



Housing Australia

August 2017

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About this publication

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CEDA – the Committee for Economic Development of Australia

Level 13, 440 Collins Street

Melbourne 3000 Australia








Telephone: +61 3 9662 3544

Email: info@ceda.com.au

Web: ceda.com.au



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Foreword



The great Australian dream of owning your own home has prevailed for more than half a century but with surging house prices in some parts of Australia, there has been much debate about whether it will continue.

Historically low interest rates, an unprecedented period of continuous economic growth and strong levels of migration have contributed to increasing demand and escalating housing prices in Australia's capital cities.

Rapid residential house price increases have inevitably delivered winners and losers, not only for individuals but also for government.

Surging property prices have delivered windfalls for government through increased direct taxes, such as stamp duty, and through increased economic activity due to construction.

However, growing housing demand has also increased pressure on governments to deliver increased infrastructure and services.

While there is much talk about growing inequality due to increasing house prices, pushing some to the outer urban fringes, and potential long term impacts if a larger number of people in the future retire without owning their home, pulling policy levers must be done with care.

Residential property ownership has become a key element for many Australians in their wealth accumulation strategy but it also means they are the most exposed to any price falls with increasing household debt.

Jolts to the housing market have the potential to significantly slow economic growth, which will have implications for all Australians.

The increased interest in the residential housing market has meant that there is no shortage of commentary in this space.

Public commentary around the future of house prices in key markets such as Sydney and Melbourne fluctuates from doom and gloom with predicted crashes to continuing growth.

CEDA's aim in drawing together this report is to take a holistic review of housing in Australia.

Key areas examined in this report include:

- Housing trends in Australia;
- The experience of Australia's housing sector compared with other countries in the OECD;
- Supply of housing: from land availability to changes in the composition of housing stock;
- Drivers of demand and possible policy levers; and
- The intergenerational consequences of high housing costs and falling home ownership.

House prices impact almost all Australians as either owners or renters, with increasing prices having a flow-on effect to rental prices, and therefore will continue to be on the national agenda.

I hope this publication can provide insight on some of the drivers and the broader impact of price fluctuations.

I would like to thank the contributing authors for their chapters and Dr Judith Yates as the CEDA consulting economist for this project. In addition, I would like to thank the CEDA research and policy committee for their oversight of this project.



Paul McClintock AO
National Chairman
CEDA

Executive summary

Historically low interest rates, an unprecedented period of continuous economic growth and strong levels of migration have contributed to ever escalating real housing prices in Australia's capital cities. The rapid pace of house price growth has contributed to growing housing affordability concerns.

However, the housing affordability problem is not uniform across Australia. While the issue has particularly affected the cities of Sydney and Melbourne, as Dr Nigel Stapledon outlines in Chapter 1, the Perth market is currently in decline. Additionally, housing booms and busts are a commonality in Australia's history. In light of these factors, where does the current period of pricing sit in relation to previous housing market cycles, and is it cause for concern?

To analyse where Australia's current affordability problem sits in relation to past property cycles, the first chapter of this publication looks at the past 50 years of housing in Australia's major cities. Dr Stapledon rounds-out this comparison with a look at the housing experience within other countries in the OECD, finding that it would be "a mistake for buyers to assume that this period is any guide to the future" and that a unique set of circumstances, including the resources boom, has led to this current period. However, he notes that cities with world-class amenities and restricted planning policies will always face greater demand and supply issues than other cities.

When housing becomes unaffordable, the obvious solutions proposed are those that increase supply or reduce demand, and indeed the Turnbull Government has a firm stance that increasing housing supply is the key to unlocking more affordable house prices.¹ In Chapter 2, Professor Chris Leishman looks at why, despite policy attention, supply never seems to be able to meet demand.

The complex market structures in the housing sector represent a number of challenges to policymakers. The Planning Institute of Australia has stated that extra costs can be accrued when there are planning delays, which then results in costs being borne by developers, which then pass onto the purchaser, thereby increasing housing unaffordability.² As Professor Leishman cites, this interaction between the planning system and the development land market can often result in developers staggering permit completions to capitalise on rising market prices. Naturally, this is a difficult issue to solve, and as Professor Leishman puts it, the very nature of the new housing sector has “inadvertently” been created in such a way that drives up the costs of housing.

Looking at the other side of the housing solutions equation, Associate Professor Emma Baker analyses the emerging drivers of housing demand in Chapter 3. As she details, demographic changes, such as unevenly spread population growth – which is predominately happening in NSW and Victoria – are increasing the pressure placed on housing in these states. Additionally, Australia’s ageing population and the increase of one-person households pose new demand-side challenges. These issues are likely to exacerbate with time, and as such, policymakers need to draw their attention to the areas where supply can adapt to these changes, as well as avenues that are available to cool demand.

In Chapter 5 Associate Professor David Morrison looks at the demand-side levers suggested by commentators that can be pulled to achieve this. The suggestions include negative gearing reforms (“by placing a limit on the number of rental properties each investor may hold”), further restrictions to offshore investors through taxation, and imposing a land tax on all property that is uniform throughout the Commonwealth.

While there have undoubtedly always been rising and falling costs of housing in the Australian market, the changes in Australia’s demographic and issues prohibiting supply keeping up with demand are certainly factors driving the current cycle. These challenges pose a number of social issues. The search for affordable housing has pushed many less well-off households to regional areas or on the urban and peri-urban fringes of the major cities, where employment opportunities and access to transport and amenities tend to be relatively poor compared with the inner and middle regions of the larger cities.

Intergenerational issues arise when many younger households, the millennial generation, are unable to access home ownership or can only afford to buy in regions where house price growth generally has been more constrained. This means they do not have the same opportunities to accumulate housing wealth as earlier generations, such as the baby-boomers, many of whom have experienced massive increases in wealth as a result of rising housing prices. Professor Rachel Ong explores this issue in Chapter 4.

Professor Ong also details in her chapter how intergenerational issues can give rise to intra-generational equity issues. For younger generations, increasing earnings inequality and increasing job insecurity have meant that many lower income households are unable to afford home purchase or are unwilling to commit to it. This inequity is compounded when some, but not all, can rely on the “bank of mum and dad” to assist them into home purchase. Additional intra-generational inequities arise for those excluded from home ownership in all generations because of tenancy legislation that tends to favour landlords over renters and results in rental housing providing less tenure security than owner-occupation.

When housing affordability becomes a national issue, economic growth is undermined in a number of ways. A lack of affordable housing can create a spatial mismatch between housing and jobs with a consequent negative impact on economic productivity as labour market participation and geographic labour mobility are reduced. When this happens, the labour market is less flexible than is needed to respond to structural change.³ Productivity is also reduced when congestion associated with this mismatch and inadequate public transport add to travel times for workers and delivery costs for producers. Reduced employment opportunities will increase income inequality which, in turn, can lower sustained economic growth, as shown by both the IMF and OECD.⁴

The resilience of the Australian economy is threatened by the potential impact of the house price induced rising household debt, held by first home buyers and by established households encouraged by the prospect of capital gains to increase their investment in housing. Concerns with financial stability led to a tightening of lending standards in 2014 but concerns with macroeconomic stability currently are of more concern.⁵

The chapters in this publication provide a more detailed analysis of these issues, and point to the key factors creating the current housing affordability issue. The recommendations that follow take into account the complicated nature of housing reform, and suggest some of the changes that might be needed to address Australia’s housing affordability problems.

Endnotes

- 1 Turnbull, M 2017, “Doorstop - Visit to Peters Ice Cream with Minister for Communications and the Arts, Senator the Hon. Mitch Fifield”, Mulgrave, Sydney, 6 March.
- 2 Senate Select Committee on Housing Affordability in Australia, 2008, *A good house is hard to find: Housing affordability in Australia*, Commonwealth of Australia, Canberra.
- 3 Productivity Commission (2014) Geographic Labour Mobility (<http://www.pc.gov.au/inquiries/completed/labour-mobility/report>) and AHURI (2016) “An efficient and responsive housing market for sustainable urban growth and social inclusion”, Research and Policy Bulletin Issue 213 (<http://www.ahuri.edu.au/research/research-and-policy-bulletins/213>)
- 4 Berg, A. and Ostry, J. (2011) “Inequality and Unstable Growth: Two Sides of the Same Coin?”, IMF Staff Discussion Note SDN/11/08 and OECD (2015) “In it Together: Why Less Inequality Benefits All”, Paris: OECD Publishing.
- 5 RBA, Financial Stability Review, April 2017. Household with lower net wealth and income or higher leverage, are less likely to have mortgage buffers that might provide them with some protection from interest rate, income or price shocks (RBA, FSR, April 2016). In their March 2017 Economic Survey (www.oecd.org/eco/surveys/economic-survey-australia.htm), the OECD suggested that house prices and housing debt point to continued economic and financial vulnerability in Australia, particularly if house prices or aggregate demand were to fall.

Recommendations

The following findings offer recommendations for Australian federal and local government that would contribute to easing supply and cooling-off demand. They draw on the content and recommendations put forward in this publication.

Priority of policy settings

Two global events – the decline in interest rates and the end of credit rationing – have combined to produce a surge in house prices globally. This is likely to be a once in a lifetime shock leading to a higher level of prices than we saw in the last half-century. While most of us have to accommodate to this, the poorest will find it hard to adapt and policy needs to adjust to this new reality.

Recommendation 1:

Policy settings need to prioritise shelter to the most disadvantaged.

This issue of planning restrictions

Prices in some markets have probably overshot. The main reason for this has been the failure of supply to adjust, most notably in Sydney.

Recommendation 2:

Planning restrictions, particularly those imposed by local councils, need to be relaxed, made more consistent and housing density increased.

Transport and infrastructure

In Australia's biggest cities, the provision of road and rail transport has traditionally lagged the growth of new dwelling precincts. Faster and more convenient transport can both increase the amenity of outer suburban developments, and ease the congestion arising from increased inner city housing density.

Recommendation 3:

Develop consistent planning and funding models for transport infrastructure to better connect new housing developments to the various employment hubs.

Tenancy protections

Australia's growing population needs to be housed. If people want to live in cities, we need to adapt to and accept higher population densities. We also need to accept that in future most people will live in apartments and will often be renting.

Recommendation 4:

Laws around tenancy must provide adequate protection and certainty to long-term renters.

Downsizing

There are some people who are over-supplied with housing and who might be encouraged to downsize, thereby making land available for greater density uses. In part this might be encouraged by more liberal rules around welfare testing of income generated from downsizing, and in part by lessening some of the impediments to trading house.

Recommendation 5:

Governments should further relax rules around the means testing of income received from downsizing in situations where it results in greater housing density.

Recommendation 6:

Governments should be encouraged to move towards charging an annual land tax in place of transaction taxes on housing.

Demand-side policies

Some of the pressures on the housing market come from the demand side. Some of this is speculative and some driven by rational calculations of return. To the extent the speculative activity poses risks to the banking system, the financial regulators are already active in lessening any threat. Other speculators face the risk of losing some of their investment, as is entirely appropriate.

Investment in housing by owner-occupiers is very sensible given the lenient treatment such investment receives in the Australian taxation system by its exclusion from capital gains taxation and from pension asset tests. Nevertheless, access to housing is an essential part of retirement planning and it is not clear that the various elements interact well.

Recommendation 7:

Governments should review the way in which pensions, superannuation and housing interact in providing support for Australians in the retirement phase.

Capital gains

Other investment in housing may be a sensible part of asset accumulation during one's working life. The recent experience of very rapid price appreciation (and capital gains) is likely to have led people to over-invest in housing. Excessively generous capital gains taxation has encouraged the flight to property and other assets.

Recommendation 8:

A larger component of capital gains should be taxed.

Contributions

Overview

Dr Judith Yates, Honorary Associate, School of Economics, The University of Sydney; and Associate Professor, Economics, The University of Sydney, in the capacity of CEDA's Consulting Economist, provides the publication overview, giving a top-level view of the current issue of housing affordability in Australia. She puts forward a series of recommendations that fall under the three categories of: structural policy changes, short-term fixes that respond to immediate issues, and longer-term policy directions.

Is the current period of price movement unusual?

Dr Nigel Stapledon, Research Fellow, CAER and Chief Advisor, Macroplan looks at Australia's current state of house pricing in the context of the last 50 years of Australia's major housing booms and busts. He also looks at international housing markets in order to determine if the current period is unusual and therefore cause for concern. In order to explain the current price period we are in, he looks at what causes a housing market to become heated, including: supply constraints, coastal locations and interest rates.

Is Australian housing supply adequate?

Professor Chris Leishman, Director, Centre for Housing, Urban and Regional Planning, University of Adelaide looks at trends in the costs of acquiring land and building on it; the impact of regulation on land availability; and changes in the composition of the housing stock. He puts forward that the relationship between housing supply and house price is more complex than some commentators suggest, and there is a gap in evidence in examining the long run relationship between supply and prices. His chapter finds that the housing supply sector unintentionally works in such a way that new supply will never fully meet the needs of the housing market.

Australia's demand for housing

Associate Professor Emma Baker, School of Architecture and Built Environment, The University of Adelaide reflects on the trends and the likely drivers of housing demand into the near future. She looks at population and demographic changes, changes in housing stock, changes in affordability, and offshore demand. She describes demand as growing steadily, but very spatially concentrated; positing that Australia could almost be considered in terms of three distinct housing markets operating – Melbourne, Sydney, and the remainder of Australia. Despite this, she says the “constraint of affordability” has become more widespread across all states this century. She concludes with a call for a coordinated national approach to data and measurement, saying “our understanding of housing demand and supply are highly dependent on the systematic and repeated interpretation of quality national and sub-national data”, which Australia lacks.

Housing futures in Australia: an intergenerational perspective

Professor Rachel Ong, Deputy Director, Bankwest Curtin Economics Centre, Curtin University looks at the competition between generations for ownership of property, discussing how policy reform, changing labour markets and housing conditions have allowed the “boomer” generation to accumulate wealth at the expense of younger generations, who are now largely locked out of the housing market. She gives an analysis of the past 30 years of property ownership patterns to outline the extent of the intergenerational problem Australia currently faces. She advocates that a broad-based approach to housing policy needs to be taken, which considers how policy affects all generations, along with a raft of policy suggestions to prevent the generational gap from widening.

The impact of tax regulation on housing

Associate Professor David Morrison, Reader in Law; and Research Fellow, Australian Institute for Business and Economics, The University of Queensland, discusses the financial instruments and regulation that could be used to change housing market conditions. He discusses who benefits currently from the established system, and possible outcomes of pulling various policy levers in an effort to make housing more affordable.

Case study: The Village, Balgowlah

Gavin Tonnet, National Head of Apartments and Mixed-Use, Stockland describes a mixed-use development case study that was undertaken by Stockland. The study illustrates how mixed-use is one way to establish greater density communities that retain high-quality liveability. Additionally, mixed-use developments provide the infrastructure and jobs many newly developed outer- and middle-region suburbs can often lack.



Overview: Housing Australia

Dr Judith Yates

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Housing affordability, particularly in Sydney and Melbourne, has been making headlines in Australia at an increasing rate. CEDA Consulting Economist, Dr Judith Yates examines the causes and consequence of half a century of real housing price growth and the impact of, and implications for, policy.

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Dr Judith Yates is an honorary associate in the School of Economics at the University of Sydney following a career of more than 40 years in academia. Her primary research has been in housing economics, finance and policy. She has produced background papers for the Australian Financial System Inquiry in the 1980s and the Australian

Government's National Housing Strategy in the 1990s, and was a member of the National Housing Supply Council in the 2000s. She holds a PhD in Economic Science from the University of Amsterdam and a Bachelor of Economics (hons) from the Australian National University.

Introduction

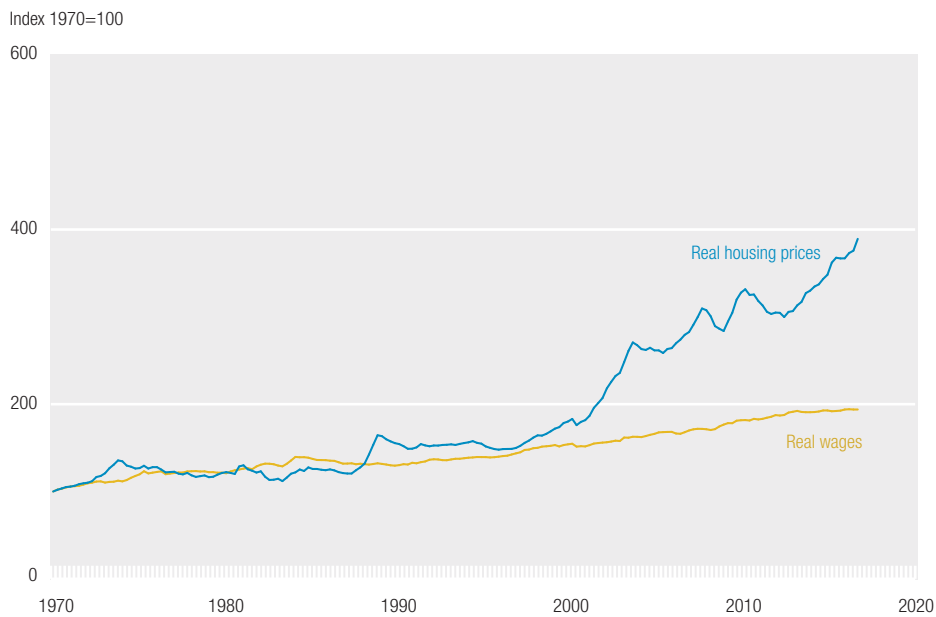
Housing, and particularly housing affordability, has become a “barbecue stopper” in Australia. Rapidly rising housing prices dominate the conversation of the well-heeled as they delight in the increasing value of their wealth portfolio, protest about the impact of increasing density on their neighbourhood, and despair over whether their adult children will ever be able to afford to leave home. Less well-resourced households worry about how many hours of work they will get next week and what will happen if they can't meet their rental payments. Both federal and state governments have declared housing affordability a policy priority and have implemented a raft of policies intended to address emerging problems.

Australia's rising housing prices

Since 1970, Australia's median real house price has almost quadrupled while real wages have only doubled.¹ This resulted in a doubling of the Australia-wide dwelling price to income ratio to a present value of around six to seven.

Real house price growth has been a post-war phenomenon. Trend growth rates have varied considerably between the major cities and the most significant increases in most cities occurred from the mid-1990s to mid-2000s.² Stapledon, in Chapter 1, shows that real rental growth, although exhibiting similar spatial variation, has been steadier and more modest than housing price growth. Increases in both housing prices and rents have been greatest in Sydney (with Sydney housing prices increasing at twice the rate of the Australia wide growth shown in Figure 1). They have been lowest in regional areas.

FIGURE 1
REAL HOUSING PRICE AND WAGE INDEXES: AUSTRALIA, 1970–2016



Source: Treasury, ABS; CPI adjusted.

Real house prices increase as a result of demand pressures arising from:

- Demographic trends, such as population and household growth, which primarily affect how many dwellings are needed; and
- Economic drivers (such as growing real incomes and wealth, low interest rates, and fiscal policies – particularly taxation policies) that treat housing favourably, which primarily affect the size, quality and location of dwellings demanded by each household.³

Tax reforms encourage investment in rental property, two notable such reforms include changes in the 1980s and 1990s. In the mid-1980s tax reforms exempted owner-occupied housing from the new capital gains tax and from the assets test for the age pension, which advantaged investment in owner-occupied housing. While in the mid-1990s, tax reforms introduced a discount on (realised) capital gains for investors but allowed the full cost of acquiring housing assets to be deducted against income from any source.

Two key institutional changes increased borrowing capacity for previously credit-constrained households.⁴ Financial deregulation from the mid-1980s provided households with increased access to finance. The adoption of inflation targeting as a framework for monetary policy in the mid-1990s contributed to the subsequent general fall in nominal interest rates, which made finance more affordable. Morrison, in Chapter 5, highlights the role of these economic drivers.

Demand pressures have a bigger impact on price when supply is less responsive to changes in demand. Short-run supply constraints reinforce housing price cycles because they create lags before supply can respond to increases in demand. Leishman, in Chapter 2, points to an inadequate supply of land and the

planning system as being at the heart of insufficient new housing supply. He also cites qualitative evidence suggesting land developers deliberately restrict serviced land supply by “drip-feeding” it onto the market to protect their profits.⁵ However, it is the interaction of increasing demand with long-run supply constraints that have caused the upward trend in real house prices.

In Australia, long-run supply is constrained because of our urban settlement pattern. Two thirds of our population live in a capital city and 40 per cent live in Sydney and Melbourne alone, as covered by Baker in Chapter 3. Structural change, with a shift away from agriculture and manufacturing to a service based economy, has contributed to an increasing proportion of the population living in urban areas. Increasing urbanisation has resulted in what might best be described as diseconomies of scale. These arise because location matters. Since commuting is costly, increasing demand puts pressure on well-located land which, because of the contribution land makes to total housing costs, adds to the cost of well-located housing. This cost is increased by:

- Resistance to increased density within the inner and middle regions of the major cities, and higher unit costs of building the multi-storey developments that economise on land; and
- A failure to provide the transport infrastructure needed and to contain transport costs to service development at the fringe of the cities.

At least since the early 1990s, this pressure has shown up in housing price gradients in our major cities, which have increased dramatically in the past three decades.⁶ Stapledon describes the role played by transport innovation and infrastructure, and provides a good example of the strong influence they have in affecting land price trends.

Increasing income and wealth inequality has contributed to steepening dwelling price gradients. Prices increase most in locations where people with the greatest capacity to pay want to live. Highly skilled workers are attracted to areas with good amenities and deep labour markets and, to the extent that these are geographically constrained, this contributes to differential increases in real house prices.⁷

Outcomes of long-term trends

One outcome of the real housing price trends summarised in Figure 1 is that, increasingly, many households have been unable to afford to buy a home. Despite generally declining interest rates from the mid-1980s, the borrowing capacity of middle or lower income households has failed to grow at the same rate as the cost of a median priced dwelling. In the mid-1970s, borrowing capacity for a household on median income was sufficient to fully cover the cost of purchase of a median priced dwelling. By 2016, a deposit gap of more than twice median income has emerged for a median priced dwelling and up to four times more than median income in Sydney and Melbourne.

Not being able to afford home purchase, or not wanting to live where they could afford it, has resulted in a marked decline in home ownership rates among younger households over the past 30 or so years as discussed by Ong in Chapter 5. As shown in Table 1, home ownership rates for under-35s fell from around 60 per cent in the 1980s to 45 per cent by 2016 and, over the same period, from 75 per cent to 62 per cent for households in the 35–44 year old group.⁸

TABLE 1
HOME OWNERSHIP RATES AS A PERCENTAGE, BY AGE OF HOUSEHOLD REFERENCE PERSON, AUSTRALIA 1981–2016

Year	Age of household reference person					
	25–34	35–44	45–54	55–64	65+	All h'holds
1981	61	75	79	81	78	70
1986	58	74	79	82	80	70
1991	56	74	81	84	84	72
1996	52	70	79	83	82	69
2001	51	69	78	82	82	70
2006	51	69	78	82	82	70
2011	47	64	73	79	79	67
2016*	45	62	72	78	82	67
Change 1981–2014	-16	-13	-7	-3	4	-3

Source: ABS Census of Population and Housing, based on special request tabulations;

*Colebatch (2017) "One census: three stories" (<http://johnmenadue.com/tim-colebatch-one-census-three-stories/>)

Note: home ownership rates based on census data exclude responses where tenure was not stated

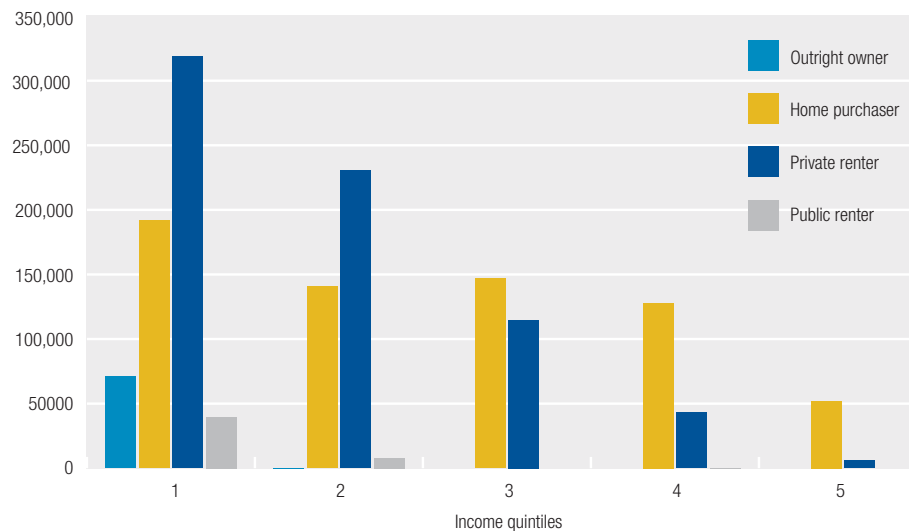
For the younger cohort, part of this decline has been attributed to socio-demographic factors such as delayed partnering and child-rearing.⁹ However, the decline has been most dramatic for lower income households where economic constraints dominate.¹⁰ Some households will choose to buy lower priced homes in regional areas or the urban and peri-urban fringes of the major cities.¹¹ This choice, however, does not reduce their debt burden if they still need to borrow the maximum amount allowed.¹² Not all are prepared to make such choices and many are constrained from doing so for family and work reasons. Some may breach the deposit gap by relying on the "bank of mum and dad" but many lower-income households simply cannot afford to buy anywhere.¹³

A second outcome, arising from the emergence of increasing spatial differences in dwelling prices, is that a significant number of middle and higher-income households, who do not want to live where they can afford to purchase, are choosing to rent in more desirable locations with better access to jobs and services. This shift of higher income households into private rental for life-style reasons squeezes out lower income households from well-located rental dwellings.¹⁴ Increasingly, the rental housing that is affordable and available for low to middle income households is disproportionately located outside of the major capital cities or is poorly located on city fringes.¹⁵

As well as being increasingly poorly located, the supply of affordable private rental housing available for lower income households has declined steadily over the past 25 years with an estimated shortfall of close to 300,000 rental dwellings in 2011 for households in the lowest income quintile and well over 100,000 for those in the second income quintile. Lower income renters do not have the option of reducing their housing costs by living in smaller dwellings, or in less well-located dwellings. There are simply not enough low-rent dwellings available and, to compound the shortage, there has been no growth in social housing.¹⁷

As a result of an increasingly inadequate supply of affordable housing where people want to or need to live, significant numbers of lower income households face high housing costs, particularly in the private rental market. The incidence of high housing costs in the private rental market is almost 90 per cent for households in the lowest quintile and just over 50 per cent in the second quintile (compared with, respectively, 68 and 33 per cent of purchasers).¹⁸

FIGURE 2
NUMBER OF HOUSEHOLDS PAYING ≥30 PER CENT OF INCOME ON HOUSING



Source: ABS Survey of Income and Housing, 2013–14, results derived from ABS Basic CURF data.

A related outcome is that lower income households looking for affordable rental housing are forced to the outer regions of our cities or to non-metropolitan regions where jobs are less plentiful and less highly paid. This means they are either forced into longer and costlier commutes into job rich areas (such as the CBD) or have to accept lower paid or part-time jobs closer to where they live. In other words, they are being forced to make location choices that are likely to reinforce their current income status. Their high housing costs in relation to income reduce their capacity to save in order to accumulate wealth of any form. They also are exposed to a tenancy that provides little security of tenure with relatively short-term leases and termination clauses that tend to favour the landlord rather than the tenant.²⁰ An extreme outcome of these trends is homelessness.²¹

A final outcome of the real housing price trends over the past few decades is that housing wealth now forms a significant share of total household wealth for households who were fortunate enough to own housing in locations where price growth was substantial.²²

TABLE 2
AVERAGE NET WEALTH BY AGE AND TENURE: AUSTRALIA, 2013–14

	Owners						Renters					
	25–34	35–44	45–54	55–64	65+	All owners	25–34	35–44	45–54	55–64	65+	All renters
Assets	\$'000s						\$'000s					
Principal residence	470	606	654	639	555	594	0	0	0	0	0	0
Other property	96	136	163	168	87	130	40	72	90	108	29	58
Superannuation	68	131	233	360	179	209	39	53	91	136	48	59
Other assets	194	285	430	413	412	371	96	117	157	203	101	120
Total gross assets	828	1158	1480	1579	1232	1304	175	244	339	449	178	238
Debt	\$'000s						\$'000s					
Principal residence	270	243	153	68	8	121	0	0	0	0	0	0
Other property	50	64	75	48	10	46	16	25	26	23	2	17
Other debt	31	43	41	34	9	30	22	25	23	18	2	20
Total liabilities	351	350	270	150	27	197	38	51	50	42	4	38
Net worth	\$'000s						\$'000s					
Principal residence	77	227	368	459	462	473	0	0	0	0	0	0
Other property	33	63	81	113	69	84	24	47	64	85	28	40
Superannuation	68	131	233	360	179	209	39	53	91	136	48	59
Other assets	163	242	389	379	403	342	73	93	134	185	99	100
Total net worth	477	808	1210	1429	1206	1107	137	193	289	407	175	200

Source: ABS Survey of Income and Housing, 2013–14, results derived from ABS Basic CURF data.

