in place, most notably the taxation concessions to investors*, then the FHSA is likely to worsen affordability for first home buyers.

In such a situation, I would expect that prices may plateau, or even decrease slightly, until 2011 when investors will begin to position themselves for the massive surge in demand from first home buyers gaining access to their FHSAs. By late 2012, when the first home buyers hit the market again, prices will have already increased by significantly more than totals in those accounts. The only Australians to benefit from the FHSA will be investors and other sellers.

Conclusions

It is clear that tax concessions to investors do not assist Australians in obtaining affordable housing. In fact, they are distortions in the market which have been a very significant factor in creating the current Housing Affordability Crisis.

Over the medium term, our housing markets must be freed from these distortions so that dwellings are valued fairly for their intrinsic worth as homes to Australians. However, I would propose that in the short term, the distortions be realigned to address the problems that they have in part created.

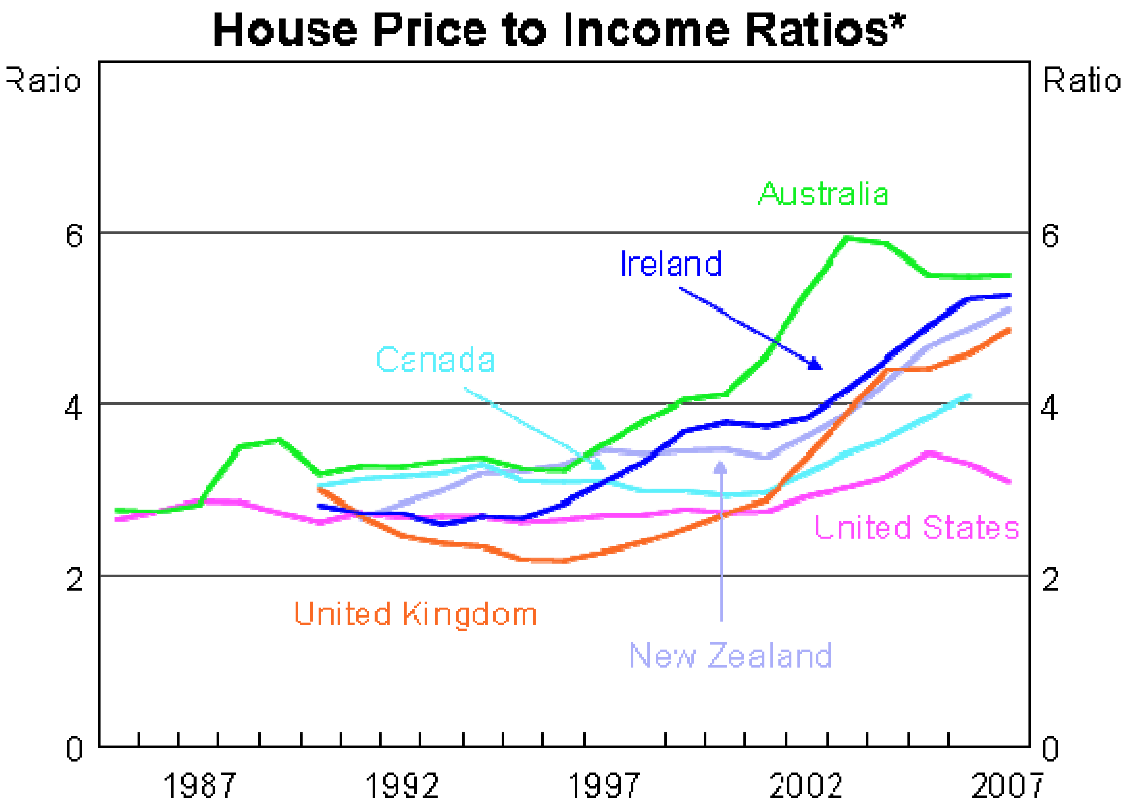
In the first stage, I propose that all of the taxation incentives be permanently removed from established housing. This will remove the speculative demand for existing housing and will allow more home buyers to enter the market. Long term investors will again become active based on the fundamentals of improving rental yields following a realignment of house prices rather than rental prices. For a period of 5 years, the investor tax incentives should be applied only to newly constructed housing. At his point there should be an assessment of whether the policy needs to be continued to further increase supply, or discontinued to prevent an oversupply of housing.

Finally, it is critical to note that at the end of bull markets in other assets, such as stocks, it is typical that regulators step in to address the less than ethical practices of some market participants through the bull market. I am aware that regulators have paid close attention to several property spruikers.

The functioning of the realestate industry and the actions of industry players through this long bull market must be closely examined. There has been some talk in the media about rental auctions, and unethical practices during auctions. I would suggest that the ACCC needs to take a very close look at the realestate industry to provide confidence to Australia working families that it has not and is not engaging in price gauging or collusion in rental and purchase pricing. Moreover, competition policy must be extended to the realestate sector - the realestate industry should be regulated so that no business with a license to sell realestate can let realestate, and that there be a clear separation between these functions to increase competition in the provision of housing. This would allow for significant efficiencies in housing markets, and provide major benefits to Australian working families in the form of more affordable housing.

Figure 1. Typical Advertisement (from “b Magazine” 08 April 2008)

Figure 2. House Prices to Income Ratios (Reproduced from Richards 2008, RBA)



* Various combinations of median and mean measures of house prices and incomes used depending on availability

Sources: ABS; BEA; BIS; CLG; CSO; OECD; ONS; RBNZ; REIA; Statistics Canada; Statistics NZ; Thomson Financial