By 2013–14 average net worth per household was a little over \$800,000, of which approximately half could be attributed to housing net worth. Renter households had an average net worth of just over \$200,000 per household compared with more than \$1.1million for owner-occupier households. Table 2 shows this is not just a life-stage outcome. Renters who could not afford to become a homeowner, or who have not remained an owner for whatever reason, have significantly lower net worth in every broad wealth category at every age.

What of the future?

Looking forward, there can be little sense of optimism about future housing affordability outcomes:

- Demand pressures are likely to continue over the next 40 years. Economic growth per capita is (still) predicted to continue, although at a somewhat lower rate than experienced over the past 40 years. Australia's population also is projected to continue to grow at only a slightly lower annual growth rate than over the past 40 years, with this growth being concentrated in Sydney and Melbourne.²³
- Supply constraints are likely to remain. Urbanisation trends are expected to continue, with the proportion of people living in Australia's capital cities projected to rise from a current 66 per cent to almost 74 per cent.²⁴ Jobs in the future are projected to grow in service and knowledge based industries with skilled labour being favoured over unskilled.²⁵ This will reinforce the steady growth in earnings inequality that Australia has experienced since the mid-1970s.²⁶

Increasing population, increasing economic growth and increasing concentration of well-paid employment opportunities, therefore, are likely to continue to put pressures on well-located land in our metropolitan regions. Such pressure will be reinforced by:

- Increasing income and wealth inequality;
- A tax-transfer system that encourages established households to hold on to the growing equity in their owner-occupied housing and to increase their housing wealth by borrowing to invest in residential property; and
- A housing finance system that remains biased towards those most able to pay.²⁷

Pressures on the private rental market will continue as low and middle income households are excluded from home ownership and higher income households choose to rent rather than own. As Baker in Chapter 3 and Ong in Chapter 5 observe, these changes indicate a new housing landscape and suggest a need to rethink housing policy.

What is the housing affordability problem?

Housing affordability has emerged as a key challenge facing housing policymakers in the 21st century. However, the question: "why is housing affordability a problem?" needs to be addressed before appropriate policies to address it can be put in place.

Is affordability a problem because many households are encouraged to take on high debt burdens and that home ownership is becoming increasingly precarious? If so, why? Is it because of the increased risks they are exposed to if interest rates rise or their incomes fall, or is it because their response to such adverse

circumstances provides a threat to Australia's economic and financial stability? If so, should policy focus on ameliorating this risk?

Is it a problem because younger cohorts are being excluded from home ownership? If so, why? Is it because of the intergenerational inequity that arises because they do not have the same options as earlier generations? If so, should policy focus on redistributive measures? Is it because they will miss out on the tax and welfare benefits of home ownership?²⁸ If so, should policy focus more on levelling the playing field with respect to these benefits?

Is it because renting is unattractive and generally less secure than home ownership? If so, should policy focus on improving the characteristics of private rental?

Is it a problem because less well-off households in search of affordable housing have little option but to choose locations with poor employment opportunities and poor access to services that potentially entrench their disadvantage? If so, why? Is it because of the lack of employment opportunities in all regions or difficulty in travelling to where jobs are available? If so, should policy focus on improving transport infrastructure and employment opportunities, or on ensuring that there is an adequate supply of affordable housing close to jobs and transport? Is it because of their initial relatively disadvantaged status? If so, should policy simply focus on reducing income and wealth inequality?

Is it a problem because new lower income purchasers, who have no choice but to locate in regions less likely to experience dwelling price inflation, have fewer opportunities to accumulate wealth than households who can afford to buy anywhere? If so, why? Is it because of the intra-generational inequity that arises from increasing wealth inequality? If so, should policy focus on reducing differentials in dwelling price inflation, or on more equally distributing unearned gains?

Is it a problem because of the differential increases in wealth that have accrued to households who bought property in the past few decades, depending on where they bought? If so, why? Is it because this is also a manifestation of the intra-generational inequity that arises from increasing wealth inequality? If so, again, should policy focus on reducing differentials in dwelling price inflation, or on the more equally distributing unearned gains?

Is it a problem because many households who bought property in the past few decades have experienced significant increases in wealth? If so, why? Is it because they have been using this wealth as collateral to further expand their housing portfolio by upgrading their existing housing or purchasing investment property and, by so doing, out-bidding potential first home buyers with less income and less wealth?²⁹ If so, should policy focus on limiting the amount they can borrow against the increased value of their property, or reduce the incentives to do so? Is it because of the inter-generational inequities arising from growing wealth inequality? If so, should policy focus on reducing wealth inequality?

“Increasing population, increasing economic growth and increasing concentration of well-paid employment opportunities, therefore, are likely to continue to put pressures on well-located land in our metropolitan regions.”

What can we do about it?

These questions provide many examples of why housing affordability is a problem and illustrate the complex issues that need to be considered when developing policies to deal with it. Concerns about housing affordability have been central to housing policy both because of the impact of declining affordability on individual households and because of its impact on the economy as a whole.

Appropriate policies require a vision of desired housing outcomes, an understanding of which aspect of “the housing affordability problem” is to be addressed, and a clear and unambiguous assessment of how different causal factors interact to affect housing markets if policies are to have their intended effect. This implies the need for coordinated policy development.

In part this is because there are multiple drivers of affordability outcomes. Many of the most influential levers that affect affordability lie outside of the range of what are conventionally described as housing policies. Fiscal (particularly taxation) and monetary policies, transport planning and infrastructure provision, population distribution and settlement planning and the income support system are just some of the ways in which governments can, and do, intervene to affect housing and housing affordability outcomes.³⁰ These levers can have different impacts in urban and regional areas.

It is also partly because housing outcomes are driven by both demand and supply factors and control over the levers that affect these is split between different levels of government. The Commonwealth government has control over most (but not all) of the levers that affect demand and sub-national levels of government have control over most (but not all) of the levers that affect supply. This mutual interdependence means that both the vision and the policy response to achieve it need to be developed jointly with all levels of government. Policy responses need to be built on an agreement about objectives and a common understanding of the ways in which levers can be used to affect these.³¹

A failure to address housing affordability problems can jeopardise achievement of other government goals such as those relating to economic growth and employment.

In a recent speech, Federal Treasurer, the Hon. Scott Morrison claimed that, along with a job and independence in retirement, home ownership was one of three important goals Australians aspired. In his view, housing affordability is a problem because it has prevented many younger households from purchasing their first home.³²

Whether this remains an appropriate goal, whether it is consistent with the desire to provide employment for all and independence in retirement, and whether current policies are effective in achieving it can all be questioned in light of the massive economic and social changes that have taken place since Menzies

“The Commonwealth government has control over most (but not all) of the levers that affect demand and sub-national levels of government have control over most (but not all) of the levers that affect supply.”

defined home ownership for the middle-class as the centrepiece of Australia's post-war housing policy and as the basis of a stable society.³³ Over the past 50 years or so, part-time employment has grown more rapidly than full-time employment, under-employment remains high;³⁴ the proportion of young people not engaged in employment, education or training is rising³⁵ and concerns about increasing precarious employment³⁶ and precarious home ownership are rising.³⁷

Income and wealth inequality has increased,³⁸ compounding the difficulties of access to home ownership. One possible outcome from the current operation of our housing system is that we will face the danger of a downward spiral in income and wealth inequality in Australia. This, as suggested by the OECD and the IMF, will work against the jobs and growth agenda set by our current government.³⁹ In this case, it is the extent that housing adds to inequality which is the major concern.

Increasingly it is being recognised that solutions to Australia's housing affordability problems are not simple.⁴⁰ As the Treasurer has said, there is no silver bullet.⁴¹

Demand side policies, such as increasing grants to First Home Buyers, introducing concessional savings schemes, or allowing access to superannuation, all aim to increase income or reduce the deposit gap. Their main effect will be to enable marginal buyers to purchase bigger homes in better locations.⁴² They are band-aid solutions that might be politically popular in the short-term, but will be ineffective in the long-run. None will change the fundamental causes of declining affordability.

A similar observation can be made regarding some so-called supply-side measures. Allowing asset rich home owners to downsize without losing any of their capital gains, of itself, is unlikely to increase the supply of affordable housing. Downsizing depends on there being an adequate supply of lower valued housing in a location to which older households are prepared to move. This relies upon increased dwelling diversity in all locations and so needs appropriate planning policies to be implemented to achieve this.

Other supply measures, such as releasing land at the city fringe, does little to reduce the cost of well-located land without complementary policies. A fast, affordable transport system from where land is available to where there are jobs is needed if pressures on land price gradients are to be reduced. Policies to expand jobs in regional areas and take the pressure off our biggest cities might also be relevant. Such policies often lie outside of what is generally regarded as "housing" policy.

Some supply side policies, however, are clearly within the domain of housing policy. An example is the current proposal to establish a National Housing Finance and Investment Corporation to encourage private and institutional investment in affordable housing. Even this will only be effective if sufficient resources are made available to fund the gap between what lower income households can afford and the cost of providing them with adequate and well-located housing.

"A fast, affordable transport system from where land is available to where there are jobs is needed if pressures on land price gradients are to be reduced."

Policies need to ensure that affordable housing is provided in locations where it is needed – in locations that provide access to employment opportunities as well as to basic services. Inclusionary zoning policies requiring new developments have a defined proportion of affordable housing make a good start in this direction. However, if this is to be a long-term solution, caveats will be needed to ensure that this form of housing remains affordable, not just for five or 10 years, but in perpetuity.

In general, incentives to encourage private involvement in an affordable housing sector will be successful in the long run only if there are mechanisms in place to ensure that affordability is sustained over time. Affordable dwellings need to be protected against profit taking in light of any future value uplift as land values increase.

Our current system of fragmented land ownership – which allows owners to choose when, and to whom, to sell – means that re-development is difficult in in-fill locations. Attempts to assemble development sites run the risk of being held to ransom by individual land-owners holding out for higher prices. Maybe we need to be less precious about our right to hold on to our property no matter what – maybe we need to have caveats placed on *all* land, and not just that used for affordable housing, to ensure that it cannot be disposed of at an inflated price.

Such caveats might not be needed if we were prepared to be more adventurous in constraining demand by following the call made earlier this year by the UN Special Rapporteur on adequate housing. She called for a shift away from the financialisation of housing and the role that it currently plays as a form of wealth accumulation and the reclamation of it as a social good and a basic human right.⁴³ Until our politicians are willing to work together to generate community support for such a change, the complex set of issues that define housing Australia's affordability problems are likely to remain.

Policy recommendations

There has been no shortage of policies proposed to address what is seen as Australia's worsening housing affordability problem. The recommendations that follow build on a long-history of recommendations made in a variety of reviews, inquiries and reports undertaken by various government departments or instrumentalities at the request of governments on both sides of politics over the past decade or more as well as those made by various stakeholders and the academic housing community.⁴⁴

They are grouped into three broad categories dealing with: structural changes to the policy making framework; a short-medium term "fix" to alleviate the worst of current affordability pressures; and longer term policy directions to resolve underlying structural determinants of housing affordability problems.

The author's recommendations draw on the material provided by the contributing authors to this report. Additional supporting material is provided in the endnotes.

Structural changes to policy making framework

The first set of recommendations deal with the questions:

- What are we trying to do?
- Why are we trying to do it?
- How are we going to do it? and
- How will we know whether we have done it?

They focus on placing housing policy reform on a broader agenda than that covered by the past National Affordable Housing Agreement (NAHA) by requiring consideration of the impact of “non-housing policies” on housing affordability outcomes. The lessons learned from the NAHA, however, should provide a basis for implementing the recommendations below.

They require recognition of the critical impact housing can have in achieving national economic goals and the need for a housing policy capability in central government beyond that defined by its welfare role in a social security portfolio.⁴⁵ Housing policy needs to be developed with a clear understanding of the complexity of the issues involved and of the impact on housing outcomes of “housing” and “non-housing” policies (including those made outside of government, such as by the Reserve Bank of Australia and the Australian Prudential Regulatory Authority). The revival of central government interest in urban development, the development of a Smart Cities Plan and emerging City Deals⁴⁶ provide a good start as does the establishment of a Minister for Cities and locating this in a key central agency (the Department of Prime Minister and Cabinet).

Because both national and sub-national policies affect housing outcomes, housing policy needs to be developed on a consistent and coherent basis. It needs mutual agreement of housing policy goals and a clear understanding of the impact of decisions made by the whole of government working cooperatively with the private and community sectors. Achieving desired housing outcomes will only be achieved if all levels of government have a coordinated approach to achieving the chosen goals.⁴⁷

Because the housing system is complex, changes may need to be made cautiously and can take time before they have effect. This suggests a greater need for bipartisan development of policy.

The following recommendations focus on the development of a national housing plan with a clear identification of what housing outcomes are desired, the impact on these outcomes of policies implemented by the whole of government, and a clear determination of the division of responsibilities between different levels of government for achieving these outcomes.

This suggests the need for an appropriate architecture to be in place: to determine what these housing outcomes should be (and why); to determine what level of funding is needed (and who provides it) to ensure the goals can be met; to assess how progress towards them can be demonstrated; and, over time, to assess what changes are needed if progress is not satisfactory.

- Appoint a federal minister for housing at cabinet level and locate the housing portfolio within one of the central, co-ordinating departments (such as Treasury or Department of Prime Minister and Cabinet) or create a separate department with formal links to these central agencies and other relevant departments (such as cities, employment, environment, finance, immigration, infrastructure, and social security).
- Identify the scale and scope of Australia’s current and likely future housing issues based on a nuanced understanding of why housing affordability is regarded as a problem in order to determine what specific issues need to be addressed in the following recommendation.
- Develop a National Housing Plan to determine both short-term and long-term goals for housing policy and the instruments to be used to achieve these and to ensure adequate funding is in place to achieve these goals. This is to be led by the federal minister for housing in collaboration with state housing ministers and with input from other stakeholders (including the community sector and relevant private sector organisations). This may be facilitated by establishing an independent ministerial advisory council.
- Establish an independent statutory authority with the capacity to develop housing impact statements for major policy decisions emerging from relevant departments (such as those identified above), and to evaluate progress against stated goals.

Short-medium term fixes

The second set of recommendations is based on the need to begin to address some of the more pressing problems immediately. This requires implementing policies that “do no harm” in the sense that they have no adverse long-term effects. They focus on the shortage of affordable rental housing in locations that provide lower income renters with access to transport and to jobs and on improving security of tenure within the private rental market because of the negative impacts of a lack of stable, secure and affordable housing.

Between 1996 and 2011, the Australia-wide shortage of dwellings affordable for households in the lowest income quintile grew from six per cent of the total rental stock in 1995 to almost 10 per cent in 2011, representing a total shortfall that increased at the rate of around 10,000 dwellings per year to a total of around 200,000 by 2011. The shortfall of affordable private rental dwellings available to lower income households in the bottom two income quintiles in 2011 is even higher.⁴⁸ The extent of the absolute shortfall is a reflection of the failure of the private rental market to generate an adequate supply of dwellings affordable for low income households and a failure of the social rental stock to grow in line with need. The shortage of affordable dwellings available for low income households arises from a misallocation of the limited affordable stock – from the failure of the private rental market to target all of its affordable

“Between 1996 and 2011, the Australia-wide shortage of rental dwellings affordable for households in the lowest income quintile grew from six per cent of the total rental stock in 1995 to almost 10 per cent in 2011.”

stock to low income households. On past trends, these shortfalls are likely to have increased by a further 50,000 dwellings by 2016.

Based on current household projections over the next 20–30 years, an immediate target should be set to ensure the annual supply of affordable rental dwellings increases enough to sustain the current share of social rental dwellings (requiring an additional 10,000 dwellings per year) and to prevent the current shortage in the private rental market from increasing any further (implying a need for a further 10,000 dwellings per year).

This target of a total of 20,000 affordable rental dwellings per year will limit the extent to which the current supply shortage for the most disadvantaged households will increase and will limit the extent to which increasing supply shortages put pressure on rents in the private rental market. It will not reduce the current shortage.

“States and local government have various regulatory tools available such as improving approvals processes, facilitating land release and rezoning and changing planning requirements to reduce costs directly or indirectly by reducing uncertainty and holding costs.”

Meeting these targets requires a consistent definition of affordable housing and an agreement on adjustments, if any, to be made to take into account regional differences in housing and transport costs. It also requires identifying how these targets will be funded, identifying what the contributions of national, state and local governments will be. States and local government have various regulatory tools available such as improving approvals processes, facilitating land release and rezoning and changing planning requirements to reduce costs directly or indirectly by reducing uncertainty and holding costs; they can employ inclusionary zoning (requiring a proportion of new dwellings in each new project to be sold or rented at below market rates) and reassess the current mix and structure of taxes and charges.

All surplus government land can be released and made available on the condition it is used for affordable housing. If any of these options are insufficient to meet the financing gap between what it costs to provide housing and what low income households can afford, additional direct subsidies will be needed.⁴⁹

Useful first steps have been taken in the May 2017 budget with, among other items, a statement of intent from the Commonwealth to:

- Work with the state and territory governments to set housing supply targets;
- Establish a National Housing Infrastructure Facility to address infrastructure choke points impeding housing development in critical areas of undersupply; and
- Establish a National Housing Finance Investment Corporation to provide cheaper and longer-term finance for the community housing sector.⁵⁰

These initiatives will contribute to establishing the institutions needed to deliver such housing, which could be supplied as publicly-provided social housing with appropriate funding arrangements in place; or as regulated private rental housing with appropriate incentives in place. However, they cannot ensure the housing

supported by these initiatives will be affordable for lower income households, and that it will be financially sustainable over the long run, unless they are underpinned by the additional resources needed to cover any financing gap.

Setting targets over a longer term – with funding mechanisms in place to guarantee that affordable housing is financially viable – will provide the security and certainty sought after by institutional investors. These investors are often seen as the primary source of finance for affordable housing in the future.⁵¹ Once mechanisms are in place to prevent any increase in the shortage of rental supply for households on the lowest incomes, a supply trajectory setting out the annual targets needed to address the current shortfall in affordable rental can be set.

- Set an initial minimum headline target of an Australia wide annual net increase of 20,000 dwellings affordable to low income households with access to jobs, transport and appropriate services and ensure enforceable arrangements are in place to meet this target.
- Each state and territory should develop regional or local government plans to identify where this affordable housing is to be provided and implement any changes needed in planning and approval processes and/or changes in taxes and charges to ensure that targets can and will be met.
- The Commonwealth government should coordinate funding requirements to provide financial incentives for state and territory governments to meet the annual targets for affordable housing provision in a cost-effective manner and to meet any remaining financing shortfall through direct subsidies in the form of tax incentives to housing producers or income support to tenants.
- Improve housing outcomes for private tenants by reforming tenancy laws: to provide better protection for tenants in relation to security of tenure; to limit frequency of rent increases and ensure increases are fair; and to require rental housing meet minimum standards and be maintained in a reasonable state of repair.

Longer term policy directions

The final set of recommendations address the underlying long-term structural determinants that are the root cause of Australia's housing affordability problems.

The first recommendation focuses on supply policies that can be used to slow down housing price inflation. The current Smart Cities Plan (with its aspirational target of a 30 minute city) has already made delivery of jobs closer to homes and more affordable housing an explicit part of that plan, as have the associated City Deals.⁵² What remains to be done, however, is to indicate what the improvement in housing affordability will be and by what mechanisms this will be achieved. The incentives to support planning and zoning reform must be sufficient to ensure that new supply both keeps up with growth in demand and that it is in locations where it is needed. Likewise, targets for a shift in jobs growth from the centres of the major cities to regional cities and outer metropolitan centres need to be an explicit part of the plan.

The second recommendation focuses on policies to reduce demand. This recommendation is largely redistributive in its impact and has the capacity to raise considerable revenue to fund other policies. However, it is likely to require a considerable political and community leadership to overcome the perceived resistance to changes in the status quo. This can be made more difficult by the disproportionate economic (and lobbying) power held by those who are most likely to be negatively affected by the changes proposed. Exactly what changes are to be implemented and the likely implications of them need to be discussed prior to their implementation. They will need to be implemented gradually and have careful attention paid to complementary policies that may be needed to offset any cases of hardship that might arise (such as for asset rich and income poor households).

The third recommendation focuses the role played by the housing finance system.

A recent UN report recommended that, as a step towards achieving sustainable development goals, states should aim:

“To reclaim the governance of housing systems from global credit markets and, in collaboration with affected communities and with cooperation and engagement by central banks and financial institutions, redesign housing finance and global investment in housing around the goal of ensuring access to adequate housing for all by 2030.”⁵³

As the Governor of the Reserve Bank reminds us, borrowing is not the underlying cause of the higher housing prices.⁵⁴ It facilitates the upward pressure on prices caused by the underlying supply-demand dynamics and can act as a “financial amplifier” in some cities.

To date, intervention in the housing finance system in Australia has focused on financial stability with the introduction of macro prudential regulations designed to constrain lending to risky borrowers. Regulators have been explicit in not setting out to control prices.⁵⁵ Some of the initiatives implemented (such as limiting the growth of investor lending and tightening lending standards) do contribute to limiting credit and, as such, have the potential to limit dwelling price growth.

However, the tightening of lending standards tends to have little impact on borrowing by the well-heeled, because their wealth and income levels mean they tend to not be affected by constraints on loan to valuation, debt to income or repayment to income ratios. Incentives that encourage lenders to shift their portfolios away from housing credit and more to business credit are likely to have greater potential to increase productivity and result in increased jobs and growth.

This last set of recommendations is as follows:

- Increase the supply of affordable housing in desirable locations by increasing density in middle-ring suburbs through use of inclusionary zoning and by including an increase in the supply of affordable housing falling within the public purpose definition for compulsory acquisition of land. Reduce location premium of well-located land through (Infrastructure Australia approved) transport projects that provide fast, reliable and affordable access to jobs and services in

all locations and by regional development policies that disperse employment opportunities.

- Reduce incentives for speculative investment in housing (e.g. by removing the asymmetric treatment of unearned capital gains and interest deductions or by taxing vacant homes); reduce incentives for owner-occupiers to over-invest in housing (e.g. by removing the land tax exemption for the family home and by including some or all of the value of the family home in the assets test for the Age Pension).⁵⁶
- Extend the mandates of Australia's financial authorities (and the FIRB) to include stabilisation of housing price inflation and require them to assist in dampening speculative activity in the housing market, develop tools to curb the excesses of financialisation and mitigate its distributional effects.⁵⁷ Examples of tools that might be considered include: extension of macroprudential regulation, imposition of maximum limits on the amount that can be borrowed or on the amount of foreign equity investment permitted for any dwelling and/or re-introduction of credit rationing with preference given to first home buyers or lending for new construction.

Endnotes

- 1 Data for average (full time adult) weekly earnings are used as a readily available approximation for median household incomes over time.
- 2 Stapledon, N. 2017, "Is the current period of price movement unusual?", *Housing Australia*, CEDA, Melbourne.
- 3 A substantial body of national and international evidence has identified these drivers of real dwelling price growth. See, for example, André, C. (2010), "A Bird's Eye View of OECD Housing Markets", *OECD Economics Department Working Papers*, No. 746 for an international perspective and Kohler, M. and van der Merwe, M. (2015) "Long-run Trends in Housing Price Growth", *Reserve Bank of Australia Bulletin*, September for an Australian perspective.
- 4 An overview of the effect of these changes on demand can be found in Ellis, L. (2006) "Housing and Housing Finance: The View from Australia and Beyond", *RBA Research Discussion Paper* No 2006-12.
- 5 This is based on a report prepared by Urbis for the National Housing Supply Council (<http://www.treasury.gov.au/PublicationsAndMedia/Publications/2012/Housing-supply-responses-to-changes-in-affordability>).
- 6 Illustrations of increasing house price gradients in the major cities from the mid-1980s to mid-2000s can be found in Yates, J. (2011) "Housing in Australia in the 2000s: Too Late on the Agenda", in Gerard, H. and Kearns, J. (eds) *The Australian Economy in the 2000s*, *Reserve Bank of Australia, Conference Volume 2011*, in Department of Infrastructure and Regional Development (2015) *State of Australian Cities* and in Kulish, M., Richards, A. and Gillitzer, C. (2012) "Urban structure and housing prices: some evidence from Australian cities", *Economic Record*, 88(282): 303-322. Ellis, L. (2015) "Property Markets and Financial Stability: What We Know So Far" (<http://www.rba.gov.au/speeches/2015/sp-so-2015-09-08.html>) shows the price differentials between inner and outer rings in all the major cities continued to rise between 2006 and 2014.
- 7 Stapledon, N. 2017, "Is the current period of price movement unusual?", *Housing Australia*, CEDA, Melbourne, also observes that Sydney's persistently higher housing prices can be attributed to its high level of natural amenity. Inherent geographic constraints are created by the harbour and beaches in the east, the mountains in the west and the water catchment areas in the north and south.
- 8 Ong points to a small proportion of younger persons (~2 per cent of 25-34 year olds and ~3 per cent of 35-44 year olds in 2013-14) who are investors without being owner-occupiers. These are excluded from the home ownership data in Table 1. Differences between the proportions reported in Table 1 here and in Figure 1 in chapter 5 arise from the use of household weights in the former and person weights in the latter.
- 9 RBA (2015) Submission to the Inquiry into Home Ownership (<http://www.rba.gov.au/publications/submissions/housing-and-housing-finance/>)
- 10 For age-specific home ownership rates disaggregated by household income over time, see Yates, J. (2015) "Living income- and asset-poor in retirement", *The super challenge of retirement income policy*, CEDA, Melbourne.
- 11 Baker, E. 2017, "Australia's demand for housing", *Housing Australia*, CEDA, Melbourne. Baker suggests affordability is the 'overarching' constraint in the trade-off decisions households make. It affects where households are able to locate, how much they are able to consume, how appropriate their dwelling is in relation to their household requirements and their tenure. An illustration of the location of dwellings at different price points for each of the capital cities can be found in Corelogic (2016) "Mapping the Market" (<https://www.corelogic.com.au/news/retrieve-download.html>). Quartile price data for all dwellings in Sydney can be found in the NSW Rent and Sales Reports.
- 12 Wood, G. and Ong, R. (2017) "The Australian Housing System: A Quiet Revolution?", *Australian Economic Review*, 50(2):197-204 estimate that the average mortgage debt to income ratio for 25-34 year olds and 35-44 year olds more than doubled from 1990 to 2013 to, respectively, around 250 per cent and 200 per cent.
- 13 Ong, R. (2017) "Housing futures in Australia: an intergenerational perspective", *Housing Australia*, CEDA, Melbourne. Ong cites evidence that points to the intra-generational inequities that arise because children of affluent parents are more likely to receive substantial intergenerational transfers.

- 14 Evidence of this trend can be found in Hulse, K., Reynolds, M., Stone, W. and Yates, J. (2015) "Supply shortages and affordability outcomes in the private rental sector: short and longer term trends", *AHURI Final Report No.241* (<http://www.ahuri.edu.au/publications/projects/p51018>).
- 15 The collaboratively produced Rental Affordability Index provides a mapping of affordable rental dwellings across Australia (<https://www.sgsep.com.au/maps/RAI.htm>).
- 16 Hulse et al (2015), op.cit.
- 17 See Yates, J. (2015) "Living income- and asset-poor in retirement", *The super challenge of retirement income policy*, CEDA, Melbourne, for an indication of the declining share of social housing over the past 25 years.
- 18 These estimates are based on gross rent and gross income; they would be lower if both rental costs and income were reported net of Commonwealth rent assistance. Wood and Ong (2017) op.cit. show that the incidence of housing stress for renters in the bottom two quintiles of the (unequalised gross) income distribution increased from 41 per cent to 69 per cent over a 30 year period to 2013. Baker, E. 2017, "Australia's demand for housing" *Housing Australia*, CEDA, Melbourne, shows increases in the share of households with high housing cost ratios are not limited to NSW and Victoria, the states with the highest population growth.
- 19 See, for example, Badcock, B. (1997) "Recently Observed Polarising Tendencies and Australian Cities", *Australian Geographical Studies*, 35(3): 243-259, Reynolds, M. and Wulff, M. (2005) "Suburban socio-spatial polarisation and house price change in Melbourne: 1986 - 1996", *Applied GIS*, 1(1): 1-25 and Randolph, B. and Tice, A. (2016) "Relocating Disadvantage in Five Australian Cities: Socio-spatial Polarisation under Neo-liberalism", *Urban Policy and Research*, published on line 1 September 2016.
- 20 Ong, R. (2017) "Housing futures in Australia: an intergenerational perspective", *Housing Australia*, CEDA, Melbourne.
- 21 CEDA 2017, *Housing Australia*, CEDA, Melbourne, does not deal with the issues and policies related to homelessness. At the 2011 Census, there were more than 105,000 people in Australia who were homeless (<http://www.homelessnessaustralia.org.au/index.php/about-homelessness/homeless-statistics>). Data from the 2016 Census will be released in 2018.
- 22 Ong, R. (2017) "Housing futures in Australia: an intergenerational perspective", *Housing Australia*, CEDA, Melbourne, shows that net real housing wealth per capita for the 55-64 year old age group rose by 90 per cent from 1990 to 2013 whereas that for the 25-34 year old age group rose by only 12 per cent.
- 23 Australia wide average annual growth rate of real income per person is projected to be 1.4 per cent per year over the next 40 years, down from 1.9 per cent over the past 40 years. Population is projected to grow at 1.3 per cent per year, down from 1.4 per cent based on a NOM of steady 215,000 per year from 2018-19 (IGR, 2015: 10) which means that, over the next 40 years, average NOM will fall to 0.5 per cent of the population as it was over the past 40 years (Commonwealth of Australia, 2015 Intergenerational Report, p27). Household growth, on the other hand, is projected to continue at a slightly higher rate, mainly as a result of population ageing and a growing share of small households, based on mid-range household projections from ABS Household and Family projections, Australia, 2011 to 2036, cat. no. 3236.0. Baker, E. 2017, "Australia's demand for housing" *Housing Australia*, CEDA, Melbourne points to differential growth between regions.
- 24 Mid-range projections from ABS Population projections, cat. no. 3220.0_2012(base) to 2101, p6.
- 25 Expected trends include: growth in automated systems and artificial intelligence with robots replacing people and a higher skills and education being needed for entry level positions; and growth in the 'creative economy' with entrepreneurially skilled individuals creating their own jobs. See CSIRO (2016) "Tomorrow's Digitally Enabled Workforce" (<http://data61.csiro.au/Our-expertise/Expertise-Strategic-insight/Tomorrows-Digitally-Enabled-Workforce>) and Department of Employment (2016) "Australian Jobs 2016" (<https://australianjobs.employment.gov.au/jobs-future/industry-outlook>).
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- 27 Yates, J. (2015) "Trends in home ownership: causes, consequences and solutions" (http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Home_Ownership/Submissions)
- 28 Daley, J., Coates, B. and Wiltshire, T. (2017) "Why should we care about housing affordability", *Inside Story*, 27 April 2017 (<https://grattan.edu.au/news/why-should-we-care-about-housing-affordability/>)
- 29 Grattan analysis of ABS Surveys shows households aged between 45 and 54 increased their wealth by \$50,000 a year in the decade to 2013-14 (<https://grattan.edu.au/news/why-every-generation-feels-entitled/>)
- 30 Yates, J. and Milligan, V. (2012) "Policies that Support Access and Affordability of Housing", in Smith, S. (ed) *International Encyclopedia of Housing and Home*, chapter 255, Oxford: Elsevier, p294 but see also Department of Prime Minister and Cabinet (2014) Reform of the Federation White Paper, Issues Paper 2 "Roles and Responsibilities in Housing and Homelessness", Australian Government, Canberra, p8.
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- 32 Morrison, S. (2016) Address to the Urban Development Institute of Australia, Sydney, 24 October 2016
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- 34 RBA Statement on Monetary Policy, November 2016, Box B.
- 35 <http://unlimitedpotential.fya.org.au/transition/youth-unemployment-and-disengagement-are-a-growing-concern/#start>
- 36 Campbell, I. and Price, R. (2016) "Precarious work and precarious workers: Towards an improved conceptualisation", *The Economic and Labour Relations Review*, 27(3) 314-332.
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- 40 Current and past inquiries into housing affordability provide an overview of the broad range of potentially viable policies that work both by increasing the supply of housing to meet the needs of new households, and by reducing demand for housing from existing households. Examples can be found in the Senate Economics References Committee report (2015), in the Productivity Commission Inquiry into Home Ownership (2004) and in the submissions to those inquiries.
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- 45 The interest and involvement of Treasurer Morrison in the development of housing policy highlights the recognition currently given to the importance of having policy developed outside of a social security portfolio.
- 46 See Turnbull (2016) <http://www.pm.gov.au/media/2016-04-29/smart-cities-will-grow-innovation-economy> and Department of Prime Minister and Cabinet (2016) "The Smart Cities Plan" (<https://cities.dpmc.gov.au/18190/documents/48080>). Information on City Deals can be found at <https://cities.dpmc.gov.au/city-deals>.
- 47 A recent review of housing policy in Australia found *"there is a wide array of housing and economic policy instruments operating in Australia at multiple levels of government. A notable feature of the various interventions undertaken by governments is the lack of systematic integration between them, and the absence of an overarching policy framework that articulates how these interventions fit within a nationally-coherent set of objectives around housing."* Dodson et al (2017), op.cit, p3.
- 48 Hulse, K. et al (2015) "Supply shortages and affordability outcomes in the private rental sector: short and longer term trends", AHURI Final Report No.241 (<http://www.ahuri.edu.au/publications/projects/p51018>). The shortfall of affordable dwellings that are available to lower income households was around 300,000 in 2011.
- 49 Independent analysis provided in the Affordable Housing Finance Working Group (2016) "Innovative Financing Models to Improve the Supply of Affordable Housing" Report suggested this could be as high as 60 per cent of the construction/acquisition cost (p14) (<http://www.treasury.gov.au/>).
- 50 Budget 2017 "A comprehensive plan to address housing affordability, Fact sheet 1.1" (<http://budget.gov.au/2017-18/content/glossies/factsheets.htm>)
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- 53 Farha, L. (2017) "Report of the Special Rapporteur on adequate housing" (<https://documents-dds-ny.un.org/doc/UNDOC/GEN/G17/009/56/pdf/G1700956.pdf?OpenElement>)
- 54 Lowe, P. (2017) "Household Debt, Housing Prices and Resilience". (<http://www.rba.gov.au/speeches/2017/sp-gov-2017-05-04.html>)
- 55 Byres W. (2017) "Prudential Perspectives on the Property Market", suggested APRA's operated under a 'prudence (not prices) catch-cry'. (<http://www.apra.gov.au/Speeches/Pages/Prudential-perspectives-on-the-property-market.aspx>)
- 56 As a complement to these options that focus on structural trends, consideration also might be given to a Property Speculation Tax to reduce pro-cyclical behaviour. (<https://smithinstitute.thinktank.files.wordpress.com/2014/11/the-case-for-a-property-speculation-tax.pdf>)
- 57 This recommendation is a part of a broader set of recommendations developed by the UN Special Rapporteur on Adequate Housing, the cover note to which suggests *"States must redefine their relationship with private investors and international financial institutions, and reform the governance of financial markets so that, rather than treating housing as a commodity valued primarily as an asset for the accumulation of wealth they reclaim housing as a social good, and thus ensure the human right to a place to live in security and dignity."* (<https://documents-dds-ny.un.org/doc/UNDOC/GEN/G17/009/56/pdf/G1700956.pdf?OpenElement>)

RESERVE BANK OF AUSTRALIA

1. Is the current period of price movement unusual?

Dr Nigel Stapledon

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This chapter provides a comparison of the local housing experience with that of other countries in the Organisation for Economic Co-operation and Development (OECD). It looks at price cycles of the last 50 years across Australia's major cities and explores the factors that have contributed to the booms and busts.

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Dr Stapledon has a PhD in Economics from the University of New South Wales (UNSW) and a Bachelor of Economics with Honours from the University of Adelaide. He started his career in Canberra in 1976–86, where he worked in the Commonwealth Treasury. He then worked at the Westpac Banking Corporation 1986–2003 where he was Chief Economist from 1993. Dr Stapledon has been at UNSW Business School since 2003 where he completed a PhD on the long-run history of house prices in Australia (1880–2006). At the UNSW Business School, he was Associate Head of School 2008–13. He is now a Research Fellow in the UNSW Centre for Applied Economic Research (CAER) and teaches the Real Estate Economics and Public Policy course for both undergraduate and postgraduate students. Dr Stapledon is a regular commentator in the media on macro-economics and housing. In 2017, he took up an appointment at Macroplan where he advises on urban economic issues.

Introduction

In the last five years house prices in Australian cities have in aggregate risen by 30 per cent in real terms, but this rise has been very much accounted for by the Sydney market, which has risen 64 per cent, with the Perth market in actual decline. Property markets are prone to cyclicity, with booms and busts featuring through history and in Australia's case in the 19th century central to the great recession of the 1890s.¹ In the period since the 1970s, there have been five major cycles in the Sydney market and a lesser number in the other markets (see Table 1).

For the Sydney market, this latest cycle comes in second, just beating the rise in 1987–89 of 59 per cent and behind the 1996–2004 rise of 85 per cent. But, it is well behind the rises recorded in other markets in the preceding boom, with the Perth market rising 173 per cent in the period 1998–2007. But while the rise in Sydney might not be the biggest, the longer-term story is that prices are rising off a high base, with these cycles part of a sustained long-term rise in all markets in the period since 1960. This has seen prices in the Sydney market rise by an average 3.8 per cent per annum in real terms (see Figure 1) and a lesser but still significant upward trend in all markets.

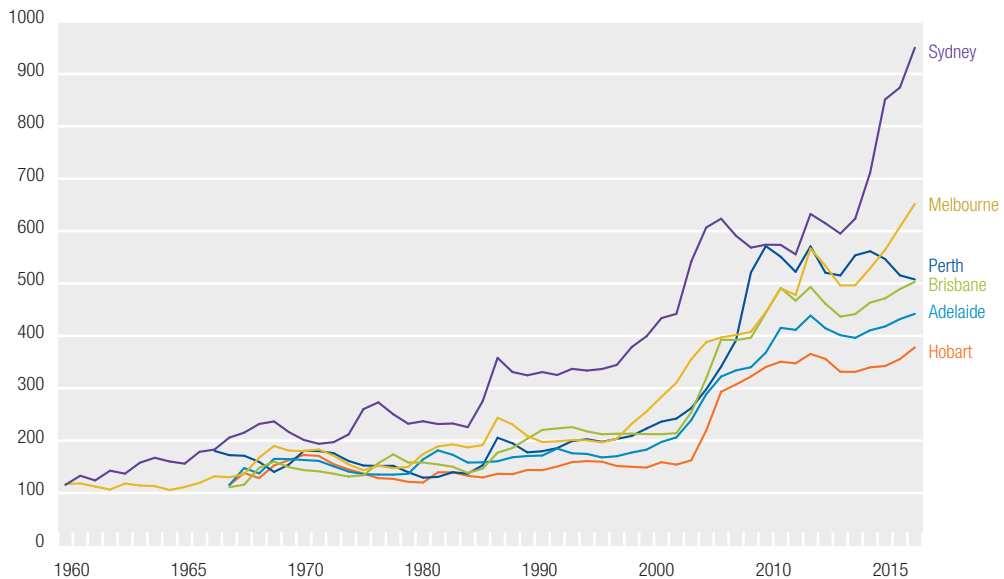
TABLE 1
KEY HOUSING PRICE BOOMS SINCE THE 1970s – CUMULATIVE PER CENT CHANGE IN REAL TERMS

Sydney	Per cent	Melbourne	Per cent	Brisbane	Per cent
1968–74	+52	1968–74	+70	1971–74	+43
1974–77	-18	1974–79	-19	1974–79	-19
1977–81	+41			1979–82	+32
1981–83	-15			1982–87	-20
1987–89	+59	1987–89	+30	1987–92	+59
1989–91	-9	1989–92	-19	1992–2001	steady
1996–2004	+85	1997–2008	+141	2001–08	129
2004–06	-9	2008–09	-3	2008–09	-5
2012–17	+64	2012–17	+35	2012–16	+15
Perth	Per cent	Adelaide	Per cent	Hobart	Per cent
1970–74*	-22	1970–74	+43	1973–76	34
1974–77	+28	1974–80	-18	1976–84	-30
1977–80	-16	1983–85	+33		
		1985–87	-13		
1987–89	+50				
1989–91	-14				
1998–2007	+173	1997–2008	+144	2002–08	+115
2007–09	-10	No material fall		No material fall	
2012–17*	-3	2012–17	+11	2012–17	+17

* Not a boom in Perth as prices fell but for this latest period, price change for all cities indicated for comparative purposes.
 Source: ABS, Stapledon (2017)

FIGURE 1
CAPITAL CITY REAL MEDIAN HOUSE PRICES 1960–2017

June quarter, \$000s, 2015–16 prices

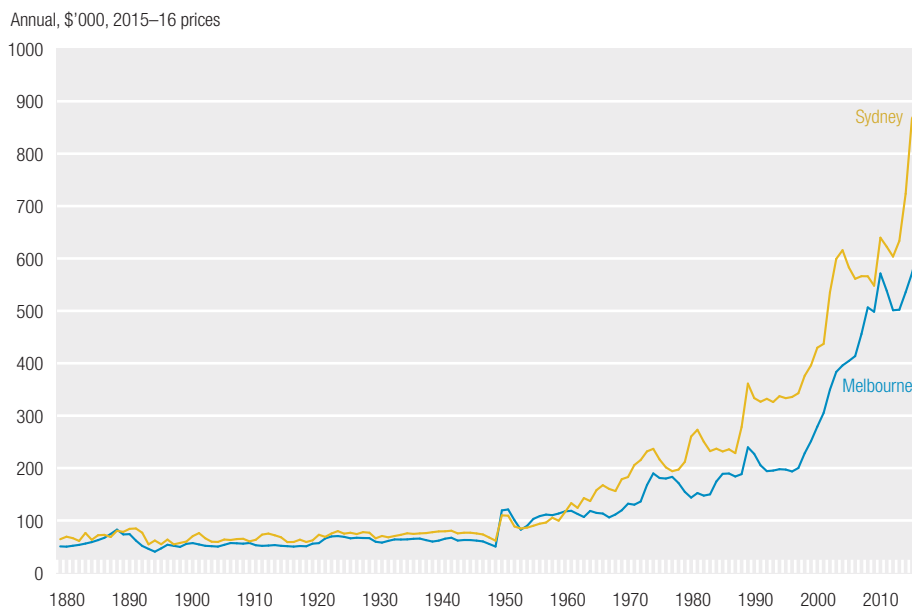


Sources: ABS and Stapledon (2017)

Rises part of a longer-term trend

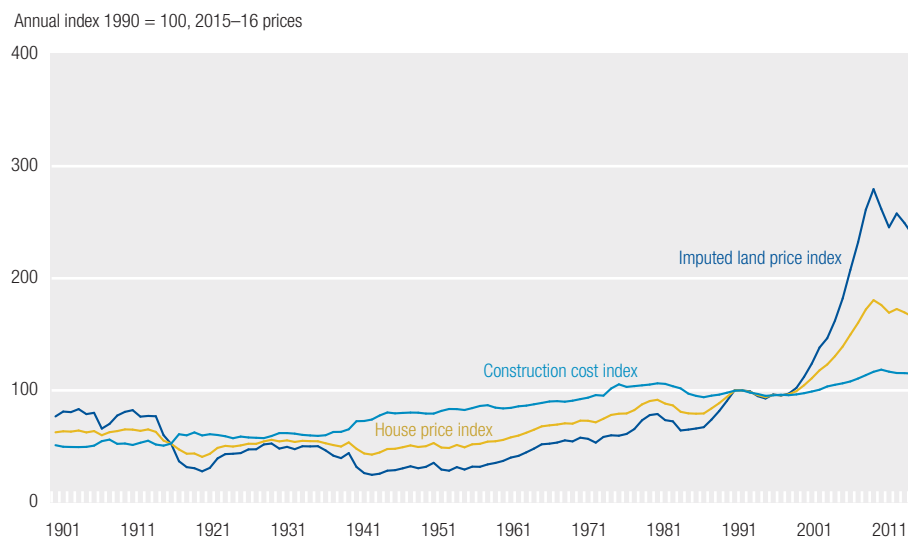
This rise in the period since the 1950s contrasts with the period 1880–1950s when house prices in the Sydney and Melbourne markets did not show any growth (see Figure 2). This longer-term story is also observed internationally (see Figure 3). In the period 1900–1955, the international series has house prices declining by about 0.5 per cent per annum in real terms, led by declining land prices. Then from 1955–1996, prices rose by two per cent per annum and in the latest period 1996–2012 by 3.5 per cent per annum.

FIGURE 2
A LONGER-TERM PERSPECTIVE ON AUSTRALIAN HOUSE PRICES – MELBOURNE AND SYDNEY PRICES 1880–2016



Source: Stapledon (2012)

FIGURE 3
INTERNATIONAL TRENDS IN HOUSE AND LAND PRICES 1900–2012



Sources: Knoll, Schularick and Steger (2017)

The 20th and now 21st centuries have seen the rise of cities globally but the growth in the first half of the 20th century was faster so, while urban theory tells us that land prices are higher in larger cities, simple reference to the size of cities is not the answer. In 1901, Australia was one of the most highly urbanised countries in the world with 36 per cent of its population in the six capital cities, but urbanisation accelerated and in 1961 these cities accounted for 59 per cent of the population, and their share has since risen to 67 per cent in 2016.²

The rise of cities is directly related to the transport revolution brought by the trains/trams (in the 19th century) and most significantly the motor car, which lowered the cost of commuting and transporting goods around a city and allowed cities to grow. This transport revolution allowed people to move out of crowded inner cities, which went into decline, and it created a supply of land that drove down the price of land. In fact, some urban economists writing in the 1950s expected the price of land to continue to fall.³

Several factors have contributed to the change in direction observed since the 1950s. One was that in time as cities grew and infrastructure struggled to keep up, the volume of traffic led to increased congestion, which lifted commuting costs and started to shift the balance back in favour of inner areas. In 1960, when manufacturing's share of economic activity reached its peak, a sizeable proportion of it was located in the old, inner areas of Australian cities near the main port and rail facilities. However, two trends changed that. One was the globalisation of manufacturing, which was related to the sharp decline in shipping costs and increased economies of scale, coupled with the rise of Japan, then South Korea and more recently China.

At the same time, within cities, in response to those same factors, manufacturing had been (since earlier) moving out to the outer areas where more space could accommodate the larger scale factories and the manufacturing workforce followed the factories out.⁴ Meantime, agglomeration economies were attracting the fast growing financial and information service sector into the CBDs, drawing with it high income jobs and households. From being run-down in the 1980s, the period since has seen the regeneration of inner city industrial areas, a phenomena (gentrification) observed in many cities in the world.⁵ This gentrification process generates some angst as the character and socio-economic mix of these areas changes, with the high rents signalling the exit of lower income households.

The other significant change has been a rising propensity for policy to impose supply constraints, a policy direction in which Australia has followed the UK and US. While financial and products markets have been deregulated in the post-World War II period, the urban land market has become more highly regulated.

One element is the zoning of cities in terms of allowed use (urban vs rural at the edge, industrial vs residential, and in terms of density) which happened at a point in history, in Sydney's case in 1951,⁶ when cities were smaller. The objective of zoning and other planning policies was to limit the outward expansion of cities to curtail "urban sprawl", but the potential impact of this supply constraint on prices was recognised early by economists.⁷ As cities have grown, the resistance to re-zoning has increasingly distorted urban markets and it has become a

more binding constraint. While restraining the outward growth of cities has been one objective, in the inner region where the high and rising value of land would increasingly favour higher density, it has also become a more binding constraint on an adequate supply response.⁸

In the Melbourne market, courtesy of good historical data, we can observe some of the intra-city shifts in response to these changes since 1971. In the period 1971–91 (see Table 2), price appreciation was higher in the inner but not significantly so. In this period land prices were pushing up the cost of houses on the outer. The position changed in the post-1991 period. While land prices and housing costs at the urban fringe continued to rise significantly in real terms, the lower interest rates in the later period underpinned a sharper rise in the value of the location premium in inner areas, so that in this period the inner urban area prices rose more sharply.

TABLE 2
MELBOURNE LGA HOUSE PRICES AND RENTS BY ZONES 1971–2016 (2015/16 PRICES)

Median House Prices \$'000	Inner LGAs	Median	Outer LGAs	Cost of housing in outer*
1971	170	140	122	(36) 150
1991	320	229	192	(90) 240
2016	1175	696	417	(200) 407
1971–91 per cent pa change	3.2	2.5	2.3	2.2
1991–2016 per cent pa change	5.8	4.9	3.4	3.2
Rents \$ per week	Inner	Median	Outer	
1971–91 per cent pa change	3.44	2.63	2.84	
1991–2016 per cent pa change	2.75	2.03	1.43	

Source: Data on house prices and rents for Melbourne and Sydney (also land in case of Melbourne) in Tables 2 and 3 are from published state government sources. For a detailed discussion of the data see Otto, G and Stapledon, N. 2017, *How Predictable? Rent Growth and Returns in Sydney and Melbourne Housing Markets*, UNSW Business School Research Paper, No. 2017–01

*Cost of land in brackets with cost of housing the sum of median sale price of land plus cost of new dwellings. Cost of new dwellings based on average cost of new house completions (ABS8752.0 Tables 39 & 42). The resultant figures are close to the median established house prices in the outer. We might expect new to have a premium over established houses but equally within LGAs there could be location differences that favour established houses.

These trends are more accentuated in the Sydney market in the period from 1991 (see Table 3). All segments of the market have risen faster than Melbourne. In the outer, fringe land prices have risen significantly faster than in Melbourne, pushing up the prices on the outer. In the inner areas, the evidence of gentrification is clearly seen, with the prices in the old industrial (inner low) areas rising significantly faster than the established expensive (inner high) areas.

TABLE 3
SYDNEY LGA HOUSE PRICES AND RENTS BY ZONES 1991–2016 (2015/16 PRICES)

Median house prices \$'000	Inner high	Inner low	All Sydney	Outer low
1991	728.0	293.2	302.5	207.2
2016	2699.1	1314.6	1012.5	589.6
1991–2016 per cent pa change	5.6	7.1	5.2	4.6
Rents	Inner high	Inner low	All Sydney	Outer low
1991–2016 per cent pa change	2.3	2.7	1.8	1.7

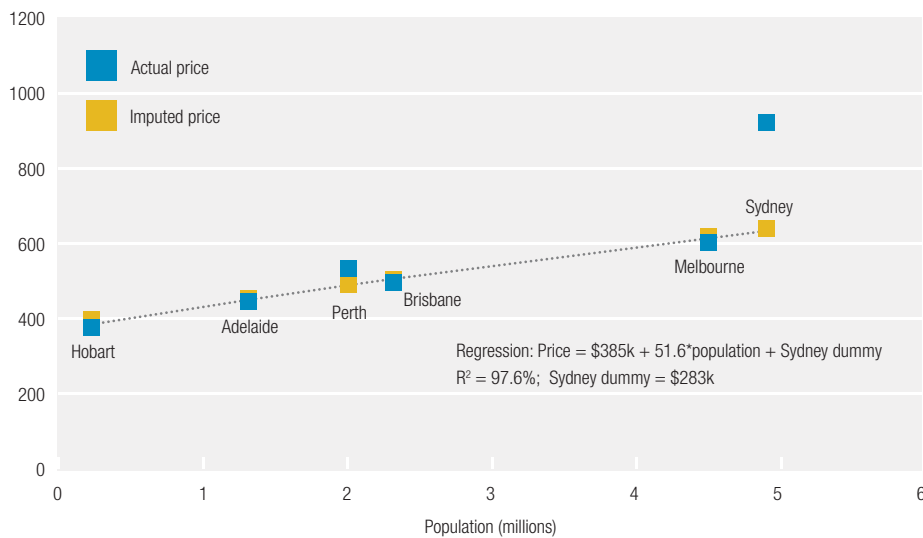
Source: See note to Table 2.

Inland vs coastal – the great divide

From an international perspective, we observe a significant difference between coastal and inland cities. This is best illustrated by the US where house prices in coastal cities, e.g. most cities in California have risen much more sharply than inland cities and have also exhibited higher volatility.⁹ This also explains why European cities – mostly inland cities – tend to have lower cost housing. Coastal cities are naturally more geographically supply-constrained and have amenities (climate, harbours, beaches) which contribute to liveability and attract a premium. As incomes have risen, particularly for highly skilled workers in information and financial sectors, they are attracted to cities with the combination of deep labour markets and, critically, good amenities.¹⁰ In addition, a relationship has been observed between coastal cities with high amenities (high prices) and the tendency for policies to restrict growth, further accentuating pressure on prices.¹¹

Pertinently for Australia, its cities share similar climate and coastal settings with those of California, while Sydney shares a similar harbour and other geographic constraints to San Francisco, which tops the list in terms of prices in California. If we contrast the six capital cities, we see that for the five state capital cities other than Sydney, relative size explains the relative differences in prices (see Figure 4). Prices in Sydney are higher and have been persistently higher than the other capital cities over the period 1971–2016. Sydney has a high level of natural amenity (the so-called Sydney premium) and geographic constraints, and these factors may explain the higher prices in part but, Sydney also appears to be a good example of the connection between high amenities and policies to restrict growth. The Productivity Commission has indicated that in terms of policies that restrict growth, it is a problem in all cities but the planning system in Sydney appears to be the most restrictive.¹²

FIGURE 4
CAPITAL CITY MEDIAN VS POPULATION AT 2016: THE SYDNEY PREMIUM



Sources: Stapledon (2016), NSW LPI and Macroplan

The late 1990s boom

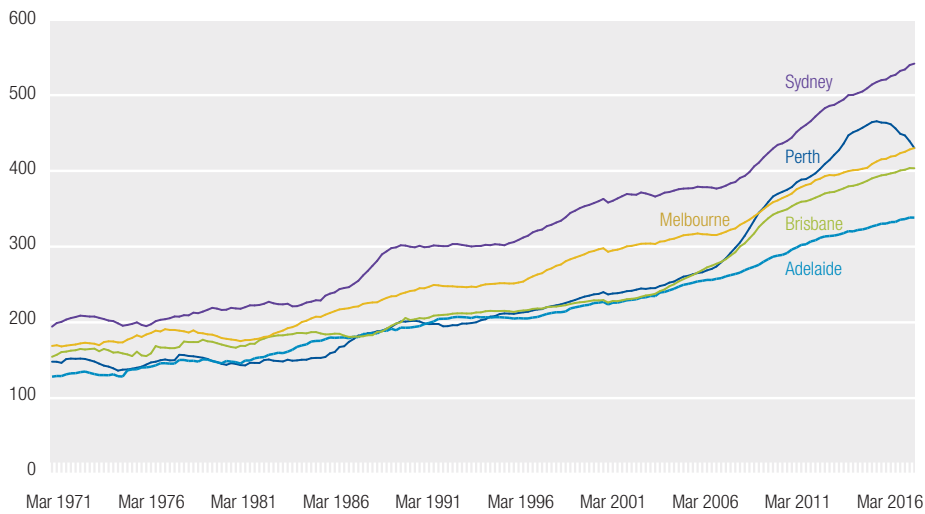
The global recessions around 1990, ironically primarily the outcome of major property booms and busts, provides a neat divide in the housing story globally.¹³ The 1970s and 1980s, culminating in those recessions, had been a period of poor economic performance (high inflation, high unemployment). The high nominal and real interest rates the high inflation era produced suppressed house prices for much of this period but saw a significant rise in rents (see Figure 5). The high inflation had also eroded the real value of debt, with a wealth transfer to house borrowers, so when we benchmark debt to income ratios against the 1980s, it should be remembered that the low ratio at that time reflects this devaluation by inflation. The high inflation had also imbued in all investors (including owner-occupiers) the value of property as a hedge against inflation.

The response globally to these adverse economic outcomes was a period of significant deregulation in product markets (lower protection), tax reform and financial deregulation. Tax reform in the 1980s saw consumption taxes introduced/broadened (albeit with a lag in Australia's case), while top marginal income tax rates were cut sharply and capital gains taxes introduced in most countries.

Lower marginal tax rates reduced the tax advantages to owner-occupation, but otherwise the tax bias to owner-occupation was generally left untouched, while (in most countries) capital gains taxes and (in some countries) capping of negative gearing benefits worked to reduce the tax benefits to investors. Financial deregulation saw interest rate controls lifted and the new competitive environment shifted the balance of power to borrowers. The deep recession in the late 1980s then purged the economies of high inflation and, certainly in the case of Australia, set economies up for a significantly better economic performance in the period post-1991.

FIGURE 5
CAPITAL CITY REAL MEDIAN RENTS 1971–2016

Quarterly series, weekly rent \$s, 2015–16 prices

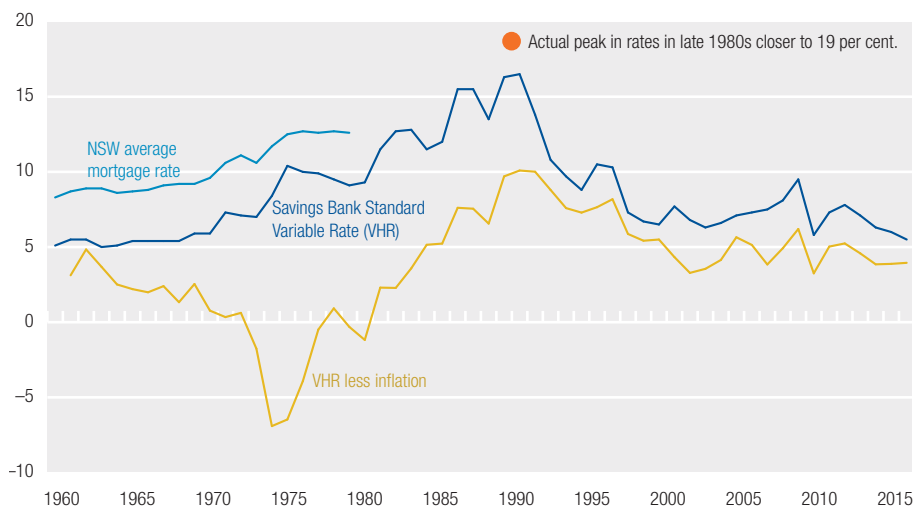


Sources: ABS and Stapledon (2017)

The decisions to deregulate the housing finance market were made in the mid-1980s but the full impact of that did not come through until the 1990s. The combination of stronger economic conditions, but more importantly a significant decline in real and nominal interest rates (see Figure 6), and the deregulation of financial markets, were extremely favourable to the housing market. If we look at bank housing interest rates, the decline in the published interest rates does not tell the full story. Actual interest rates, particularly for marginal borrowers (low income households), were significantly higher in the period of regulated rates.¹⁴ In addition, also working against low income households, the constraints on supply meant that power was with lenders who imposed very conservative lending criteria (high loan to valuation ratios).

FIGURE 6
SELECTED NOMINAL AND REAL HOUSING INTEREST RATES 1960–2016

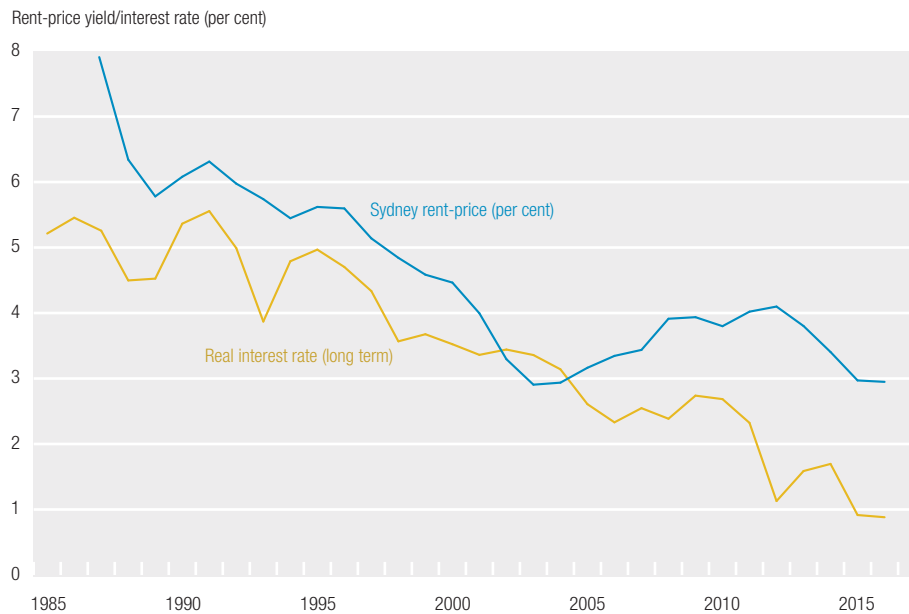
Per cent per annum, interest rate



Sources: RBA, ABS and Yates

In a sense, while the supply side was being steadily more tightly regulated, the demand side was deregulated. The decline in interest rates happened in the early 1990s but prices did not start rising till the second half of the 1990s. While rates fell, borrowers had bad memories of the high interest rates in the 1980s and it took a number of years for them to be convinced that the low inflation/low interest regime was here to stay. The location premium in land values are, like any asset, a function of interest rates. In time, the lower interest rates started to be factored into land (house) prices, starting with Sydney, the market with the largest location premiums. While lower interest rates saw prices bid up, the lower rates also translated to a lower cost of capital and a period of slow growth in rents. Reconciling the two, the rent-price ratio for Sydney declined from over six per cent circa 1991 to under four per cent (see Figure 7). The rent-price ratio is the favoured metric for assessing housing valuation¹⁵ – while it has fallen roughly consistent with the decline in real interest rates, the experience of 2004 suggests the market was over-valued at that time.

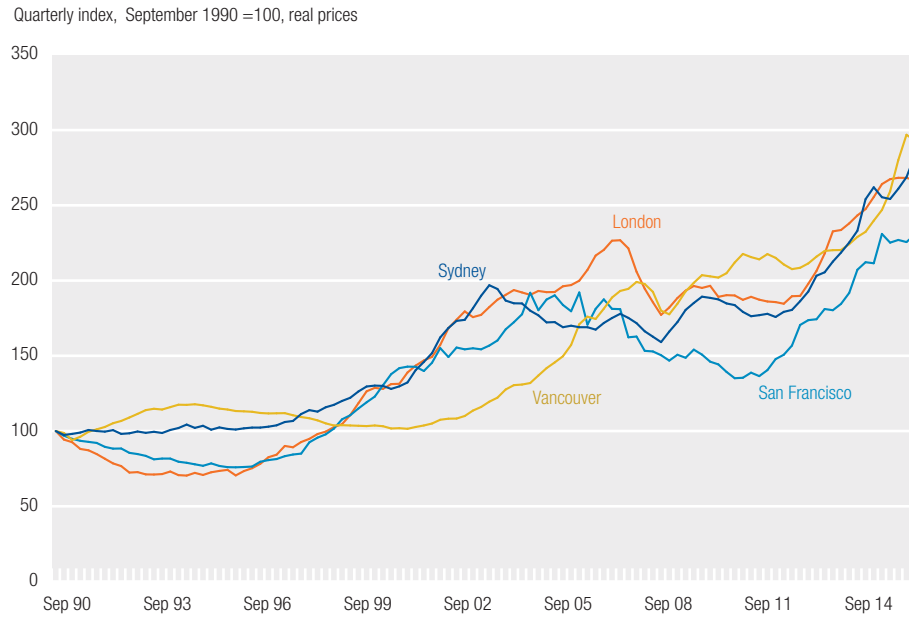
FIGURE 7
RENT-PRICE RATIO SYDNEY VS REAL INTEREST RATES 1985–2016



Sources: Otto and Stapledon (2017)

In the Australian market, Sydney led the way with prices rising 85 per cent (in real terms) in the period 1996–2004. That boom ended due to a combination of the market overshooting and the lagged supply response that was putting downward pressure on rents in 2004, with prices declining nine per cent 2004–06. Other markets in Australia lagged the Sydney market and their rising prices caught the stimulus provided by the resources boom and a surge in immigration, which underpinned a period of sharp rises in rents. The upshot was that these markets showed much bigger price gains in this period, prices more than doubling in each, with even Hobart prices rising 115 per cent. At the epicentre of the resources boom, the Perth market topped the list with a rise of 173 per cent (see Table 1), which briefly had the Perth median price touching that of Sydney.

FIGURE 8
SYDNEY VS OTHER MAJOR CITY HOUSE PRICES 1990–2016



Sources: ABS, FHFA (US), Tetranet (Canada), Nationwide(UK)

The previous time Perth prices had matched those of Sydney had been in the early 1970s, following the 1960s resources boom after which Perth prices fell 22 per cent and back to their normal relationship to Sydney prices. In each of those markets, the end of those booms circa 2008 roughly coincided with the GFC but without a serious fall in prices. The end of the Sydney boom had been cushioned by the resources boom, which meant that the overhang in the market was absorbed more quickly than otherwise. Rather than prices falling, rent-price ratios largely adjusted (see Figure 7) via a rise in rents, whereas typically it is prices that do most of the adjustment.

When the Sydney boom ended in 2004, the expectation was that this boom had been a one-off lift in prices in response to a one-off fall in interest rates. Things turned out differently for two reasons. One was that the parallel housing booms in the US and Europe (see Figure 8), which had started later, had ended badly for the US and European economies with the GFC. This then led to another ratcheting down in interest rates, which provided a significant boost to all asset markets, including housing markets. And, secondly, while the US and European markets suffered over-supply, that was not the case in Australia where the rise in immigration meant the markets were generally tight and facing upward pressure on rents. During this second phase of the resources boom (2009–12), interest rates in Australia were substantially higher than in other developed economies. The RBA was actually tightening and this was acting as a constraint on housing activity and prices. Then, in response to the end of the resources boom, the RBA cut interest rates aggressively (2012–16), looking to housing to help fill the growth gap created by the collapse in mining investment. This triggered the 2012–17 boom.

Sydney's place as the strongest in this period is explainable; the previous cycle in the Sydney market had finished earlier, and the market was being more tightly constrained. Again, whether valuations (the rent-price ratio) have fallen too low, as they had in 2004, is the question that will be answered in time.

Home-ownership – beware?

The Menzies Liberal Government (1949–1966) has been widely credited by some commentators for the rise in home-ownership that occurred in the 1950s and 1960s. Indeed, there had been a sharp rise in the home-ownership rate from 52 per cent in 1947 to a peak of 73 per cent in 1966 (see Table 4), with a similar rise in the UK and US.¹⁶ There were concessional war service home loans given under the War Service Homes Act 1918, but this was not of scale to explain the rise.¹⁷ In addition, with the imputed rental income of housing exempt from tax, the significant rise in marginal tax rates in this period would have also encouraged ownership.¹⁸

However, the largest factor in the rise in home-ownership in the period 1947–1972 was a policy failure, namely rent controls that were imposed in all three countries as a War-time measure in 1939 and were then continued into the 1950s. Coming during a period of high inflation, the sharp fall in real rents caused the supply of private rental housing to decline, a shortfall not made up by an increase in public housing. As with all controls, it created a group of winners – those established renters enjoying the protected low rents – and losers, the landlords and new households who could find nothing to rent.

The contraction in rental supply at a time of strong growth in demand led to, in effect, a forced rise in home-ownership, led by a generation of young households unable to enter the rental market. This was a period when land was relatively inexpensive so households did not need much capital to acquire a block of land. There were also few building regulations and Dingle (2000) estimated that over one-third of all new houses in the 1950s were owner-built.¹⁹

From this artificial high in 1966, the subsequent decline no doubt in part reflects the significant rise in prices. But to a large extent it could simply reflect a return to a more normal pattern as subsequent generations chose to be more mobile. Young households will choose to rent because they value their future earnings and that can be optimised if they are more mobile.²⁰ The high transaction costs of buying/selling are a major constraint on mobility so that renters are more mobile. So, while young households have less wealth and are credit constrained, household choice is as much about “settling down” (when investment in education is

“Young households will choose to rent because they value their future earnings and that can be optimised if they are more mobile. The high transaction costs of buying/selling are a major constraint on mobility so that renters are more mobile.”

TABLE 4
OWNER-OCCUPATION RATES BY AGE GROUP 1911–2014

	15–24	25–34	35–44	45–54	55–64	65 and over	All households
1911	na	na	na	na	na	na	49.4
1921	na	na	na	na	na	na	52.4
1933	na	na	na	na	na	na	52.6
1947	29.6	40.6	49.3	57.2	64.3	71.2	53.0
1954	39.7	56.6	63.7	67.0	71.6	75.4	65.5
1961	37.4	61.3	71.8	74.9	77.6	80.5	71.9
1966	29.5	60.0	73.7	78.1	80.3	82.1	72.8
1976	42.9 (15–29)		72.2 (30–44)	79.6 (45–64)		80.3	70.0
1984	27.5	56.6	74.8	81.5	82.6	84.1	71.5
1993–94	15.2	50.7	70.2	80.2	81.4	82.4	68.5
2003–04	22.5	50.0	67.2	79.4	82.5	82.8	70.0
2009–10	17.2	46.6	63.2	76.5	81.5	83.3	68.8
2013–14	12.8	38.6	62.6	73.5	80.4	84.5	67.2

Sources: ABS Census (1911–1966) and thereafter household expenditure surveys.

complete and career and family are established) as about “saving up”. Overlaying that, in the post-1991 period, the initial impact of lower interest rates would have assisted entry into the market but as those interest rates became factored into higher prices, the difficulty posed in building equity increased the hurdle to get into the market.

If home-ownership is the objective, the US provides a salutary lesson on the risks of over-promoting it. Between 1996 and 2006, a mix of policies encouraged young households into the market lifting the ownership rate from 62 per cent to 68 per cent before the GFC saw the housing market crash and the defaults and shattered dreams saw the ownership rate crash back to 62 per cent.²²

Conclusion

In the period since the mid-1990s the most significant influence on the housing market has been the very significant decline in interest rates. A structural decline in interest rates delivers a structural (or one-off) rise in prices. It would be a mistake for buyers to assume that this period is any guide to the future. It should also be noted that the resources boom has played a significant role with its impact on demand. When the Sydney market turned down in 2004, it highlighted that markets can overshoot but, the downside was very much cushioned by the positive demand shock from the resources boom.

Looking beyond the cycle, the history of the past 50 years tells us globally that supply constrained and amenity rich cities, to which Australian cities very much fit the bill, have experienced much more significant rises and this is generating debate and angst in most countries. In terms of the housing affordability debate, in 2016 a US White House report was issued with a quote from then-President Barack Obama capturing the “yes we can” flavour of that report:

“We can work together to break down the rules that stand in the way of building new housing and that keep families from moving to growing, dynamic cities.”

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- 9 J. Duca, J 2014 Regionally, Housing Rebound Depends on Jobs, Local Supply Tightness. Chart 2: Sales Price for Single-Family Home More Volatile in Coastal Regions - highlights the significant price difference between coastal regions and other regions and the higher volatility. Table 1: Metro House Price Changes Since 2006 Reflect Affordability, Unemployment – this table highlights the dramatic difference in housing affordability between cities of California (LA, San Francisco) and NY vs Chicago, Atlanta, Houston, Dallas and Miami. The gap has widened significantly since 2000.
- 10 Albouy, D 2016, 'What are cities worth? Land rents, local productivity, and the capitalisation of rents.' *Review of Economics and Statistics*,98(3) July 2016, pp. 477–487
- 11 Gyourko, Mayer and Sinai Gyourko, J. Mayer, C. and Sinai, T. 2013, 'Superstar cities.' *American Economic Journal: Economic Policy* · vol. 5, no. 4, November 2013. pp. 167-99. It could be that the more valued is land the greater is the propensity for friction over changes which impact on its value. If land has a low value, there is less to fight over.
- 12 Productivity Commission (2011) Performance, Benchmarking of Australian Business Regulation: Planning, Zoning and Development Assessment. The RBA has also been vocal on the impact of supply constraints. See for example Richards, A (2008) "Some Observations on the Cost of Housing" Address to 2008 Economic and Social Outlook Conference, The Melbourne Institute, Melbourne – 27 March 2008
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- 14 In 1970 the savings bank housing lending rate was 9.5% but the average mortgage rate in NSW was 12.5%. Yates (1982) inferred that clearly some borrowers were paying higher than the 12.5%. In 1971 with the savings bank rate at 7.25% and the NSW average at 10.6%, the same inference (Yates 1982)
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- 20 For good discussions of recent developments in the US, see Halket, J. and Santhanagopalan, V. 2014, 'Saving up or settling down: Home ownership over the life cycle.' *Review of Economic Dynamics* vol.17 pp. 345-366 and Fisher, J. and Gervais, M. 2011, 'Why Has Home Ownership Fallen Among the Young?' *International Economic Review*, vol.52, no. 3, pp. 883-912.
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- 22 The White House (2016) Housing Development Toolkit, page 1



2. Is Australian housing supply adequate?

Professor Chris Leishman

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This chapter looks at the trends in the costs of acquiring land and building on it; the impact of regulation on land availability; and changes in the composition of the housing stock. It questions whether the housing system is designed to add new housing to the market at a slower rate than it's needed, in order to make the housing development and construction market viable.

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Professor Chris Leishman is a housing economist, and Director of the Centre for Housing, Urban and Regional Planning at The University of Adelaide. Professor Leishman is currently an editor for the *Urban Studies* journal, and was previously the editor-in-chief of the *Housing Studies* journal. He has undertaken a large number of studies funded

by UK central, devolved and local government departments, for third sector organisations including CRISIS and Centrepoin, and a range of academic funders including the UK's Economic and Social Research Council (ESRC). He has led numerous consultancies for private sector firms, third and public sector organisations, and has published extensively in the economics of housing systems and markets, and subjects concerning the interface between individuals' choices (behavioural analysis), and outcomes in the housing system. He is perhaps best known for his contributions to understanding the economics of new-build housing supply, the linkages between housing supply and housing affordability, and modelling the housing system as a complex interaction between demographic, housing, labour market, housing supply, and migratory dynamics.

Housing supply – the Australian policy context

“Planning and zoning requirements can restrict competition by creating unnecessary barriers to entry. The regulations should encourage competition and not act to limit entry into a market.”

*Harper Review*¹

Debates concerning housing supply – and associated issues such as the adequacy of the supply of land, the responsiveness of the housing construction industry to housing prices and affordability, and the degree of competition in the housing development sector – have followed a fascinating path in the United Kingdom, and now Australia, during the past 10 years. In the UK, government concern that there may be structural deficiencies in the private housing development industry began to surface in the mid-2000s, not long after a wave of very significant planning reforms that followed the *Barker Review of Housing Supply and Affordability*.² To put it simply: the UK government appeared surprised and concerned that significant efforts to simplify planning and boost the supply of land

suitable for development had yielded a more modest increase to annual housing completions than hoped for, putting long-term housing affordability targets at jeopardy. As I recount in *Housing supply and suppliers: are the microeconomics of housing developers important?*,³ the UK's Office for Fair Trading launched a market study on homebuilding in the UK⁴ and the government announced a further review of housing supply⁵ but these largely gave the industry a clean bill of health in the sense that they reported improved levels of customer satisfaction and no evidence of “unhealthy” lack of competition.

Returning to the Harper Review⁶ and the Commonwealth Government's response, concerns over competition in new housing supply have risen high on the policy agenda, but the debate looks through the lens of the planning and development permit system rather than the structure and organisation of the development industry itself. In this regard, the debate differs from the slightly earlier UK discussions. The Australian Government, in its response to the Harper Review, has accepted that development permit processes should be simplified, and that planning systems “should be consistent and transparent to avoid creating incentives for gaming appeals”. These are probably the most interesting and relevant aspects with respect to the residential development industry and housing supply (many of the recommendations relate, in fact, to commercial/retail activities and development).

Planning and developer competition in Australia

Gurran and Whitehead,⁷ discussing the role of planning regulation in housing systems, argue that Australia has a more efficiency-orientated market housing system while the UK has a more redistributive housing system. In the former, planning works to reduce negative externalities and promote more equitable market outcomes, but is very much seen as intervention in an otherwise private market. In the latter, they note a stronger role for promoting land supply, but coupled with financial policies such as development charges or land taxation. They describe the Australian planning system as having its roots in the pre-1947 UK town and country planning system, whereas in the UK there was a move away from zoning and towards discretionary planning in the 1947 *Town and Country Planning Act*; Australia did not follow suit. They argue that this significantly reduces the scope for negotiating planning gain because, in effect, land values are fixed by expectations arising through zoning far in advance of development decisions.

Gurran and Whitehead⁸ mention that dwelling completions matched the growth in households in only one year of this century although, of course, this study is now several years old. They cite the National Housing Supply Commission⁹ in their finding of a 493,000 shortfall in affordable dwellings in 2007–08. They go on to analyse the development of reforms designed to reduce planning delay and promote the supply of land that took place simultaneously in Australia and the UK between 2004 and 2008.

In more recently published work, Gurran and Phibbs¹⁰ emphasise the vested interests that exist in the housing system. Current home owners have an interest in seeing housing values persist, and preferably rise, and are considered to have an important political voice. This relationship is also evident in the UK, where there exists an uneasy relationship between the policy goal of rendering housing more affordable to lower income and younger households, and the imperative to protect the asset values of more established voters. A similar paradox exists in relation to the interface between the new and second-hand (established) sectors of the owner occupier housing market. The relationships are much more complex than simplistic policy analyses would have you believe. To illustrate, consider a recent study by Ryan et al,¹¹ who carried out a mixed methods project to examine the response of housing supply in relation to deteriorating affordability. A strand of qualitative analysis based on interviews with 17 housing developers makes particularly interesting reading given the strong echoes of causes of poor housing supply cited in a UK context. For example, the Australian developers' responses emphasise high land prices, competition and planning delays.

“This relationship is also evident in the UK, where there exists an uneasy relationship between the policy goal of rendering housing more affordable to lower income and younger households, and the imperative to protect the asset values of more established voters.”

These are familiar UK arguments. But responses to questions about land supply do appear quite different for Australian compared to UK developers. In Adams et al¹² it was noted that UK housing developers often trade or swap land with other developers owing to their own capacity constraints, but there is a strong preference to trade within groups or networks of trusted land buyers. Leishman¹³ builds on this, and the work of Adams et al¹⁴ who argued that developers have no option but to build slowly in a rising housing market in order to realise profit sufficient to compensate for the bid required to secure the development land in highly competitive and aggressive land markets. Leishman's¹⁵ argument is that housing developers themselves face downward sloping demand curves, rather than being price takers, with the result that they must also drip feed new supply onto the market. Meanwhile, reflecting the Australian experience, Ryan et al¹⁶ report qualitative data indicating that housing developers regard the supply of serviced land from land developers as being deliberately restricted. Again, the argument being put forward is that the restricted supply of land helps land developers realise the prices they want (or need). This probably also reflects the fact that Australian development land prices reflect future hope value from the moment of zoning for residential use.

Later in the chapter, I will return to the question: how much of a difference will recent regulatory reforms really make to housing supply and housing affordability? In the next few sections, the chapter examines recent trends in housing supply, beginning with a definition of the scope of this chapter.

Defining housing supply

It is convenient to think of housing supply as exclusively relevant to the flow of newly constructed dwellings onto the home ownership, investment and rental markets. Indeed, this is the implicit assumption of most commentaries. Yet, housing supply has other components, and these are often omitted from analysis of housing market performance. For example, we know that people move home from time-to-time, and may switch between home ownership and private rental tenures. Depending on demographic circumstances, life cycle effects, lifestyle factors and the performance of the economy, people may increase or reduce housing consumption. Even in the simplest case of a household moving from one second-hand or established dwelling to another, the impact on housing supply is not straightforward. We often think of households moving up the housing ladder, and this entails the supply of a smaller or lower quality dwelling to the market than the new dwelling being demanded. But, this is not always the case: older households may downsize to reduce consumption or free up housing equity to be used for non-housing consumption, or for intergenerational transfer.

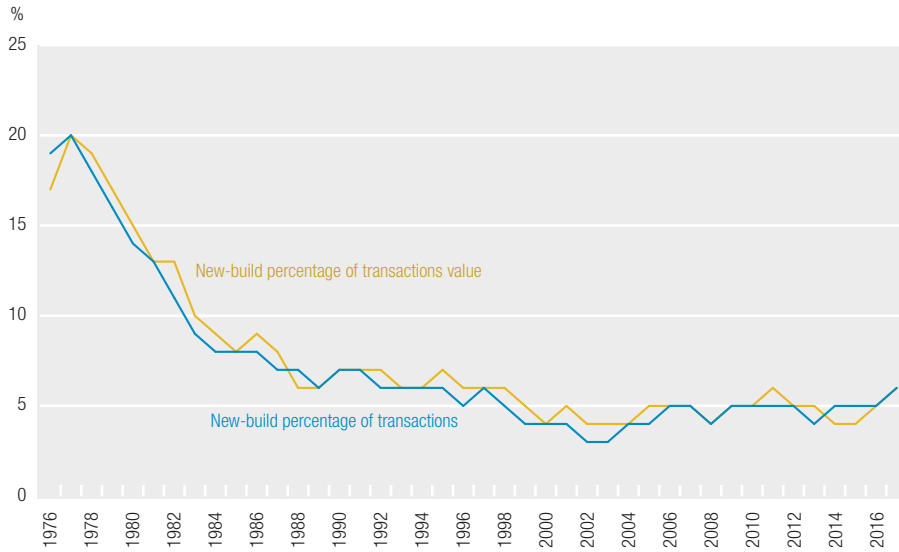
Trends in relationship breakdown are also important, given that such life events generally act to split households, leading perhaps to greater demand for smaller dwellings. The rate children reach adulthood, and the age they seek to leave home and form new households is also important, though these are clearly demand side effects. We will examine these trends later in the chapter, looking specifically through the lens of housing supply, i.e. in this chapter we are really only interested in the trends as they pertain to housing supply effects.

“We often think of households moving up the housing ladder, and this entails the supply of a smaller or lower quality dwelling to the market than the new dwelling being demanded. But, this is not always the case.”

The supply of new housing

In this section, we consider the recent performance of new-build housing supply, i.e. the volume of newly constructed dwellings. Figure 1 shows a very long term analysis, based on a 1976 through to 2016 time series. When we consider this long time frame, the overall impression is that new housing supply has declined significantly over the years, accounting for around 20 per cent of all market transactions in the mid-1970s, falling to around 10 per cent by the mid-1980s, and then stabilising to account for four to five per cent or so of all housing transactions by the late-1990s.

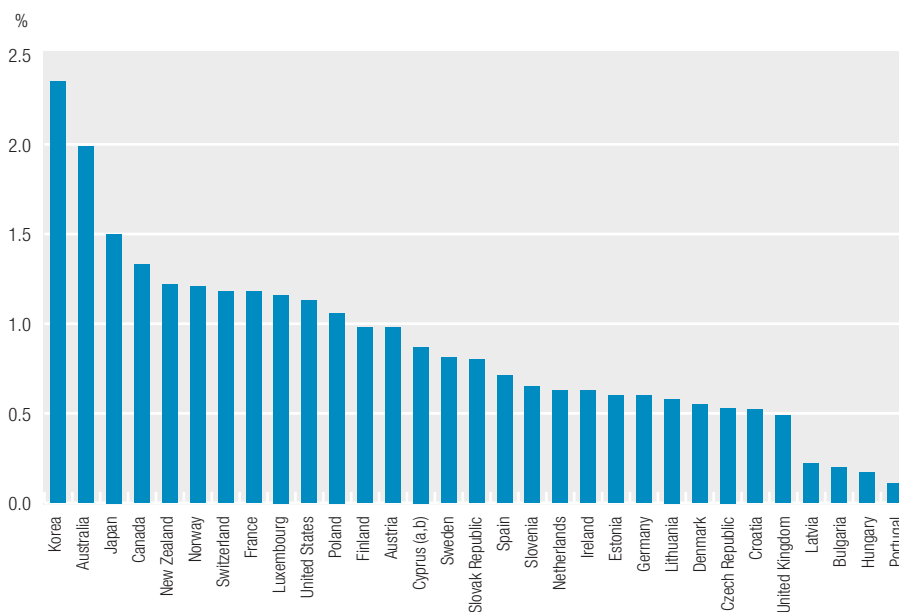
FIGURE 1
NEW-BUILD SHARE OF TRANSACTIONS AND VALUE



Source: Australian Bureau of Statistics

An inspection of more recent trends shows that the volume of newly built dwellings, as a share of all transactions or transaction value, has increased from under four per cent in the early 2000s to just over five per cent in 2015. On the face of it, this level of new housing supply might be argued to compare poorly with levels in other developed countries. For example, in the UK new housing supply accounts for approximately 10 per cent of all private housing each year.¹⁷ In fact, when measured in relation to the size of the existing dwelling stock, new housing supply in Australia is at one of the highest rates in developed countries. Figure 2

FIGURE 2
NEW SUPPLY AS PROPORTION OF DWELLING STOCK IN OECD COUNTRIES



Source: OECD 2015

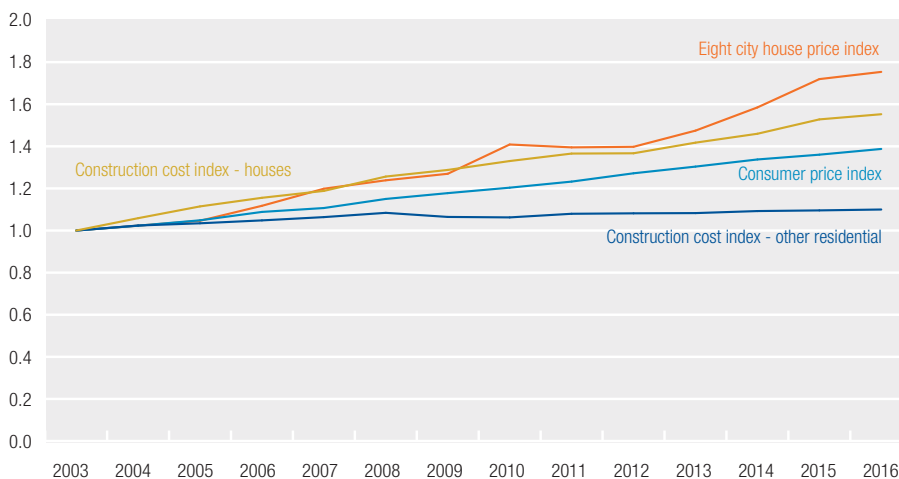
shows that at approximately two per cent of the dwelling stock, Australia's annual new housing supply is the second highest in OECD countries, exceeded only by Korea.

Of course, it is important to be cautious when drawing conclusions on the basis of national data – particularly in a country in which housing supply and affordability vary markedly between states and cities. It has been argued by a number of commentators recently that this level of new housing supply is poor, and inadequate to deal with the nation's burgeoning problems with the affordability of housing. A number of possible explanations have been put forward by such commentators, including that:

- Australia has an inadequate supply of development land, perhaps arising from irresponsive planning or planning processes inherently subject to delay;
- High construction costs have had a knock-on impact to development viability; and
- As a consequence of unionisation, Australia has an irresponsive construction industry.

Stanford¹⁸ analyses these arguments, arriving at the conclusion that an inadequate supply of land almost certainly lies at the heart of insufficient new housing supply. He demonstrates that construction cost inflation has fallen well below general inflation in recent years, and that the level of strike activity during the past five years is at a much lower level than the 10 years hitherto. This can be seen from Figure 3. This shows that the house price index for Australia (based on a weighted average of the ABS published indices for eight capital cities) has out-stripped consumer price inflation and construction cost inflation. A particularly interesting trend is the divergence between the construction cost index for houses, and the index for other residential, such as units. The cost indices are based primarily on the prices and quantities of building materials, and wages, and exclude land costs. On the face of it, there does seem to be a very discernible trend in the divergence between the costs involved in constructing houses,

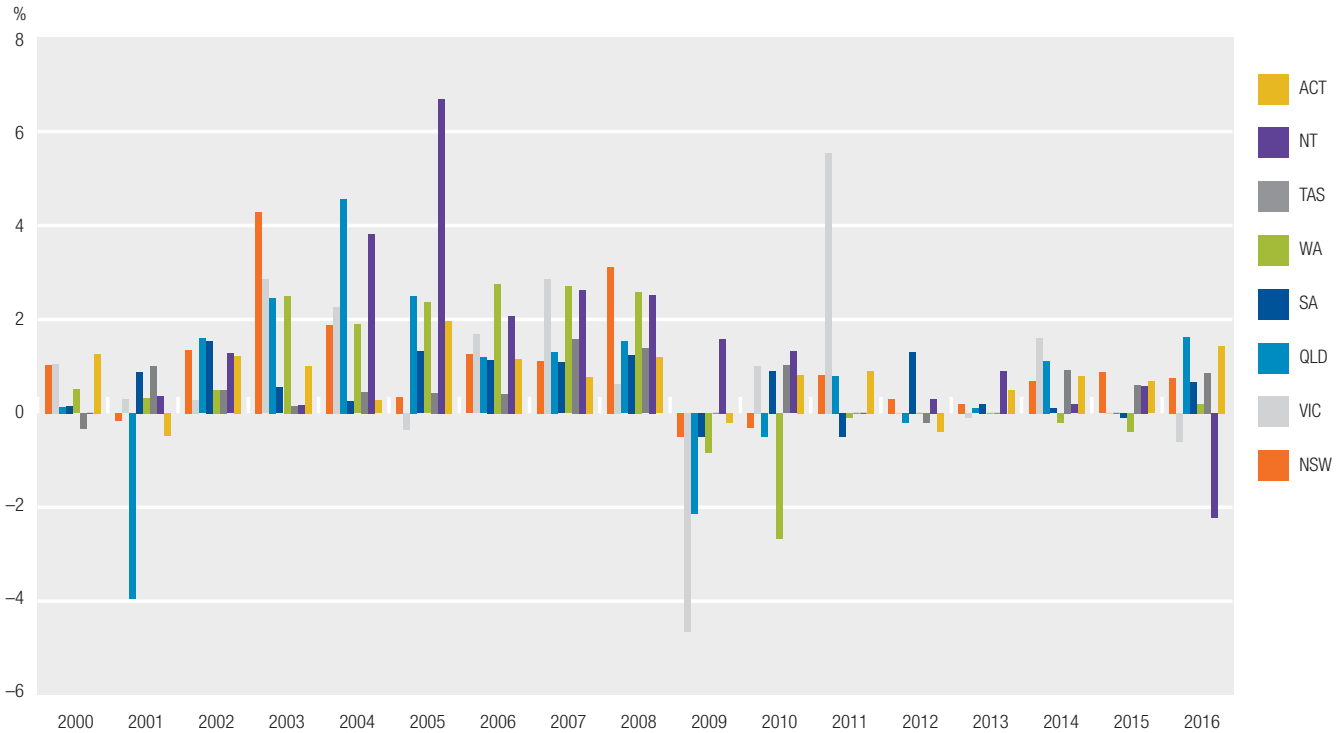
FIGURE 3
HOUSE PRICE AND CONSTRUCTION COST INFLATION



Source: Australian Bureau of Statistics

and units. A much more detailed analysis would be needed before any firm conclusions are drawn, but the trends might indicate rising quality in housing construction or a rising emphasis of new-build housing to the top end of the market. The relatively flat performance of other residential construction costs might be interpreted as arising from increasing efficiency, economies of scale, or simply cheaper construction methods.

FIGURE 4
STATE/TERRITORY COST INFLATION (OTHER RESIDENTIAL)



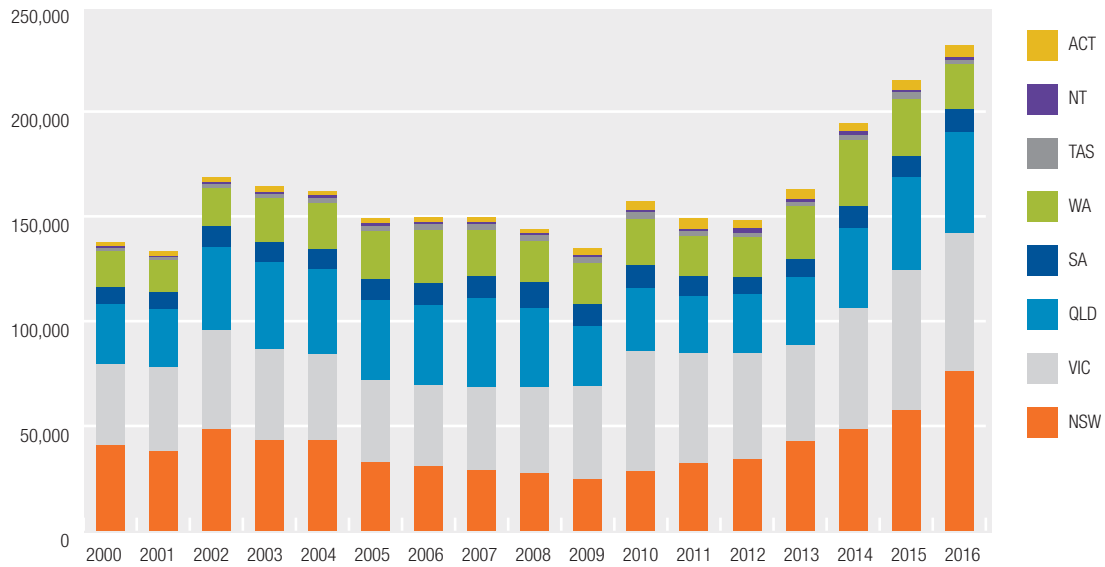
Source: Australian Bureau of Statistics

Breaking the figures down further, by state or territory, reveals some interesting insights as shown in Figure 4. In general, there is a noticeable shift in construction cost inflation rates after around 2008–09. Inflation is much lower in this time period, and there is also evidence of lower variation between states/territories.

The more recent trends shown in Figure 1 do not account for the general level of housing market activity – the analysis is based on newly built dwelling transactions as a proportion of all transactions. This may be misleading given that it is well known that housing market activity, i.e. the transactions volume is a leading indicator. Transactions tend to rise significantly and earlier than prices rise. It is also received wisdom that rising housing prices act as a price signal to developers with the result that new construction tends to lag any upswing in transactions volume.

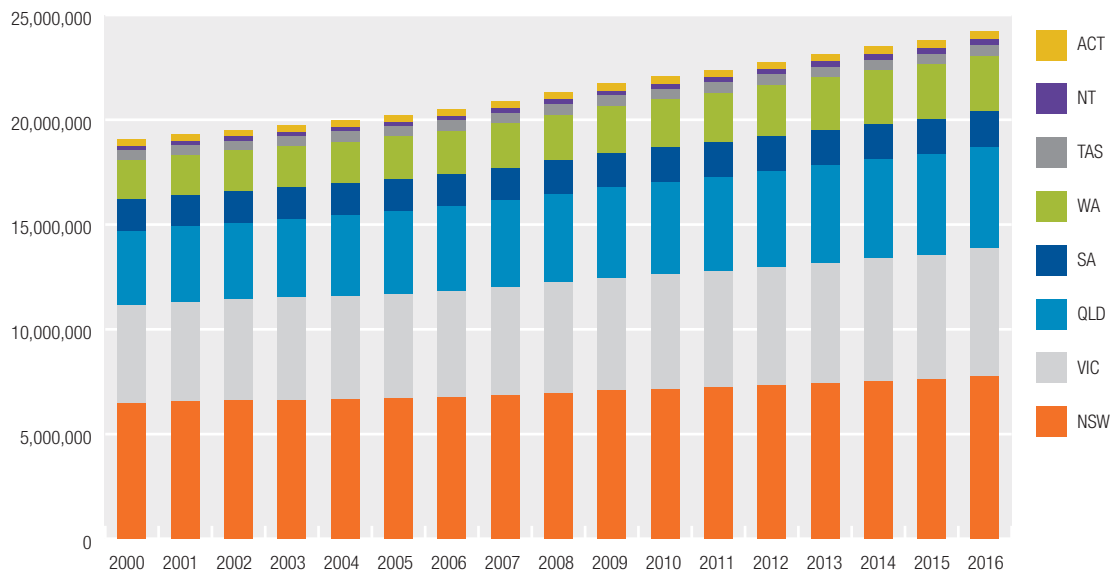
Figure 5 shows the trend in the total volume of private housing commencements. The impression stands in stark contrast to the pattern shown in Figure 1. When we consider the absolute number of dwellings being constructed it is clear that

FIGURE 5
TRENDS IN PRIVATE HOUSING COMMENCEMENTS



Source: Australian Bureau of Statistics

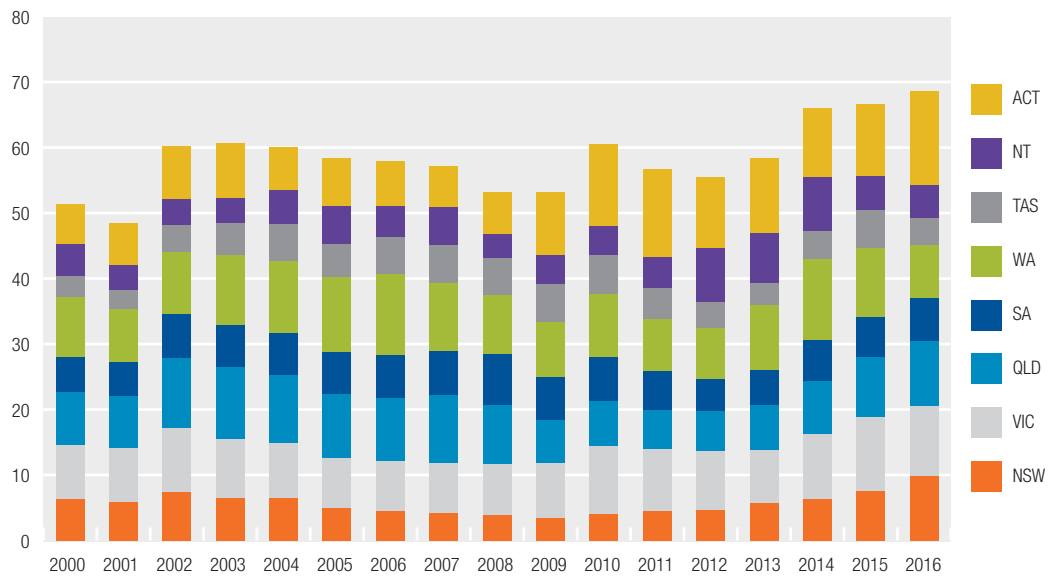
FIGURE 6
POPULATION IN AUSTRALIAN STATES AND TERRITORIES



Source: Australian Bureau of Statistics

there has been a significant rise since 2012. For the previous 10 years, commencements were on a plateau of around 150,000 per annum. From 2012 this volume increased rapidly and rose to a new high of around 225,000 in 2016. In addition, we can easily see that NSW, and to a lesser extent Victoria and Queensland, have contributed disproportionately to this growth. Yet, this analysis is also a partial picture given that Australia is experiencing pronounced and prolonged population growth (see Figure 6). The important question is whether the growth in new housing supply is adequate to meet the needs of the growing population.

FIGURE 7
COMMENCEMENTS PER 1000 HEAD OF POPULATION



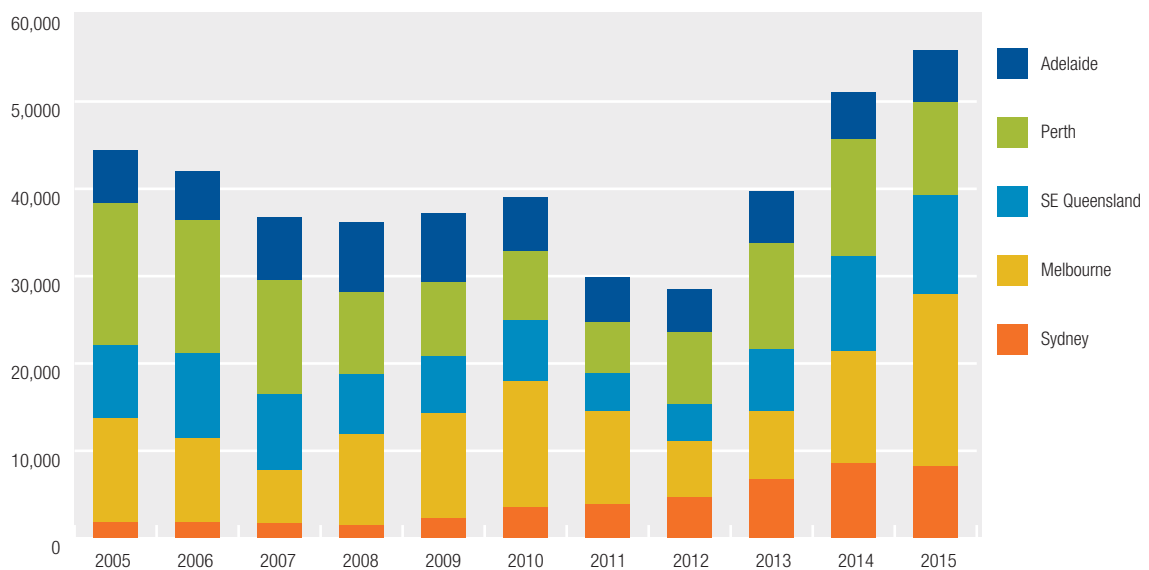
Source: Australian Bureau of Statistics

Once again, a very different picture emerges when we examine development activity in relation to a control variable. Figure 7 shows trends in the volume of private housing commencements with respect to 1000 head of population. We can immediately see that the growth since 2012 is more subdued, as we might expect, because both variables have been growing since this period. Yet, there is still net growth in private housing commencements even after controlling for population growth during this period.

A number of other interesting trends can be seen in Figure 7. For example, commencements in NSW were very low (with respect to population) between 2005 and 2012, and have only recently recovered to a level comparable to Victoria, Queensland or WA. We can see a modest decline in the level of new supply in WA from around 2008 onwards. Meanwhile, the level of supply appears much lower in Tasmania, NT and SA compared to Victoria, Queensland and WA. The ACT jumps out as having a much higher level of housing commencements than any other state, with respect to its total population.

The viability of housing development is a function of expected new-build housing prices (sale prices), construction costs, land costs, interest rates and required profits. The relationship between construction output and housing prices is a complex one because there is a degree of dual causality: higher house prices should trigger a development response but, in theory, higher levels of housing supply should help to control rates of house price growth – at least, in the long run. Given that lending conditions have been generally fairly benign in Australia, compared to other developed countries in the aftermath of the Global Financial Crisis, it is logical to look to the supply of land and the planning system as a

FIGURE 8
ESTIMATED SUPPLY OF DEVELOPMENT LAND



Source: Urban Development Institute of Australia

possible contributor to inelastic/irresponsive new housing supply. Earlier in the chapter, it was shown that high construction costs are unlikely to be a major factor in having suppressed new housing supply.

Absence of data

Data on land supply are not easy to come by, and there is no single, centralised statistical source that can be relied upon. This is not unusual in an international context. The assembly of data on development land availability or supply is very much a bottom-up process involving piecing together considerable detail at local or sub-regional level. Different planning authorities and jurisdictions tend to have slightly different data systems and working practices, with the result that variables are not readily comparable over time or between different geographical units. In Australia, perhaps the most robust source of land supply data is the Urban Development Institute of Australia (UDIA). Their annual reports provide estimates of the volume of development land released for Australia's main cities, but the coverage is patchy outwith capital cities, and the data are difficult to monitor on a time series basis.

Nevertheless, Figure 8 reveals the approximate land supply for Australia on a time series basis, using figures derived from the annual UDIA reports. The pattern very much mirrors the trend in housing commencements, with significant annual increases evident after 2012, largely reflecting activity in Victoria and Queensland and, to a lesser extent, NSW.

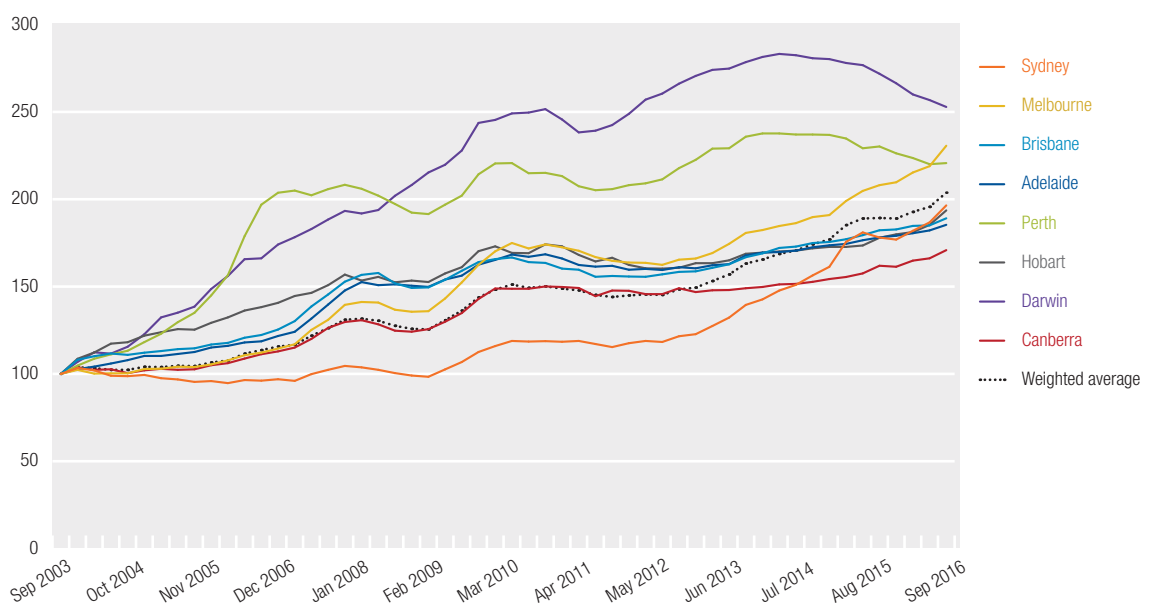
Is the supply of new housing adequate?

Whether the supply of development land or the flow of newly constructed dwellings are adequate are matters open to debate. As noted earlier in the chapter, the relationship between housing supply and house price (change) is more complex than some commentators suggest. There is undoubtedly a relationship between the size of the dwelling stock (hence, stock generated supply) and the housing price level in the long run (see Meen,^{19,20}; Leishman et al,²¹). Yet, the relationship between new housing supply, i.e. the annual flow of new housing completions, and annual change in the housing price level is much weaker. Behavioural, and also pragmatic business considerations, are also at work. While this has not yet been tested in an Australian context, Adams et al²² and Leishman²³ have shown that the design and operation of the UK planning system and development land market compel developers to build slowly to ensure that this “trickle feed” of supply permits completions to capture rising market prices. Thus, while higher levels of new supply help to control rising prices, there is a lag at work with the appearance that rising prices slowly “drag up” new supply levels, yet at a lower level than required to fully prevent further price rises.

“While higher levels of new supply help to control rising prices, there is a lag at work with the appearance that rising prices slowly ‘drag up’ new supply levels, yet at a lower level than required to fully prevent further price rises.”

Casual evidence of this effect can be seen visually in Figure 9, which shows the private housing price index for Australia’s capital cities. An overall price index for Australia reflects a weighted average index of housing prices in the capital cities.

FIGURE 9
HOUSE PRICE INDICES FOR AUSTRALIA'S CAPITAL CITIES



Source: Australian Bureau of Statistics

The period since 2011 has seen price growth in Sydney far out-stripping price inflation in other cities, although Melbourne and Brisbane have grown at the next higher rate, noticeably ahead of the remaining cities. Yet, these cities have had the highest rates of new housing supply as shown in Figure 9. It is noteworthy that the supply of housing development land and the flow of new completions has been lower in Sydney than Melbourne and Brisbane, lending weight to the idea that the supply has not been adequate to control the inflationary pressures on prices.

It is clear that the annual level of housing supply in Australia has fallen dramatically since the 1970s, but when we look at the past 20 years the picture is different: the level of supply plateaued and has been gradually rising over the past 15–20 years. Figures published by OECD show that Australian annual new housing supply remains at the very high end. It is notable that there has been no serious examination of the relationship between housing supply and housing prices, or affordability, in the long run in Australia. There is a clear gap in the evidence base, and a significant piece of research is urgently needed to address this deficit. In the absence of such an evidence base it would not be appropriate to draw firm conclusions about the next steps for policy makers, but it is worth reflecting on several emerging facts about the interfaces between land markets and new housing supply, and between new and established sectors of the home ownership housing market.

Developer competition

There is evidence that competition is a potential problem. In the UK, housing developers cite intense competition for land with the result that they bid aggressively to acquire land, paying high prices and are then compelled to build slowly to take advantage of rising housing prices. Some UK housing developers are orientated towards high volume, low margin housing completions. Others make as much money from land speculation and development than housing development. Concern about the level of competition in the UK housing supply system led the UK's Office for Fair Trading to launch a market study.²⁴ The system in Australia is clearly very different, but similar concerns arise. There is some evidence of concern among housing developers that serviced land is priced to the margin of viability.

“It is notable that there has been no serious examination of the relationship between housing supply and housing prices, or affordability, in the long run in Australia. There is a clear gap in the evidence base, and a significant piece of research is urgently needed to address this deficit.”

Some commentators have pursued the argument that planning gain, betterment or contributions to the development of affordable housing, might be yielded through inclusionary zoning. Indeed, there is potential for Australian housing policy to learn from the successes (and failures) of UK policy (see Leishman and Rowley²⁵ for a discussion).

With discretionary zoning, the potential for success rests on the ability of the state (policymakers) to second-guess the potential locations of viable new housing development more effectively than the private sector. The underlying idea is to secure a commitment to societally-beneficial contributions from developers before land suitable for housing development is identified and zoned as such, and

the hope value reflected in the market value of the land. However, economists have long recognised the superior ability of private markets to find viable development opportunities in advance of policy markets. We should be cautious about the potential for the public sector to realise planning gains through inclusionary zoning.

Perhaps the greatest problem for policymakers lies in the interface of complex markets with very different market structures. This might sound unappetisingly theoretical, but perhaps it is time to acknowledge that housing and land markets, and housing supply, are simply not understood well enough? Perhaps we should permit ourselves to theorise the problem. Consider the headline market structure attributes of the following markets, to illustrate:

“Huge numbers of non-urban land owners exist as potential suppliers of land suitable to be zoned for residential development land, serviced and sold to housing developers. These owners are clearly in a weak position in terms of market power. Land developers are in a stronger position in the negotiation process, but are exposed to risks...”

Market	Potential vendors	Potential buyers	Possible market structure
Unserviced development land market	Very many	Very few	Oligopsony
Serviced development land market	Very few	Few	Oligopoly
Construction contracting	Many	Many	Monopolistically competitive
Market for established housing	Very many	Very many	≈ perfectly competitive
Market for new-build variant of housing	Few	Very many	Monopolistically competitive

Putting this into words, huge numbers of non-urban land owners exist as potential suppliers of land suitable to be zoned for residential development land, serviced and sold to housing developers. These owners are clearly in a weak position in terms of market power. Land developers are in a stronger position in the negotiation process, but are exposed to the risks inherent in purchasing or taking options on land without official approval to be developed for housing. Housing developers are in the weakest position of all in that they must purchase development land from the few land developers in the local market, and have weak market power as a result, but must supply finished housing to a market dominated by established or second-hand housing units, and thus have weak market power in that market also. Overall, the conclusion must be that our housing system has been designed – inadvertently, of course – to supply new additions at a lesser rate than needed to keep housing prices and affordability within acceptable limits.

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3. Australia's demand for housing

Associate Professor Emma Baker

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This chapter looks at the drivers of housing demand in Australia – including changing demographics, foreign investment and patterns of housing trade-offs – and what these drivers mean for future housing supply requirements.

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Associate Professor Emma Baker leads the Healthy Cities Research Group at the University of Adelaide. A geographer by training, her research is focused on the role of housing and residential location in improving health and wellbeing. Her work is intentionally interdisciplinary and collaborative, combining the methods and understanding from econometrics, social epidemiology, architecture, geography, and demography. Her recent published work includes a spatial analysis of urban densities, an examination of the effectiveness of housing affordability measures, cross national comparisons of the health effects of housing, and the construction of the National Housing Conditions Data Infrastructure. She is currently an Australian Research Council Future Fellow, investigating the extent and effects of accumulated housing problems.

Introduction

The early release of the 2016 Census of Population and Housing records more than 24.5 million people living in Australia, spread across 8.3 million households in private dwellings.¹ Importantly, this number of households is projected to increase by more than 1.7 million in the 10 years to 2027.² These simple population projections suggest an ongoing challenge for housing provision. They suggest that within a decade we may need to plan for, build, finance, and make available 1.7 million appropriate new homes for Australian households. But, what will this future housing demand look like?

This chapter reflects on the likely drivers and implications of Australian housing demand into the near-future. Looking to the available data, this chapter characterises housing demand as growing, steady, but very spatially concentrated. Australia has always been a nation of uneven population distribution, but a strong momentum of new household growth in Melbourne, and to a lesser extent Sydney, has developed. Correspondingly, regional areas and the smaller capital cities are projected to grow much more slowly.

What drives demand?

Housing demand is most simply driven by the number of new households needing to be housed “since every new household needs a dwelling”.³ Demographic change is hence the overarching driver of housing demand, describing the absolute number of new households formed over time, and defining the composition of those new households, across age, size, location and structure. In addition to demographic change driving the creation and composition of new households, demand is secondarily influenced by the housing preferences of the whole population, and the trade-offs that individual households make to realise their housing preferences. Thirdly, the surrounding economic and policy environment (for example relative access to housing finance, local employment, or the level of offshore demand) may directly or indirectly influence the magnitude, distribution and focus of housing demand.

Households – changing numbers and characteristics

Any form of demographic change which influences the number and characteristics of Australian households can be regarded as a determinant of housing demand. This section describes current and projected population growth in Australia, the contribution of international and interstate migration, the likely grouping of population growth into households, and the characteristics of those households.

Australia’s population has grown steadily in recent years. Net migration and natural increase (births minus deaths) have contributed an average 360,000 additional people to the Australian population each year since 2010.¹ This steady national population growth is expected to continue on a similar trajectory into the future. Importantly, our population, and hence our demand for housing, is very unevenly spread across the continent. We are clumped into large and small cities and regions, and dappled across the more remote parts of the interior. This uneven distribution of the population reflects both historical and emerging patterns of population growth. For example, in the last year rates and components of population change were markedly different across the states and territories. Figure 1 shows that while population growth in Queensland was largely fuelled by natural increase, net overseas migration was a more dominant source of population change in NSW and Victoria. The pattern of interstate migration shown in this data is particularly interesting, suggesting that when Australians move within Australia, they tend to move from everywhere else to Victoria and Queensland.

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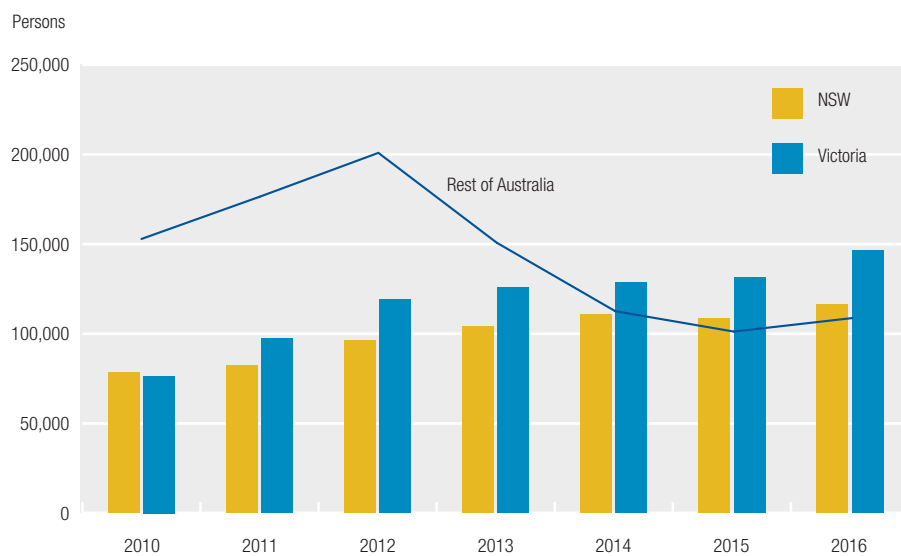
FIGURE 1
POPULATION CHANGE, COMPONENTS OF POPULATION GROWTH RATE 2015–16, BY STATE, PER CENT



Source: Australian Demographic Statistics, ABS, 2017 Cat no. 3101.0

What this examination of growth rates hides is a substantial (and increasing) concentration of Australia’s population into two states – NSW and Victoria. Figure 2 highlights this trend, showing annual net population growth for NSW and Victoria, compared to net population growth for the rest of the nation. It shows that not only has Victoria overtaken NSW in annual growth each year since 2010, but that in 2015 and 2016 both NSW and Victoria experienced net increases of their population in excess of the whole of the rest of the country.

FIGURE 2
ANNUAL POPULATION CHANGE, NSW, VICTORIA, AND REST OF AUSTRALIA



Data source: Australian Bureau of Statistics, Australian Demographic Statistics, Cat no. 3101.

While there have been quite substantial changes in the age structure of the Australian population since World War II, these appear to have largely stabilised in recent years – with one ongoing exception, a steady increase in the proportion of older people. Between 2011 and 2016 for example, the proportion of the population who were children, teenagers, young adults and middle aged all fell just slightly, but correspondingly, the proportion of the population who were aged over 60 years increased by more than eight per cent. This is a continuation of a long run ageing of the Australian population.

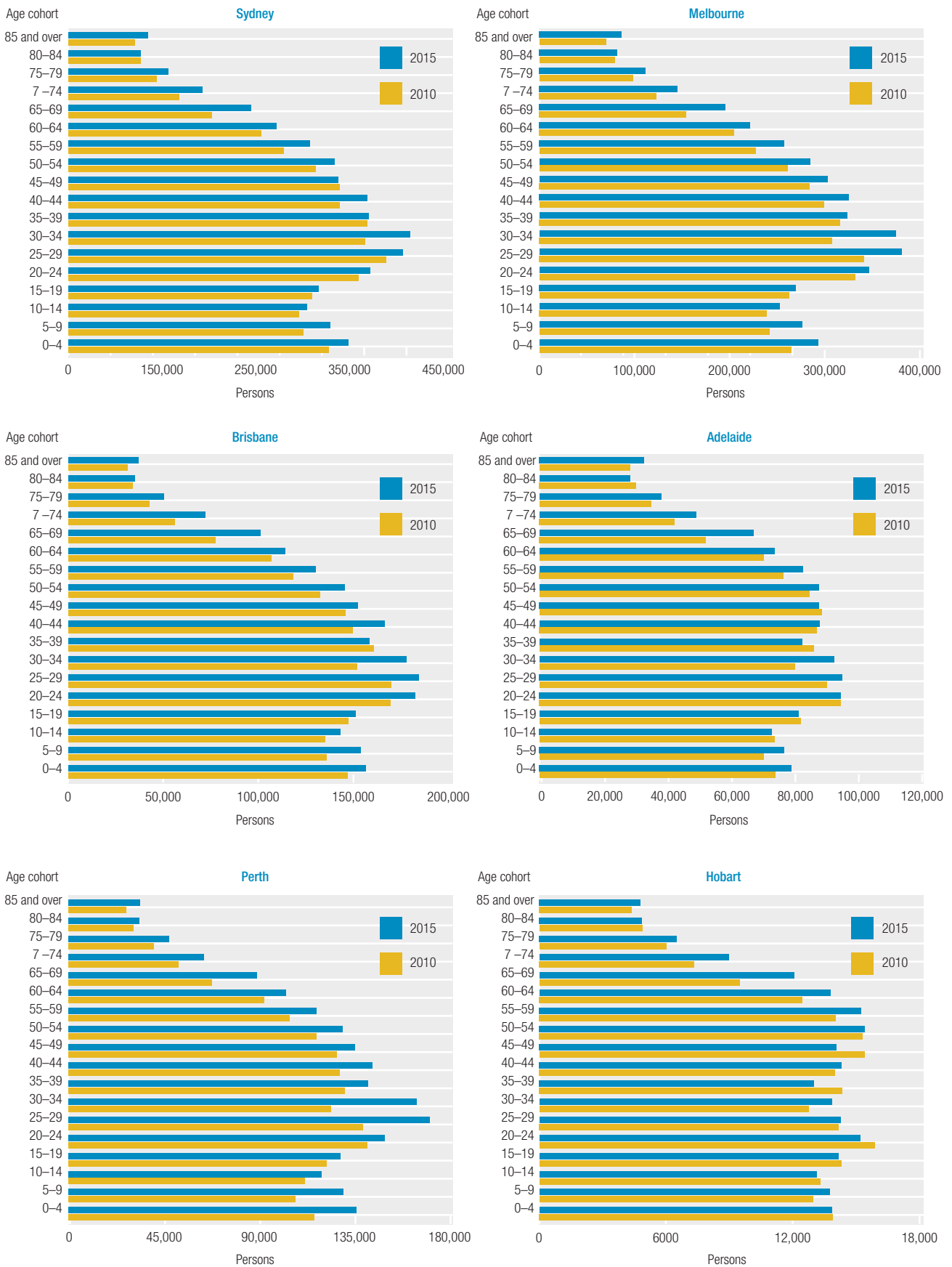
TABLE 1
PERCENTAGE OF POPULATION IN CENSUS AGE COHORTS, 1947–2006

Age (years):	1947	1954	1961	1971	1981	1991	2001	2006	2011	2016
Children (0–9)	18.1	20.9	20.5	19.1	16.1	14.7	13.6	12.9	12.9	12.7
Teenagers (10–19)	14.8	14.3	17.3	18.2	17.5	15.1	13.6	13.7	12.9	12.0
Young adults (20–29)	16.0	14.5	12.8	16.1	16.9	16.2	14.0	13.2	13.8	13.8
Middle age (30–59)	38.8	37.8	36.7	43.2	35.5	38.5	41.8	42.0	40.8	40.2
Older (over 60)	12.8	13.1	12.2	11.4	12.8	14.2	15.1	18.1	19.6	21.3

Data source: Derived from Australian Historical Population Statistics, 2008, cat no 3105.0.65.001 and ABS, 2017, Census Time Series Profile, cat no. 2003.0

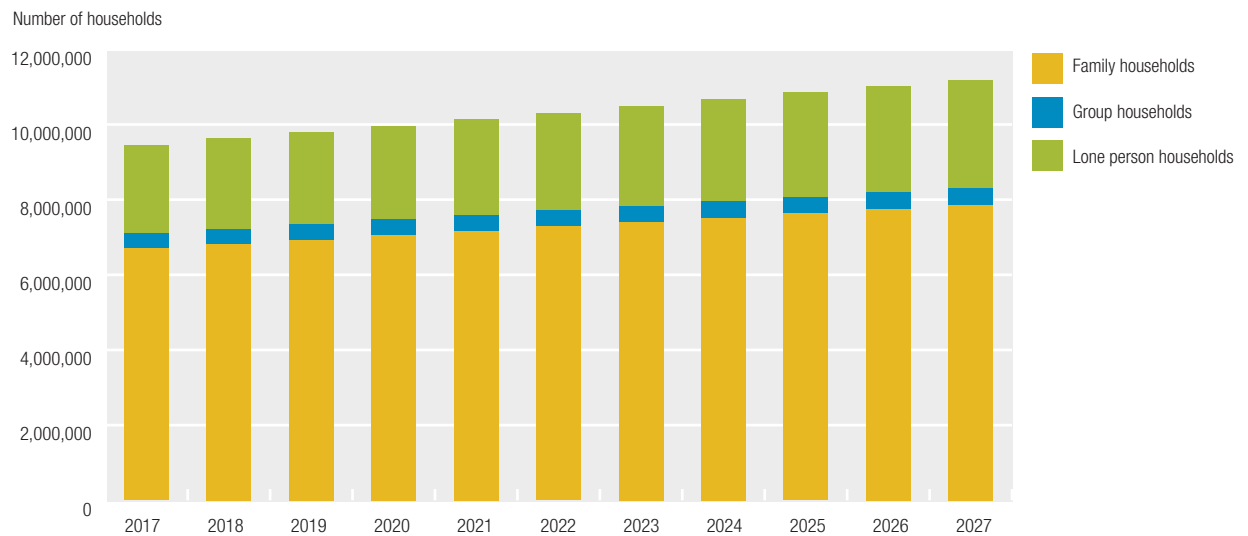
Underlying these national changes, the age profiles of Australia's major capitals have evolved in different ways. Comparing the age structure in 2010 with that in 2015 (Figure 3), it is evident that Sydney, Melbourne, Brisbane and Perth have all experienced population growth in the key working aged cohorts. This corresponds to the patterns of population growth in Adelaide and Hobart, which was much more focused in the older, 60+ age groups. Further, these two cities had negligible growth or loss in the younger age cohorts, who are more likely to form new households. Assuming these patterns of recent population growth continue, the demand for new housing in Melbourne, Sydney, Brisbane and Perth will be more focused on larger, family and couple dwellings, and in Adelaide and Hobart demand is likely to stabilise and any growth will be focused on smaller, lone person dwellings. These findings are also reflected in the household composition projection data (derived from the Australian Bureau of Statistics, 2015)² for 2017–2027 (results not shown).

FIGURE 3
POPULATION CHANGE, 2010–2015, MAJOR CAPITAL CITIES



Data source: Australian Bureau of Statistics, Population by Age and Sex, Regions of Australia, 2015, cat no. 3235.0

FIGURE 4
PROJECTED NUMBER OF HOUSEHOLDS, HOUSEHOLD TYPE, 2017–2027



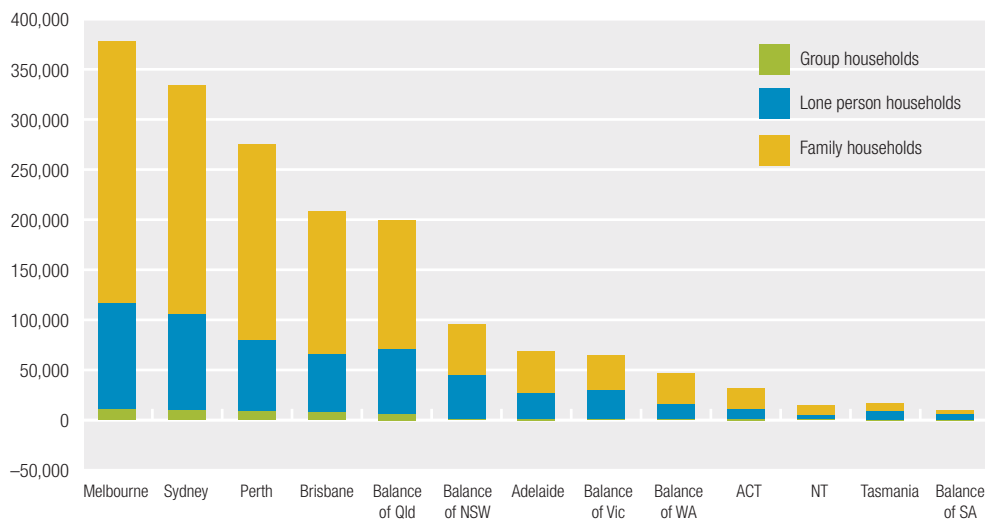
Data source: ABS, 2015, Household and family projections, Australia, 2011–2036, cat no 3236.0

While understanding population growth is important for predicting future housing demand, households, rather than people, are the “critical demographic unit”⁴ of housing demand. Australian households currently contain on average 2.6 persons, a number that has been stable for the last 15 years.⁵ Figure 4 shows that, like the population, the number of households is projected to increase steadily over the next decade. Though growth will be across all household types, family households will dominate. Perhaps unsurprisingly, it is lone person households who will have the highest rate of growth (an estimated increase of 22 per cent over the 10 years).

Available household projection data also suggests that the growth of households over the next decade will be especially concentrated in Melbourne and Sydney – and to a lesser extent in Perth, Brisbane, and wider Queensland (Figure 5). Further, while family households are expected to dominate growth across most of the nation, lone person households will make a substantial contribution to population growth in the non-metropolitan parts of states.

This brief description of recent and projected demographic data suggests a number of implications for housing demand. Overall, demand can be characterised as steadily increasing, driven roughly as much by migration as natural increase. The proportion of older and lone person households is increasing, and importantly demand is becoming overwhelmingly concentrated in Melbourne and Sydney.

FIGURE 5
PROJECTED GROWTH OF HOUSEHOLDS 2017–2027



Source: ABS, 2015, Household and family projections (Series I), Australia, 2011–2036, cat no 3236.0

Forces stimulating demand – and constraint

Subordinate to demographic drivers, the patterns of housing trade-offs that Australians have already made provide a strong indication of emerging demand. Housing trade-offs are effectively the choices households make within the constraints that they have (for example, income, employment mobility, or household size). It is probable that both the choices available and the constraints that apply to households have broadened in recent years. Our housing stock has certainly become more diverse and Australia has moved away from the dominance of the single house on a quarter acre block that many of our parents grew up in. In 1991, for example, 77 per cent of the dwelling stock were separate houses, and since then this proportion has decreased slightly at each of the six Census collections that followed. By the 2016 Census, 72 per cent of the private occupied dwelling stock were separate houses. This seemingly minor (five per cent) change is large in absolute terms, and was accompanied by substantial increases in the number of semi-detached dwellings, and flats and apartments (150 per cent and 80 per cent respectively) over this time.

The Australian population is also much more likely to rent, rent into older ages, or hold a mortgage into retirement age.⁶ Historically in Australia, age has been closely correlated with position on the housing ladder (as well described by Beer and Badcock),⁷ and therefore the housing required by households. The traditional housing ladder conceptualisation describes the movement of people, from leaving the family home to forming new households, followed by short periods of renting, then home purchase, outright ownership, eventually downsizing once children left the family home, and perhaps moving to aged care accommodation. However, there is evidence that the housing ladder analogy is becoming less useful in Australia. Children are leaving home later, are staying in formal education longer, having to save for longer to accumulate a first home loan deposit, and

TABLE 2
PROPORTION OF HOUSEHOLDS WITH HOUSING COSTS GREATER THAN 30 PER CENT OF GROSS HOUSEHOLD INCOME, AUSTRALIAN STATES, 2000–01 – 2013–14

	NSW	Vic	Qld	SA	WA	Tas
2000–01	15.6	13.6	15.8	8.7	12.9	8.9
2013–14	19.5	16.1	20.5	13.9	16.0	12.1

Data source: ABS, 2015, Cat no 4130.0

they’re marrying later (or not at all). When they leave home, many young adults will become lifetime renters, they will have children later than their parents did, and perhaps be less likely to obtain full time employment. In addition, fewer Australians are becoming home owners, and many fewer will eventually own their home outright. All of these delays along the ladder mean that an increasing proportion of Australians will be mortgage holders or renters in retirement.

The overarching constraint in the dwelling trade-off decisions of Australian households is, without a doubt, affordability. Affordability shapes (and also masks) demand by constraining where households are able to locate, how much housing they are able to consume, how appropriate their dwellings are to the requirements of the household, and importantly, which tenure they are able to secure. In order to reflect on the changing number of households with affordability problems, we examine the proportion of households who are paying more than 30 per cent of income for housing costs (shown in Table 2).

This table shows that the constraint of affordability became substantially more widespread among Australian households this century. In all states, a larger proportion of the population had affordability problems in 2013–14 than did in 2000–01. What is interesting in this table is the fact that growth in the prevalence of affordability problems isn’t concentrated in the two states (NSW and Victoria) with highest population growth. Rather, the two states with smaller populations and negligible population growth (SA and Tasmania) have experienced the fastest growth in the prevalence of affordability problems since 2000.

One interpretation of these affordability findings is (remembering that housing affordability is measured as a ratio of housing costs to income) that though house

prices, rents, and overall housing demand may be higher in NSW and Victoria, housing cost increases have been more than met by growth in average incomes and employment growth in these markets. The explanation for this difference may also be supply related – that housing supply responses have been more efficient in NSW and Victoria. The data also suggests that the smaller states may have

“Affordability shapes (and also masks) demand by constraining where households are able to locate, how much housing they are able to consume, how appropriate their dwellings are to the requirements of the household, and importantly, which tenure they are able to secure.”

experienced a catch-up in house prices over the 14 year period – for example, the mean value of NSW dwellings in 2000–01 was \$357,000 and this rose 46 per cent to \$520,000 in 2013–14, whereas in South Australia the 2000–01 mean value was \$185,000, but this more than doubled to \$385,000 by 2013–14.⁸

While not drivers per se, the surrounding economic and policy environment indirectly influence the quantity and character of housing demand and, perhaps more importantly, the housing trade-off decisions that households make. For example, untargeted housing policy interventions such as the First Home Owner Grant (FHOG) (as well described in *The first home owner boost in Australia: a case study of outcomes in the Sydney housing market*),⁹ which sought to encourage, or bring forward, entry into the housing market. The evidence on Australia's FHOG suggests that it was successful in bringing forward household formation decisions, and allowing households to shift from one tenure (rental) to another (ownership). The effectiveness of FHOGs of creating *new* demand has always been questioned though, with many authors suggesting that it mainly brought forward home purchase decisions of households who would have eventually purchased without the intervention.¹⁰

The issue of offshore housing demand is of particular current policy and media interest. Predominantly, this demand comes from Chinese investors, but also from investors from the US, Singapore and the United Arab Emirates. While some of this investment results in owner occupied or rental housing outcomes, Australian real estate is increasingly used by international investors as a place to store wealth within global markets (as well discussed in *Chinese investment in Australian housing: push and pull factors and implications for understanding international housing demand*).¹¹ This storage may be temporary, and highly vulnerable to shifts in international interest and exchange rates, or regulatory changes anywhere in the global market. In order to achieve this, many of these investment properties are never lived in. This means that some residential property becomes “locked up” as unoccupied investment property, which has obvious implications for Australian housing supply.

The most recently published statistics capturing offshore demand for residential real estate show that more than three-quarters of all residential real estate foreign investment approvals last year focused on Victoria (39 per cent) and NSW (29 per cent), and this was largely concentrated in the high growth cities of Sydney and Melbourne.¹² Unsurprisingly, this concentration of foreign demand into the larger Australia cities mirrors similar real estate investment patterns documented in UK and Canadian “global cities”.¹³

“The most recently published statistics capturing offshore demand for residential real estate show that more than three-quarters of all residential real estate foreign investment approvals last year focused on Victoria (39 per cent) and NSW (29 per cent), and this was largely concentrated in the high growth cities of Sydney and Melbourne.”

Conclusion

This chapter has examined a number of parts of the current and emerging housing demand story for Australia. Perhaps the most important finding evident in the data is the increasing dominance of Melbourne, and to a lesser extent, Sydney. Australia could almost be considered to have three distinct housing markets operating – Melbourne, Sydney, and the rest of Australia. In such a spatially expansive nation this may eventually be problematic for infrastructure and service provision, housing affordability, or local employment – across both fast growing as well as slowing cities and regions. While underlying demand is dominantly centred on these larger cities, it may be appropriate to refocus some of that demand to smaller cities or regional areas. Interestingly, housing affordability may not provide enough of a motivation to shift demand to the slower growing areas.

A second important finding is that Australia, like the UK, has moved relatively rapidly from being a nation of homeowners to a nation where people increasingly rent. One implication of this change is that growing numbers of Australians “face a working life of insecure, expensive and often poor quality private renting”.¹⁴ There is increasing demand for rental dwellings, but to some extent our housing market still assumes that we are a nation of homeowners. Because our traditional view of the Australian housing ladder regards renting largely as a temporary step towards the eventual goal of homeownership, it probably has fewer protections for residents than if it were considered a lifetime option. Close to one third of Australians now rent, and many of them will never purchase a dwelling, so problems of tenure insecurity, rental unaffordability, and limited overall tenant rights become lifetime issues.

This brief examination of the ongoing and emerging drivers of housing demand in Australia provides insight into the likely pattern and character of future demand. It should be noted, however, that the substantial importance to Australia of understanding demand (alongside housing supply) provides strong justification for a coordinated national approach to data and measurement. Our understanding of housing demand and supply are highly dependent on the systematic and repeated interpretation of quality national and sub-national data. Much of this role was, until their abolishment in 2013, performed by the National Housing Supply Council, and since then our monitoring and prediction has been based upon more piecemeal, and unstandardised (government and non-government) data collections. Acknowledging this, this chapter ends with an addition to the loud and growing call across policy and research for a “consolidated, independent source of diagnostic data on Australian housing market trends”¹⁵ on which we can properly predict, understand and plan for future housing demand.

“Australia could almost be considered to have three distinct housing markets operating – Melbourne, Sydney, and the rest of Australia. In such a spatially expansive nation this may eventually be problematic for infrastructure and service provision, housing affordability, or local employment.”

Note: At the time of writing, early data from the five yearly Australian Census of Population and Housing was released, providing an important initial update on changes in the Australian population since 2011. While this early look is valuable, further releases scheduled throughout the year will develop our current understanding of housing demand.

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4. Housing futures in Australia: an intergenerational perspective

Professor Rachel Ong

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This chapter looks at the widening intergenerational housing wealth gap between the young and old. It discusses how the timing of historical policy reforms, alongside changing labour market and housing conditions, have given rise to fewer opportunities to accumulate housing wealth among the young in comparison with their boomer parents.

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Rachel Ong is Deputy Director of the Bankwest Curtin Economics Centre, Curtin University. Her research addresses a range of critical housing policy issues, including housing affordability dynamics, housing pathways in the new millennium, intergenerational housing concerns, and the links between housing and the economy. She has long-standing expertise in the evaluation of housing tax-transfer reforms. Professor Ong also has an established research record in the area of population ageing and has conducted extensive research into the role of home ownership within the retirement incomes system. She has been appointed to several research expert panels including the Economic Society of Australia's National Economic Panel. She is a member of the Steering Committee for the Asia-Pacific Network for Housing Research.

Introduction

It is widely accepted that many baby boomers have enjoyed favourable economic conditions during their wealth accumulation years. According to the Australian Bureau of Statistics' (ABS) Survey of Income and Housing, nearly 70 per cent of Australians in their 30s and 40s owned a home in the mid-1990s. These Australians make up the baby boomer cohort, so housing market conditions have played a critical role in their wealth expansion as house prices soared exponentially from the mid-1990s to the early 2000s, adding tremendously to the housing asset base of home owners in those years. Between 1997 and 2005, real median house prices in Australian capital cities soared by 80 per cent, from \$267,000 to \$497,000. While the housing market slowed during the 2008 Global Financial Crisis (GFC), Australian home owners in general were less adversely affected from global shocks to the housing market than their overseas counterparts. House prices continued to climb after the global financial crisis and by 2014, real median house prices were sitting at \$621,000.¹

The historic expansion in housing wealth of baby boomers has been accompanied by a contrary development for their children. As real house prices continued its climb through the turn of millennium, housing affordability has been worsening so that those who were not fortunate enough to have purchased their first home by the mid-1990s have found it increasingly challenging to break into the home ownership market. The “great Australian dream” of becoming home owners has receded rapidly for younger generations, now widely dubbed “generation rent”.²

This has undoubtedly aggravated intergenerational tensions in housing markets that pit the young and old against each other in fiery debates around home purchase opportunity. Such a development is unsurprising. In Australian society, there has long been a strong economic and cultural emphasis on home ownership. Not only is home ownership typically considered the main store of wealth for households, the attainment of home ownership is often tied to the achievement of independent adult status.³

This chapter tracks historical policy reforms and changing labour market and housing conditions that have potentially given rise to unequal access to property purchase opportunity across generations. This is followed by an empirical analysis of trends in property ownership in Australia by different age cohorts over three decades. The implications of a growing intergenerational housing wealth divide for Australia’s housing futures are unpacked following an analysis of the historical trends. The chapter concludes with a call for rethinking housing policy formulation via an intergenerational lens so the needs of co-existing generations are accounted for.

“As real house prices continued its climb through the turn of millennium, housing affordability has been worsening so that those who were not fortunate enough to have purchased their first home by the mid-1990s have found it increasingly challenging to break into the home ownership market.”

Housing past: ownership over three decades

Wealth accumulation opportunities: a historical context

The timing of policy reforms, and changing labour market and housing conditions are key factors that influence access to wealth accumulation opportunities that each generation has access to. Figure 1 tracks the history of several policy reforms and changing labour market and housing conditions over the last four decades from 1977 to 2017, over the first 40 years of a typical Gen X individual’s lifespan. Because generations X and Y refer to the cohort born 1966–86,⁴ the median Gen X is defined here as an individual born during the median year of this period, that is, 1976.

The Higher Education Contribution Scheme (HECS) was introduced in 1989, when many Gen X individuals were preparing to commence tertiary education. By 1997, the HECS contribution rate had been raised for new students and lower HECS repayment thresholds were applied.⁵ Hence, while many baby boomers enjoyed access to free education, the decline in tertiary education subsidy would have slowed the wealth accumulation capacity of Gen X relative to their boomer parents. However, the introduction of the superannuation guarantee in 1992⁶ would have boosted the retirement savings capacity of Gen X relative to boomers.

Financial deregulation grew during the 1970s then spread rapidly during the 1980s, allowing banks to increase the share of property lending in their assets. Interest rate controls on all new housing loans were abolished by 1986.⁷ Deregulation widened access to home ownership but it also fuelled demand for housing, as did the introduction of the First Home Owners Grant (FHOG) first introduced in 2000.⁸ The real values of property were

pushed to ever higher levels as the decades passed. House prices soared, offering up windfall gains to many boomers, who were already home owners in those years, while pushing home ownership more and more out of the reach of large numbers of Gen X renters.

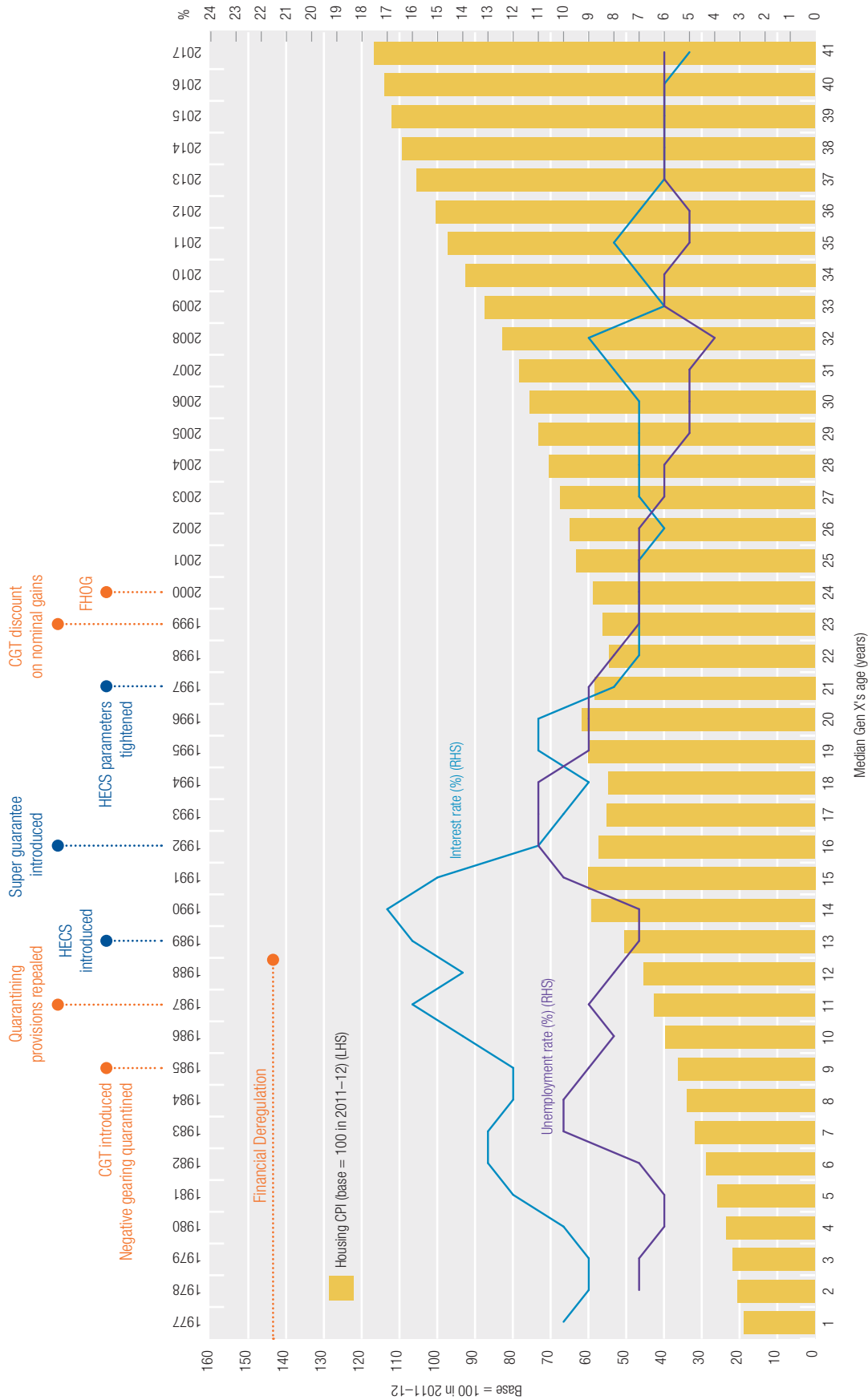
Negative gearing provisions in Australia are among some of the most generous within the OECD.⁹ During 1985, the Australian government briefly quarantined negative gearing provisions, but this was repealed after just two years due to its political unpopularity.¹⁰ Prior to the 1999 Ralph review,¹¹ capital gains on investment properties were taxed at their real values at investors' marginal income tax rates. However, after the Ralph review, the capital gains tax (CGT) discount system was reformed such that only 50 per cent of capital gains would be taxed, albeit at nominal values, to encourage greater levels of investment.¹² These reforms have proven to be pro-cyclical, thus exacerbating housing market volatility.¹³ The combination of generous negative gearing provisions and the CGT has encouraged debt financed property purchase by investors to chase speculative capital gains that are lightly taxed in comparison to ordinary sources of income.¹⁴

“The combination of generous negative gearing provisions and the CGT has encouraged debt financed property purchase by investors to chase speculative capital gains that are lightly taxed in comparison to ordinary sources of income.”

After nearly two decades of healthy labour market conditions, the unemployment rate has been creeping upwards since the GFC. Labour markets are increasingly precarious.¹⁵ The spread of insecure employment has further threatened the chances of home purchase by young aspiring homebuyers.

Overall, those not fortunate enough to have purchased a home before the housing market boom of the mid-1990s have found it increasingly difficult to access home ownership as house prices have soared amidst growing job insecurity and rising HECS debts that hamper their wealth accumulating capacity. It is therefore unsurprising that concerns around intergenerational housing inequality persist, as younger generations find themselves having fewer opportunities to accumulate housing wealth than their boomer parents did due, at least partially, to the timing of their birth.

FIGURE 1
HOUSING AND LABOUR CONDITIONS AND RELATED POLICY CHANGES, 1977 TO 2017



Source: Ralph (1999), Jackson (2003), O'Donnell (2005), Australian Taxation Office (2011), Daley et al. (2016)¹⁶, ABS (2017a¹⁷, 2017b¹⁸), RBA (2017)¹⁹
 Note: The time series reflect data from March each year. A "median" Gen X is defined as an individual born in 1976.

An intergenerational divide

A long-run analysis of property ownership patterns over the past three decades sheds light on the magnitude of the growing intergenerational divide between younger and older age groups. Table 1 draws on the Surveys of Income and Housing to compare four key groups that take into account not just the family home but also ownership of investment properties. The four groups are as follows:

- **Home owners only** are individuals who own the home they live in, but who do not own investment properties from which they draw rental income;
- **Renters only** comprises rental tenants and rent-free individuals who do not own investment properties from which they draw rental income;
- **Home owner-investors** own the home they live in, and own at least one investment property from which they draw rental income; and
- **Renter-investors** do not own the home they live in, but own at least one investment property from which they draw rental income.

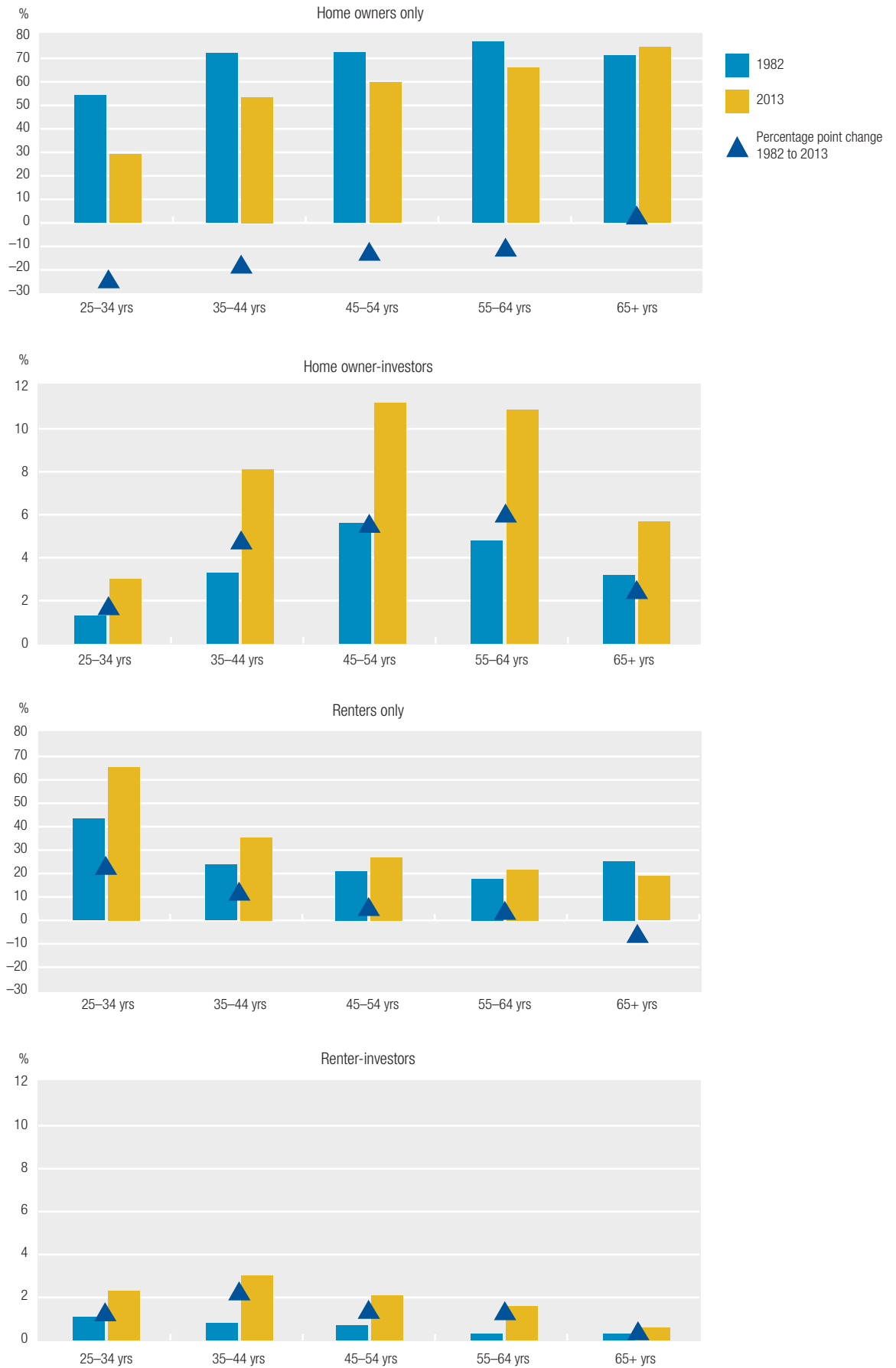
In Figure 2, the blue bars represent the proportion in each of the four categories in 1982, the yellow bars show the same for 2013, and the blue triangles show the percentage point difference between 2013 and 1982.

The share of home owners only has declined significantly for the youngest age groups. Among those aged 25–34 years, the share of home owning individuals with no investment properties has declined by 25 percentage points. Once the dominant group among the 25–34 year olds, the share of home owners only has dropped from 54 to 29 per cent. Among those aged 35–44 years, the decline is also a worry at almost 20 percentage points from 72 to 54 per cent. The share of home owners with no investment properties has also declined by some 10 percentage points among mature age groups aged 45–64 years. The only group to experience a slight increase in the share of home owners with no investment properties are those aged 65 years and over.

Some interesting trends are evident among home owner-investors. As shown in Figure 2, the share of home owner-investors has risen for all age groups. However, it is clear that the greatest increase in the share of home owner-investors has occurred among those aged 45–64 years. Over the period 1982–2013, the share of home owner-investors nearly doubled within these aged groups by six percentage points to 11 per cent. A relatively large proportionate increase of five percentage points also occurred among those aged 35–44 years. What is clear is that the youngest age group is lagging further and further behind older age groups in terms of multiple property ownership, with the share of home owner-investors in this age group rising only from one to three per cent.

Turning next to those who do not own the home they live in, it is evident that there has been a decisive shift towards renting (including living rent-free) with no investment properties. The share of renters only has climbed the most for younger age groups by 22 percentage points among those aged 25–34 years. This is a significant increase, far outstripping the 12 percentage point rise in renting only among the 35–44 year olds, six percentage point rise among the 45–54 year

FIGURE 2
SHARE OF PROPERTY OWNERSHIP, BY AGE GROUP, 1982 AND 2013



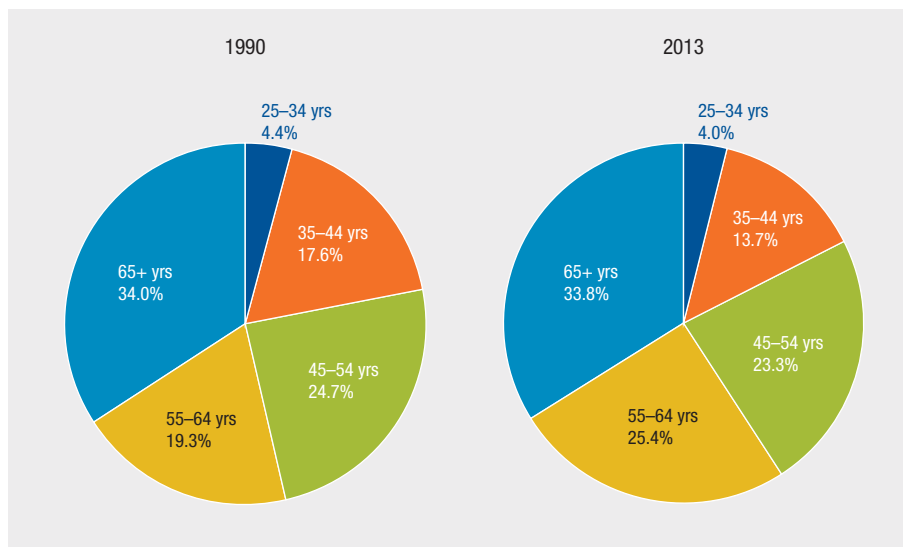
Source: Author's own calculations from the 1982 and 2013 ABS Surveys of Income and Housing

olds and four per cent rise among the 55-64 year olds. By 2013, renters have overtaken home owners as the dominant group among the 25–34 year olds, with renters not holding investment properties soaring to around two-thirds among this youngest age group.

Taken together, these trends present a distinct picture of a growing divide between generations in terms of access to housing market opportunity. It would appear that young people’s access to both home ownership and property investment opportunities has lagged further and further behind the opportunities available to older age groups.

The property ownership trends have inadvertently resulted in housing wealth becoming increasingly concentrated in the hands of smaller subgroups. As shown in Figure 3 below, the intergenerational housing wealth gap has widened in the last two decades. Between 1990 and 2013, the share of housing wealth held by any age cohort has only expanded for those aged 55–64 years from 19 to 25 per cent. This has come at the expense of all other age groups, in particular those aged 35–44 years who endured a decline in their share of housing wealth from nearly 14 to 18 per cent.

FIGURE 3
SHARE OF HOUSING WEALTH IN THE POPULATION AGED 25 YEARS AND OVER, BY AGE BAND, 1990 TO 2013



Source: Author’s own calculations from the 1990 and 2013 ABS Surveys of Income and Housing

The rise in the share of housing wealth held by those aged 55–64 years in part reflects the growing share of 55–64 year olds in the population as baby boomers age. However, the rise in real housing prices have clearly played a parallel role in increasing the share of housing wealth owned by the 55–64 year olds. Between 1990 and 2013, the real value of housing wealth per capita owned by the 55–64 year olds rose by 90 per cent, a hefty rise compared to a comparatively trivial 12 per cent increase experienced by those aged 25–34 years old.

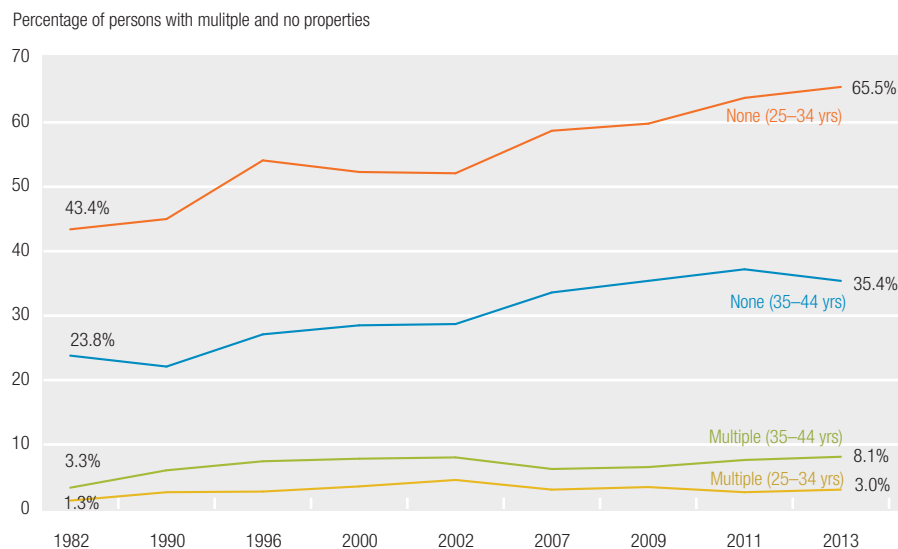
Intra-generational shifts

A dimension of the debate around intergenerational tensions in housing markets that is often missed is its spillover effect on intra-generational equality. There is widespread agreement across the literature that children of affluent parents are more likely to receive substantial intergenerational transfers.²⁰ Conversely, the children of economically disadvantaged parents are more likely to not be in the intergenerational circulation of wealth. Hence, children of parents who are able and willing to transfer housing wealth are better positioned to access home ownership.²¹

Figure 4 tracks the percentage of young individuals aged 25–34 and 35–44 year olds who hold multiple properties (i.e. both the family home and investment properties)²² and no properties (i.e. neither the family home nor investment properties) over various years from 1982 to 2013. The figure presents a vivid illustration of growing intra-generational housing wealth inequality within age groups. There has clearly been a rise in the proportion of young people aged 25–34 years who hold no property by over 22 percentage points. However, at the other end of the spectrum, we find that the proportion of young people who hold multiple properties has also risen albeit mildly and from a low base. Similarly, among the 35–44 year olds, the proportion who hold multiple properties has risen by some five percentage points and at the same time, that the proportion who hold no properties has risen by 12 percentage points. These trends suggest a growing intra-generational disparity as similarly aged individuals become increasingly polarised towards the two extremes of property ownership – either multiple property ownership or none at all.

Young people who hold multiple properties in their wealth portfolios are more likely to have received bequests or inheritances than those who own neither a family home nor an investment property. According to the Household, Income

FIGURE 4
PERCENTAGE OF INDIVIDUALS WITH OWNERSHIP OF MULTIPLE PROPERTIES VERSUS NO PROPERTIES, BY AGE BAND, 1982 TO 2013



Source: Author's own calculations from the 1990, 1996, 2000, 2002, 2007, 2009, 2011 and 2013 ABS Surveys of Income and Housing

and Labour Dynamics in Australia (HILDA) Survey,²³ over 14 per cent of individuals 25–34 years in 2014 had received a bequest inheritance some time during 2001 and 2014. On the other hand, only nine per cent of similarly aged individuals with no family home or investment property received a bequest or inheritance over the same period.

Regrettably, it would appear that property ownership has become the new class divide in Australia. It is increasingly a marker of distinction between young aspiring home buyers and older home owner-investors. In addition, it is exacerbating intra-generational inequality, creating a widening chasm between the haves and have-nots as young people are fortunate enough to receive substantial transfers of wealth from their parents while others miss out on such intergenerational transfers.

Housing futures: shifts and shakes

The long-run housing trajectories over the past three decades throws doubt on the appropriateness of current housing policy settings for the changing housing needs of the population. Current policy settings are strongly reliant on the assumption of linear housing careers. This career pathway begins with departure from the parental home leading to renting while saving for a home deposit. This is inevitably followed by home purchase with a mortgage that is paid off over the course of one's working life, ending with outright home ownership with low housing costs in old age.

An inevitable concern relates to whether these policy frameworks are outdated as the nation witnesses the growth of two phenomena, resulting in the emergence of a new housing landscape that disrupts the notion of linear careers that culminate in outright ownership. The first is a decisive shift towards long-term renting. The second relates to growing precariousness within the home ownership sector, as spiralling real housing prices force new home owners to take on ever higher levels of mortgage debt relative to their incomes to access home ownership. Home ownership, long regarded as a secure housing tenure, is undergoing substantial changes that threatens its role as a source of stability for young families.

“Regrettably, it would appear that property ownership has become the new class divide in Australia. It is increasingly a marker of distinction between young aspiring home buyers and older home owner-investors.”

A generation of long-term renters

Unless the present steady decline in home ownership rates is reversed, long-term renting is also a very real possibility that young people have to contemplate as they consider their future prospects in the housing market. Looking forward, this suggests the number of Australians still renting as they enter later stages of the life course will spiral, with implications for both federal and state governments

and necessitate a shift, or at least an expansion in primary focus, from supporting home ownership to promoting affordable and secure rental tenures.

Australia has a fairly lightly regulated private rental market. In countries such as the Netherlands, Germany and Sweden, long-term contracts exist within the private rental market, and termination is only possible in limited circumstances.²⁴ However, such legislative provisions are not applicable in Australia, where contractual terms are typically shorter and termination clauses are less strict.²⁵ Hence, it is critical to direct stronger policy consideration towards security of tenure for renters in the private market as the numbers of long-term renters grow. An international review of provisions for secure occupancy found support for increasing institutional investment in rental housing as a means of improving landlord-tenant relations and service quality. Additionally, the review highlighted the need for landlord registration and accreditation systems to ensure professional standards for tenancy management among private landlords.²⁶

“The need for new housing solutions for low-income renters is clearly a pressing issue, but generating additional capital to fund the expansion of public housing appears unlikely. Hence, there is growing policy interest in Australia in public-private partnerships that might expand the range of rental housing assistance options for low-income renters.”

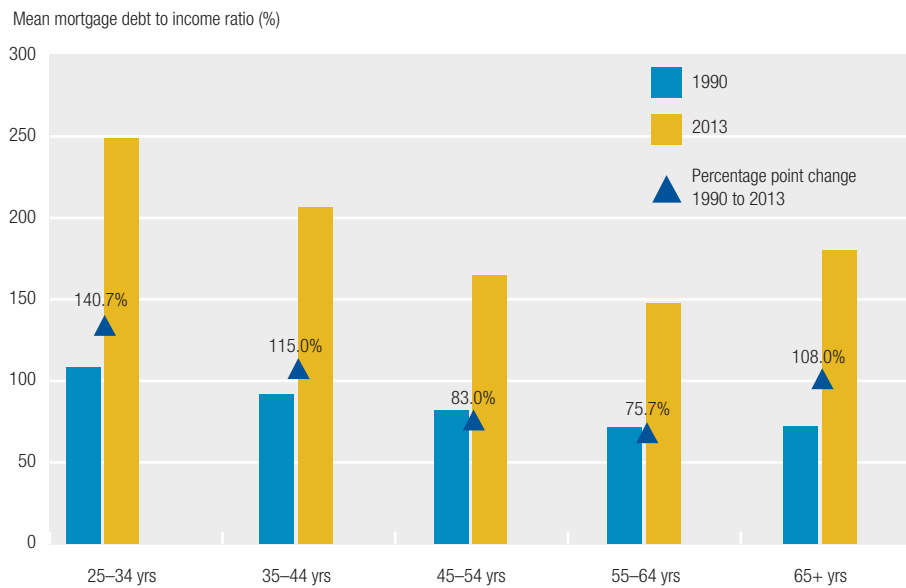
Public housing offers greater tenure security for low-income renters than the private rental sector. However, estimates from the 2013–14 Survey of Income and Housing show that it comprises a very small segment of the housing stock (four per cent) compared with the private rental sector (around one-quarter). Furthermore, the Productivity Commission’s 2017 report on government services show that nearly 150,000 households were on public housing wait lists in June 2016.²⁷ Hence, the demand for low-income rental housing is clearly outstripping the supply of public housing.

The need for new housing solutions for low-income renters is clearly a pressing issue, but generating additional capital to fund the expansion of public housing appears unlikely. Hence, there is growing policy interest in Australia in public-private partnerships that might expand the range of rental housing assistance options for low-income renters. A recently mooted example is the offer of secure five-year leases to private rental applicants otherwise eligible for public housing. This would be facilitated via a private-public partnership whereby the government would offer a rent premium to private landlords in exchange for the landlords offering longer term leases to eligible applicants. The rent premium is required to compensate landlords for the returns on other investment opportunities they forego when they enter into a long-term lease.²⁸

A new breed of precarious home owners

As shown earlier in Figure 1, though the rate of home ownership had suffered a steep decline for young people between 1982 and 2013, around 30 per cent of individuals aged 25–34 years were home owners in 2013. However, mortgage

FIGURE 5
MEAN MORTGAGE DEBT TO INCOME RATIO, BY AGE BAND, 1990 TO 2013



Source: Author's own calculations from the 1990 and 2013 ABS Surveys of Income and Housing

indebtedness is at record high levels for younger age groups based on historical trends, indicating that those who do manage to attain home ownership status are increasingly having to do so by taking on higher levels of debt relative to their income. The proportion of home owners who hold a mortgage debt has risen from under 80 per cent to 94 per cent between 1990 and 2013 among the 25–34 year olds. Back in 1990, around six in 10 home owners aged 35-44 years held a mortgage debt. In 2013, nearly nine out of every 10 home owners in this age group held a mortgage debt.²⁹

As shown in Figure 5, among owners with a mortgage, younger age groups are increasingly highly geared, with the mortgage debt to income ratio of those aged 25–34 (35–44) years spiralling by 141 (115) percentage points. As real housing prices have outstripped real incomes, young aspiring first home buyers have had to commit to greater levels of borrowing and diverting greater shares of household budgets to meet mortgage loan repayments.

These worrying patterns contribute to the growing precariousness in home ownership. Data from the longitudinal HILDA Survey show that during the first decade of the millennium, 1.9 million episodes of home ownership were terminated. The home ownership exit rates differed by age groups; over the period in question 23 per cent of home ownership spells among the under 50s ended as compared to 16 per cent among those aged 50 years and over. Furthermore, over 60 per cent of ex-home owners returned to home ownership during the 10-year period, and seven per cent churned in and out multiple times.³⁰

There currently exists a myriad of demand-side subsidies for home owners and property investors. Home purchasers receive the First Homeowners Grants and stamp duty concessions, and the family home is exempted from capital gains tax, land tax, and pension and allowance assets tests. Investors also receive subsidies in the form of a capital gains tax discount and negative gearing. These

subsidies have contributed to inflationary pressures in housing markets by fueling competition for properties.³¹ Support for purchasing a family home and property investment is clearly warranted given the myriad of benefits attached to home ownership and the role of landlords in promoting affordable rental housing supply. However, an undesirable unintended consequence has been the spiraling of housing prices as competition for property purchase has intensified over decades. The policy focus may now need to be broadened out from first home buyers only, to also offer greater assistance towards those on the edges of home ownership to sustain ownership status.

Moreover, reforms to demand-side subsidies that contribute to high real house prices will likely be critical for steering the return of real house prices to more affordable and sustainable levels. For instance, currently stamp duty is partly capitalised into housing and land prices. On the other hand, while a broad-based land tax would have the quality of driving a reduction in land values, the current land tax settings prevent this from happening as it is applied to landlords only while home owners are exempt. Both these state taxes represent levers that can be pulled to assist with affordability concerns.³²

Looking forward: an intergenerational housing policy lens

The historical trends presented in this chapter have highlighted a widening intergenerational housing wealth gap between the young and old. Unfortunately, the timing of historical policy reforms, alongside changing labour market and housing conditions, have given rise to fewer opportunities to accumulate housing wealth among the young in comparison with their boomer parents. There are at least three striking trends that point to this growing intergenerational chasm.

Firstly, the share of home owners with no investment properties has declined the most among young people aged 25–34 years, by a substantial 25 percentage points between 1982 and 2013. Secondly, over the same period the share of home owner-investors has risen by the least among the 25–34 year olds by just two percentage points. It would appear that young people’s access to home ownership as well as property investment opportunities has lagged further and further behind the opportunities available to older age groups. Thirdly, between 1990 and 2013, the real value of housing wealth per capita owned by the 55–64 year olds rose by 90 per cent, a hefty rise compared to a comparatively trivial 12 per cent increase experienced by those aged 25–34 years old. This has undoubtedly aggravated intergenerational tensions in housing markets. Moreover, a related phenomenon that is less often addressed is a rise in intra-generational inequality driven, at least in part, by unequal access of young people to parental wealth.

“The policy focus may now need to be broadened out from first home buyers only, to also offer greater assistance towards those on the edges of home ownership to sustain ownership status.”

There has been a growing intra-generational gap as similarly aged young individuals become increasingly polarised towards the two extremes of property ownership – either multiple property ownership or none at all. Regrettably, property ownership is increasingly a marker of distinction between young aspiring home buyers and older home owner-investors and between the haves and have-nots within younger age groups.

These historical trajectories have led to the emergence of a new housing landscape that disrupts the notion of linear housing careers and which features two phenomena – long-term renting and precarious home ownership. This necessitates a re-thinking of housing policy in Australia. Policy settings that are predicated on the assumption of linear housing careers will need to be reviewed in regard to their appropriateness to this new housing landscape.

In principle, as life expectancies continue to lengthen, housing policy formulation and reform will increasingly need to address the concerns of co-existing generations. An intergenerational policy lens is required so the impacts of new policies and policy reforms are assessed through their potential impacts on both the old and young. This can best be illustrated via an example of a potential housing policy reform.

Consider current state stamp duty settings. Stamp duties are levied on every property purchase. Stamp duties deter residential mobility and downsizing moves as older Australians may very well shy away from opportunities to trade down into smaller dwellings due to the cost of stamp duty payments on the next property purchase.³³ This in turn results in inefficiency in utilisation of the housing stock as older home owners occupy larger dwellings than they might otherwise need and which might meet the housing space requirements of younger growing families.

A unique opportunity exists to reap multi-generational benefits via abolition of stamp duties. This would remove a financial barrier to downsizing, freeing up more housing space for young families while facilitating the release of some housing equity for older downsizers to supplement retirement income. No doubt, such a move would impact adversely on state revenue flows. However, such impacts can be mitigated via the replacement of stamp duties with a broad-based land tax (currently levied on landlords only while exempting home owners). Federal financial assistance would be helpful for facilitating a transition by the state and territories away from a stamp duty regime. The greater release of housing equity by older downsizers will in turn likely contribute towards easing pressures on the retirement incomes system, which primarily falls under the jurisdiction of the Federal Government.

“In principle, as life expectancies continue to lengthen, housing policy formulation and reform will increasingly need to address the concerns of co-existing generations. An intergenerational policy lens is required so the impacts of new policies and policy reforms are assessed through their potential impacts on both the old and young.”

Examples of potential policy reforms that can reap generational general benefits are few and far between. However, the above example suggests strongly that such reforms are possible and even feasible when policy impacts are viewed through an intergenerational lens and federal-state cooperation is forthcoming. Such policy reforms that take into account long-term multigenerational concerns are compatible with the principles of intergenerational reciprocity. On the other hand, reforms that rely on a short-term single-generation outlook will likely continue to aggravate intergenerational tensions in housing markets in the years to come.

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5. The impact of tax regulation on housing

Associate Professor David Morrison

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This chapter explores the implications of the current monetary policy regime and the outcomes it has had on residential housing investment. It looks at the winners and losers from the current housing policies, and the likely consequences of changing the current tax arrangements around housing in Australia.

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Associate Professor David Morrison is a researcher at The University of Queensland. His research is interdisciplinary with its focus upon the intersection of taxation law; corporate and insolvency law; bankruptcy; and how those areas of interest apply to finance/financial literacy; the economy; social and policy framework; climate change; and genomics.

Introduction

The Reserve Bank of Australia's (RBA) latest Statement on Monetary Policy¹ suggests that the long-expected rise in inflation will continue gradually, rather than rapidly. This is due in part to low wage growth and a likely continuation of unemployment figures, assisted by the decline in the mining industry. On the housing front, the RBA reports that growth in rents is at a 20-year low on the one hand, however, the cost of new dwelling construction is up noticeably in the March 2017 quarter. Levels of residential investment will probably remain high because of lower interest rates and the remaining amount of construction projects still in play.

For property in Sydney and Melbourne, the housing sector remains strong; however, in the remainder of the country this is not so. The RBA considers that household balance sheets are at risk because of both high and rising household debt; hence the lending measures that have been recently put in place by both the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC), reflecting adjustments to bank lending practice along with bank increases in their lending rates. The rate of credit growth in the housing sector is steady and expected to dampen when the full impact of credit demand is reflected by the various measures taken. At this stage the effects of relative stability in world economic indicators seems to be consistent with expectations in Australia for the medium-term.

From a long-run point of view, the current interest in the housing market is due to three main factors:

1. The relatively low mortgage interest rates since the 1990s, coupled with lower barriers to borrowing money, including interest only loans that require no capital contribution from the borrower;
2. The strong productivity gains and accompanying resources boom increasing household wealth and economic growth from the 1990s through to today; and,
3. The increasingly attractive taxation environment provided by successive commonwealth governments giving investors beneficial tax treatment for investing in real estate, including residential income property.²

Even though the economic outlook is cautious, there remains concern in some quarters about the *affordability* of housing in Australia. This is a complex problem and difficult to unravel: although the level of emotion directed towards a seemingly inevitable disaster suggests otherwise. In April this year, various commentators were reported as holding the view that housing affordability will worsen,³ with Moody's Investor Service quoted as suggesting that the rise in property prices outweighs low interest rates and low wage growth.

Financial instruments and regulation used to influence the market and their effectiveness

According to the Australian Government's Affordable Housing Working Group:

"In 2013–14, approximately 31 per cent (2.7 million) of Australian households were in the rental market... At the aggregate level growth in rents has increased broadly in line with CPI over the period 2000 to 2016, with rental affordability largely in line with long-term trends... (Notwithstanding), the situation for lower income households, those that are generally seeking affordable rental housing, is markedly different with a significant percentage of these households experiencing rental stress... 42.5 per cent of lower income households who rented indicated that they were spending more than 30 per cent of their household income on housing costs..."⁴

If it does turn out that Australia has a housing price bubble, then the traditional means of managing the bubble with monetary policy is somewhat risky. This is because an increase in interest rates, for example, runs the risk of being too blunt a tool; the RBA's efforts to restrain property prices may have an adverse effect on unemployment and cause havoc within the economy. This is a risk given the current climate of decreased consumer spending.

Rather than implementing one broad measure to deal with a housing bubble, there is an increasing trend towards targeted measures, or so called "macro prudential" regulations. Macro prudential regulations are measures taken by the government to reduce financial system instability. In March 2017 the APRA provided further measures to reinforce sound lending practices,⁵ and limited

Australian deposit taking institutions (primarily the banks) in granting riskier loan-to-value ratios on interest only loans – reducing these type of loans to 30 per cent of new residential mortgage lending.

To date, the use of this measure has not had an adverse impact on the Australian economy, however, it does not and will not address issues around pricing. So, while the banks are somewhat constrained in lending to risky borrowers, this is only one part of the complex matrix of factors driving Australian residential house prices, especially given the significance of wealthy investors (onshore and offshore) with the ability to push prices up, where those investors are not constrained to the macro prudential efforts of APRA. The humble first home buyer will simply have to ride the tide while the levers are pulled and aimed at the perceived bigger challenges.

The influence of current tax policies on the housing market from negative gearing to capital gains treatment

In Australia, residential housing is a desirable and important asset. Like superannuation, the family home is a large asset, relative to total household wealth, and it “serves a unique, dual role as an investment vehicle and a durable good from which consumption services are derived”.⁶ Changes to residential housing investment and tax treatment policy is therefore a contentious matter within Australia and one that tends to be tinkered with slowly and deliberately, and often with much accompanying heated political debate.

The primary residence of an individual or couple in Australia is usually “free” of capital gains tax upon sale, thus making it a safe long-run tax free place to park significant amounts of wealth.⁷

Because of the Australian fascination with property, a significant number of owners have investment property in addition to their primary residence. The Reserve Bank posits, unsurprisingly, that income, wealth and employment status are “important factors in the ownership and gearing choices of households”,⁸ an assertion backed by recent research backing older, wealthier Australians at least in part motivated by taxation considerations.⁹ In instances where the investment property was originally used by the investor as a primary residence, it may still carry full or partial taxation exemptions so that on sale it may be spared some capital gains tax obligation. This makes the family home, and the value-enhancing improvements made to it, a desirable tax-reduced choice for household funds.

“Changes to residential housing investment and tax treatment policy is therefore a contentious matter within Australia and one that tends to be tinkered with slowly and deliberately, and often with much accompanying heated political debate.”

Where a rental property is owned by a taxpayer, the rental income is assessed as income. However, deductible costs incurred in earning that income can be claimed as allowable deductions. The term “negative gearing” refers to where the costs that are being claimed in connection with the rental property, (notably the interest paid on borrowings used to purchase the property), exceed the income that the property garners. This amount is, nonetheless, a loss. As such it means that the property investor must find cash from other sources, (typically wage and salary income), to make up the shortfall, *some* of that being eventually returned by way of tax refund. The amount of the tax refund returned to the property investor is a function of that person’s marginal rate of taxation and, at best for those earning taxable income in excess of \$180,000 per annum, means close to 50 per cent of the loss returned as a taxation refund. It is posited that some property owners don’t really understand that a tax refund against a loss is still a loss.

“In the case of real estate that is negatively geared, the property investor is counting on the longer-run accumulation of a capital gain that will, after tax refunds, exceed the losses being sustained in the meantime.”

Most investors expect that when they make an investment, that the returns to them will be positive and exceed the rate of inflation. In the case of real estate that is negatively geared, the property investor is counting on the longer-run accumulation of a capital gain that will, after tax refunds, exceed the losses being sustained in the meantime. Capital gains are not easy to predict in advance and will vary depending on many factors outside the control of the investor. Because any losses that the taxpayer has each year from the negatively geared property are deductible, the taxpayer is nonetheless out of pocket and the extent of that depends on their marginal rate of taxation.

Any gains made on the increase in the value of the property are not taxed until the property is sold. This means that in standard cases, tax breaks are obtained by investors immediately but any gains are deferred until the sale of the property. This allows for accumulation of wealth over time in circumstances where there is no need for the investor to sell the property. By the time the asset is sold, the tax paid on sale has beneficial economic time value, even then giving the investor a benefit. The extent of the benefit on a negatively geared property is then only able to be measured in retrospect when the cumulative yearly losses can be measured, in real terms, against the net capital gain (after tax is paid) on the sale of the property.

It is unlikely that many property owners make these calculations and readjust their interest in property accordingly. Those owners who treat the family home as a tradeable asset, along with its tax beneficial status, are able to balance the emotional use of the property as home and the mostly “tax free” gains from its sale as a win-win. This view of the family home’s utility no doubt contributes to the popularity of seemingly over-investment, (in the sense of total assets of the household allocated to the family home), in residential property in Australia.

When the investment property is sold, capital gains tax will usually be payable and this is calculated by adding the gain on sale of the property to the taxpayer's other income and the taxpayer paying tax on that gain where the property has been held for less than 12 months. Where the property is held longer than 12 months (usually the case), then the individual investor still calculates the capital gain but is able to reduce it by half before adding the gain to their assessable income, thus resulting in less tax being paid on the disposal of the investment. For those taxpayers at the top of the pile in taxable income, this means a tax rate of around 24 per cent and one that is deferred, often for significant amounts of time, until the income tax year of sale of the property.

Taxpayers who own more than one property are often in line for a further state based tax called land tax and this tax is paid based on the value of land holdings, (above a threshold set after allowing for the family home), and must be paid each year. That tax cannot be passed along to residential property tenants, although if one proposal to levy the tax across the board to all land holders becomes law, then that cost will inevitably be passed on to renters.¹⁰

The complexity of the taxes that apply to property in Australia make it difficult to see an easy fix that does not disrupt the economic functioning in a macro sense. There is little doubt of the significant role that taxation plays in the housing debate.

The economic consequences of current housing policies and who wins and loses

The Federal Government's current housing policy is not designed to disadvantage any Australian. The long-run holding of owned property versus rented property in Australia is stable. There is a plentiful supply of adequate housing for all inhabitants of this country. The evidence shows that housing price elasticity in Australia is low as against the US and Canada on the one hand, and high, as against England. The comparison with North America is apposite since the population density demographics are similar to those in Australia.¹¹ However, the macro-view and the concomitant wide view of property investment is not the full picture.

More usefully, new supply of housing stock in Australia is not producing a positive trickle-down effect for those with lower incomes and therefore simply increasing supply of housing is not necessarily a solution for those most in need.¹² This means that housing supply for those most in need is best directly addressed by government investment, (or government incentivised investment), directly in housing and land supply where required. A failure to address this will further divide those with lower incomes seeking to own residential property in preference to renting.

“The complexity of the taxes that apply to property in Australia make it difficult to see an easy fix that does not disrupt the economic functioning in a macro sense.”

The current demand side of the property market also means that offshore interests find our property market attractive in the short to medium term. Offshore interest in Australian property appears to be based on capital gains that the overheated market is currently returning and possibly also longer-term reasons, including long-term holding of offshore savings in an environment where sovereign risk is perceived as less risky than the capital's country of origin.¹³ To date, the Federal Government has been either unable or unwilling¹⁴ to stem the tide of offshore investment in residential housing in Australia, perhaps in part due to concern about the impact of a sudden restriction on investment within the housing sector on both the sector and the economy more generally,¹⁵ and in part because it has difficulty in understanding the detail of the investment landscape regarding residential property.¹⁶

Continued offshore interest in Australian property will, in the short-term, add pressure to the property price bubble. In the long-run, if Australian property continues to be attractive to a global population with greater financial means than Australian resident owners of property, then the consequences may override the current understanding of the economic factors that currently shape the market. The consequence of the progression of the housing price bubble will place considerable pressure on the Federal Government to implement a blunt instrument, (similar to Canada, for example),¹⁷ to tax the offshore acquisition of property. If this action is taken, it is critical that the government direct the revenue earned to provide affordable housing for the most vulnerable in our community, namely those identified who are paying a high proportion of their disposable household income in rental payments to landlord owners of residential property.¹⁸

Potential reform and the consequences of changing current arrangements

Ideas advanced; such as removing negative gearing, taxing the family home and allowing early access to superannuation will produce adverse consequences that make it very difficult for the government to predictably manage the economy overall. One key difficulty with such policy suggestions – assuming the incentives of the proposers and the objectors can be set to evaluate the merits of such proposals – is that they are part of the government's dwindling reign on taxation effects and incentives. This is because first, the political imperative to reduce taxation regulatory complexity is weak: taxation policy appears to be useful only as a political tool. Unhelpful political point scoring, by both "sides" of government, is the death knell for effective long-run change to taxation policy. Governments must be able to make effective legislative change for taxation laws that encompasses meaningful bipartisan support for a more efficacious taxation system; namely one that effectively collects revenue for the use of public-good funding.

The laws contained within the Australian taxation system are the most complex in the world. This is a remarkable achievement for an economy of Australia's size. Complex taxation legislation is problematic for two reasons. First, it is difficult to

interpret, apply and enforce. Second, and not as apparent, is that legislative complexity produces unintended consequences, typically in the way that legislation interacts with other legislative and policy measures. In the context of the housing debate, taxation complexity makes it almost impossible to accurately predict the economic impact of proposed policy changes. The Commonwealth regularly mis-estimates its collection of revenue when laws with a revenue impact are changed. Significant proposals such as removing negative gearing are almost impossible to understand and quantify ex ante, even where real world ceteris paribus assumptions are made.

The Keating Government managed to place limits on negative gearing for a short time in the 1990s and the Turnbull Government is now contemplating a similar move with either a cap on the amount able to be claimed against each rental property for tax purposes, or by placing a limit on the number of rental properties each investor may hold. The upside is an increase in taxation revenue (billions each year) and the downside is the impact that might have on so called “mum and dad investors” – those who are heavily exposed to such policy changes. It is difficult to imagine that some kind of limit is not worth a shot, with the strong caveat that the government direct the revenue from such a measure solely towards providing housing for those most in need. Putting any proceeds into consolidated revenue will otherwise be counterproductive if the revenue windfall is used for other government purposes.

“The most efficient means of taxing the family home is probably via land tax, although land tax is levied and administered by state and territory governments, and as such, is not uniform throughout the Commonwealth.”

The most efficient means of taxing the family home is probably via land tax, although land tax is levied and administered by state and territory governments, and as such, is not uniform throughout the Commonwealth. At this stage, such a tax is in the hands of the individual state and territory governments who are unlikely to broaden the application of such a tax. Thus far, the state and territory governments are reluctant to accept the Commonwealth’s recent suggestion that they legislate for the collection of income taxes themselves in addition to those levied by the Commonwealth. Land tax is an efficient means of levying and collecting revenue based on wealth, although broadening it to include taxing the family occupied home will add pressure to those owner-occupied households already having difficulty making ends meet as well as those at the lower-income end of the earnings spectrum where they are most often renters. Watch this space.

Dipping into superannuation fund capital to enable purchasing of housing property is a reckless idea. In itself, it demonstrates how politicised the debate is, given that we are living in a society that is, supposedly, more informed and increasingly educated about money. This debate ought to be quickly dropped simply because superannuation exists for a specific long run economic purpose: namely, the provision of retirement income to a future population of Australians who will have

diminished or no ability to rely on Commonwealth coffers in the form of an old age pension. Australian superannuation holdings, while vast, are inadequate and will not extinguish the reliance placed on the Commonwealth for social security in the medium and possibly longer term. From a policy perspective, and to try to keep some clarity around legislation that currently works well, it is a terrible idea to allow anyone, (other than the extreme cases already provided for, including terminal illness), access to their superannuation prior to their entitlement.

The difficulty for Australia is that as the superannuation pot gets larger, it becomes a target for presumably well-intentioned politicians to access it for various purposes. This has included: mandated infrastructure commonwealth infrastructure support (proposed by the Gillard Government), and lately, helping younger folk make deposits on home loans (proposed by the Turnbull Government). Withdrawals from superannuation at an early stage have an adverse impact on the compounding value of the present value sum, meaning that after the house has been sold or divided in divorce, or leveraged for personal borrowings, the long run residual amount left locked within the safe bounds of the superannuation fund will be inadequate to pay rent or other household expenses. Much better to put away and preserve as much as possible for a likely long retirement, especially if the current proportion (or more) of the population will be renters.

Conclusion

Whatever the state of the residential housing market today, and however it has been shaped, it is now in a state of longer-run flux, and as such, housing market uncertainty means difficulties for Australian residents seeking to buy real estate for home occupation. For now, a steady and deliberate approach is best, rather than responding to the apparent discontent and nervousness being played upon in the media. A determined approach to reducing regulatory complexity with a view to removing the perverse incentives around Australian preferences for investment vehicles will help greatly. Measures to ensure broad-based support for the direct provision of housing to those in need will never be a bad idea.

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- 17 In British Columbia for example, the Property Transfer Tax on residential property transfers is levied by the Province on foreign entities or taxable trustees: <http://www2.gov.bc.ca/gov/content/taxes/property-taxes/property-transfer-tax> <accessed 24 June 2017>; Mayoh L, "Canada's plan to tax foreign investors is already working", 18 March 2017, <http://www.news.com.au/finance/real-estate/buying/canadas-plan-to-tax-foreign-investors-is-already-working/news-story/38af5331ef2fd9c9730dc5b24c8096e5> <accessed 24 June 2017>.
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6. Case study: The Village, Balgowlah

Gavin Tonnet

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This case study examines how innovative property development can help overcome supply and demand challenges associated with housing. It looks at how mixed-use development can provide access to infrastructure and jobs in new residential areas.

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Gavin Tonnet has more than 20 years' experience in property development, having held senior management roles with major global and Australian companies, including Leighton, Mirvac and Sekisui House.

Mr Tonnet has established and led major residential and mixed-use property businesses throughout his career, and has been responsible for more than \$20 billion of projects in this time. These projects have included some of Australia's most significant urban renewal projects.

Mr Tonnet is head of Stockland's national growth strategy in apartment and mixed-use, and has also been responsible for Stockland's \$4.5 billion New South Wales residential development pipeline. With qualifications in science, architecture and business administration, he has a considered, strategic ability to deliver world class precincts that add to the innovation and evolution of cities.

Introduction

Where people live and the way they live is changing. The Australian population is expected to reach more than 40 million by 2061 with Greater Sydney expected to grow by an extra million people over the next 10 years. And much of this growth will be absorbed by our big cities.

It's no longer acceptable that increasingly larger buildings and structures are erected on a site by site basis assuming they will deliver viable and meaningful components of our city.

There is a much greater interest in the quality of our public domain than ever before as our cities become more dense and less personal, humanity is placing more importance on meaningful places for gathering and recreation. We have to be intelligent about designing mixed-use communities to provide experiences, be incredibly authentic and memorable and, particularly, to provide places for people to connect.

So how will our cities cope with this change and how can we ensure we shape places that are highly liveable?

Ingredients for successful cities

If you look at cities and communities across the world there are some key ingredients for successful evolution. At a broader level, great cities and communities plan for the integrated delivery of transport with land use and development, as well as incorporating key attributes such as environment, culture, heritage and proximity to jobs. However, on closer inspection there are elements of design and activation in a community that make all the difference in creating truly liveable places.

Stockland is responding to increasing densification of our major cities with a focus on creating connected, healthy and smart places.

The Village, Balgowlah

In 2002 Stockland acquired land at Balgowlah, NSW, with a vision to create a compact community hub for the northern beaches. At the time the site was a small shopping centre.

Seven years later, and with input from the local community and council, The Village, Balgowlah emerged as a mixed-use development incorporating 242 apartments in seven mid-rise buildings above a village-style retail hub.

Home to over 500 people and with locals visiting the shopping centre daily, The Village has become an important focus of the Balgowlah community – a place to meet, catch up over a coffee, do some shopping or visit the gym.

The Village Balgowlah, snapshot

Date of completion

- 2009.

Project value

- Approximately \$360 million.

Local government area

- Manly.

Key features

- Mixed-use development on Sydney's northern beaches;
- Home to more than 500 people in 242 apartments;
- Shopping centre with over 60 specialty stores and a supermarket;
- Heated outdoor swimming pool for residents;
- Large public plaza with restaurants and premium gym; and
- High quality landscape and public art.

An exercise in place-making – creating a retail hub integrated with residential development

One of the factors critical in the success of The Village is design. Good design has enabled a vibrant shopping precinct to thrive while still retaining privacy and quiet enjoyment for residents. In the planning process the team of architects from Allen Jack and Cottier (AJ&C) worked together with Stockland to create distinct precincts at The Village that are key to its success:

Retail precinct – a very public retail precinct comprising 60 specialty shops, cafés and a supermarket across 17,700 square metres of retail space, together with 370 car spaces, providing convenient places for locals and visitors to meet.

Civic precinct – a neighbourhood business and recreation square with a local civic character suitable for event based place making.

Mews precinct – an intimate canopied landscape providing through site access.

Garden precinct – apartment living, with private gardens for residents to enjoy.

Resort precinct – a resident resort-style swimming pool and recreation deck overlooking the ocean.

These precincts – spread over seven buildings and including a diverse range of housing types and two levels of retail – were designed with a mixture of building heights.

Innovative design has been central to separating the residential and commercial functions of the town centre at Balgowlah. One of the challenges of the mixed-use community was integrating the residential community into the event and retail spaces while maintaining privacy, and a sense of intimacy and safety for residential areas. Key to this has been a fundamental desire to leave the majority of the development accessible but moderating behavior and expectation by changing the design character and urban design of the precincts

The resolution of the 10 metre fall across the site was crucial to achieving this. The gradation of scale, with the tallest building in the middle of the site, makes the scale feel comfortable and assists in creating separation from busier to quieter zones.

This also allows the development to have the same total floor space as a tower design but with much more diverse housing, and shows that achieving a high density does not imply only tall buildings.

Other contributory features of the design include:

- Public roads and pathways allowing non-residents access through the site easily while maintaining resident privacy;
- Mature landscaping from day one, because the trees were purchased and grown during the planning and construction phase;
- Inclusion of public art linked to the beachside context and a wall that tells the story of Manly;

- Hierarchy of spaces to create an intuitive sense of public and private space, without excluding non-residents from the residential parts of the site; and
- Sustainability initiatives to lower energy and water usage.

When designing great places, it is often the spaces between the buildings that are most important, rather than the buildings themselves. At Balgowlah the public spaces are all under 20 metres wide to create compression and intimacy.

Sustainable design

Ecologically sustainable development initiatives were incorporated into the design and construction of both the retail and residential components of The Village.

An innovative heat reclamation system uses excess heat generated by the retail cooling system to energise the apartment hot water system. This initiative reduces household energy and saves 444 tonnes of CO₂ per year, the equivalent of removing 100 large cars from the road.

A 500,000 litre rainwater tank collects rainwater from the roofs of the buildings, which is then treated in a basement holding tank and re-used for flushing in retail bathrooms, irrigation of gardens, and in washing machines. This reduces potable water use by more than 6.5 million litres and cuts energy use in apartments by 30 per cent – delivering cost savings to residents.

While the world's population soars and we continue to live in more dense and connected communities, and our demand for, and reliance on, technology and information soars, we have not lost our sense of reliance on nature and environmental responsibility for future generations.

Community engagement

While The Village is now an example of best practice density and receives positive feedback from the community, this was not initially the case. When Stockland first acquired the site and submitted plans to council, the company faced concern from local residents as density development was not common in that community.

Opposition is a common challenge faced by developers and government in confidently delivering higher density living within existing communities. A challenge Dr Tim Williams from the Committee for Sydney has been looking at for some time through its work on Density Done Well.¹

“Despite the growing body of evidence that points to improved productivity, sustainability and quality of life in well-designed and denser urban areas, public suspicion towards increasing urban density across metropolitan Sydney persists. Projects... that combine density with community amenity should be celebrated,” Dr Williams said.

For Stockland, the key to turning this concern into support was positive stakeholder engagement with the local community and council.

With listening and engagement, it became evident that the differing expectations of the community could be harnessed to shape a positive development outcome. Locals wanted to see less tall buildings and more community facilities. This led to the plans being substantially reworked to better reflect that vision.

The experience at Balgowlah shows that getting the consultation right is critical to securing support for a project and ultimately community outcomes. The lessons learnt from this project have helped inform Stockland's stakeholder engagement approach, which is still in use today.

Top three stakeholder engagement principles:

1. Share lessons, trends and initiatives to learn from successes and failures, incorporating the perspectives of community stakeholders;
2. Engage early with the community to help build a clear project vision and identify key milestones; and
3. Ensure there is a clear understanding of stakeholders and their drivers to build trust beyond the project.

Social infrastructure

Designing a great public environment requires clear programming to create a thriving community. At Stockland Balgowlah, having a shopping centre with restaurants, a gym and resort facilities below residential meant there was instantly a reason for people to come together and interact. Stockland had to build on this community and create more than just a convenient place to shop – to produce a destination for locals.

The first step was providing convenient access to the centre. A “hop skip and a jump” bus service providing free transport between The Village and Manly was provided as soon as the centre opened. This council-run service funded by Stockland was critical to the success of the shopping centre and demonstrates the importance of key transport infrastructure being introduced from the outset.

In addition, Stockland Balgowlah has a convenient carpark that separates resident carparking from shopper parking, providing a highly accessible shopping experience.

“Designing a great public environment requires clear programming to create a thriving community... having a shopping centre with restaurants, a gym and resort facilities below residential meant there was instantly a reason for people to come together and interact.”

To connect residents and locals with each other, events were held and still are held in the civic and retail precincts.

One such example is the annual “Eat Street” events held at the end of February to celebrate the last of the summer evenings. The events attract locals keen to enjoy the live music, share fresh food from Stockland retailers and enjoy the children’s entertainment in a beautiful outdoor setting.

Additionally, the shopping centre provides ongoing employment for over 200 people and supports local community groups and activities.

A rich understanding of community

As cities continue to experience strong population growth, an overarching focus on ensuring places are liveable will be increasingly vital. The factors that constitute a healthy urban lifestyle are varied and fluid.

In a mixed-use setting this requires developers, local governments and the community to work together to create communities where higher density residential is coupled with good design, infrastructure, purposeful spaces, events and heritage.

Endnotes

1 The Village at Balgowlah was featured in the Committee for Sydney’s Density Done Well campaign as an exemplar project.

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Level 13, 440 Collins Street
Melbourne VIC 3000
GPO Box 2117
Melbourne VIC 3001
Telephone 03 9662 3544
Email info@ceda.com.au

South Australia and the Northern Territory

Level 5
2 Ebenezer Place
Adelaide SA 5000
Telephone 08 8211 7222
Email info@ceda.com.au

New South Wales and the ACT

Level 14
The John Hunter Building
9 Hunter Street
Sydney NSW 2000
GPO Box 2100
Sydney NSW 2001
Telephone 02 9299 7022
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Victoria and Tasmania

Level 13
440 Collins Street
Melbourne VIC 3000
GPO Box 2117
Melbourne VIC 3001
Telephone 03 9662 3544
Email info@ceda.com.au

Queensland

Level 17, 300 Adelaide Street
Brisbane QLD 4000
GPO Box 2900
Brisbane QLD 4001
Telephone 07 3229 9955
Email info@ceda.com.au

Western Australia

Level 5
105 St Georges Terrace
Perth WA 6000
PO Box 5631
St Georges Tce
Perth WA 6831
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