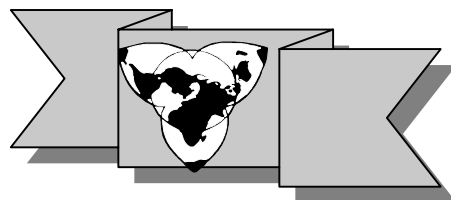


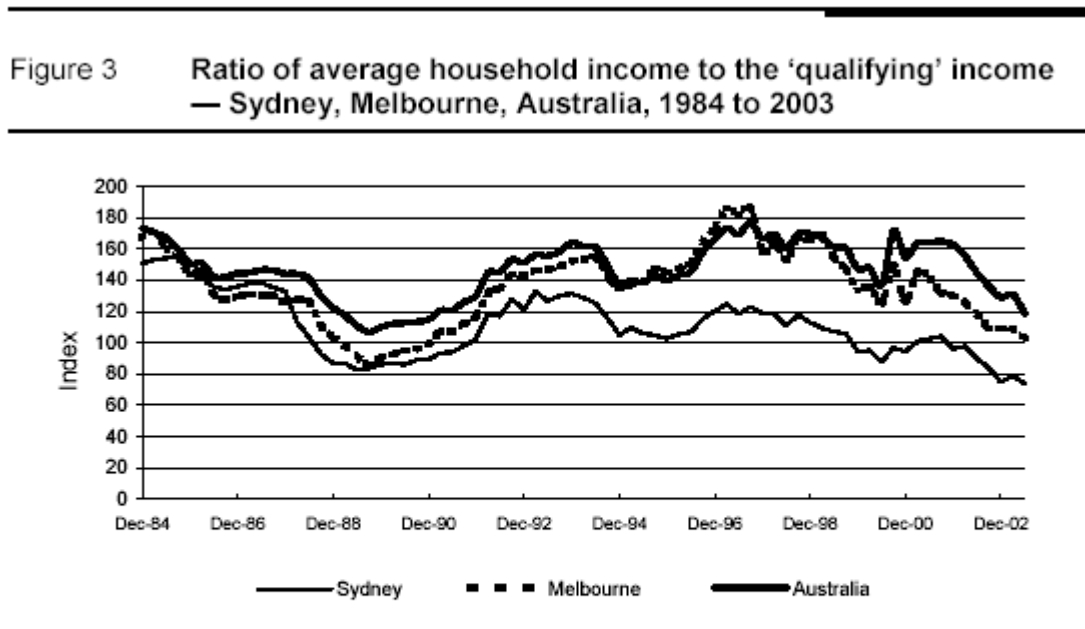
THE UNCERTAIN FUTURE OF HOUSING AFFORDABILITY



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The Housing Industry Association has talked of a housing affordability crisis. The Association for Good Government accepts that there is a crisis in housing affordability. Evidence of it is clearly represented in *Figures 1. and 2.*

Figure 1 (2,7)

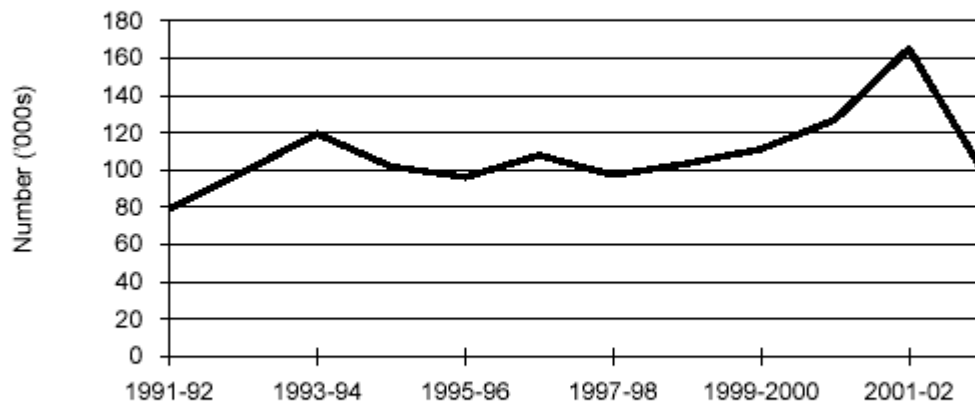


Note Housing affordability is measured by the ratio of average household income to the 'qualifying' income required to meet payments on a typical dwelling. The ratio is expressed as an index. If average household income is equal to the qualifying income, the index value is 100. In calculating the qualifying income, a deposit of 20 per cent is assumed, with repayments equivalent to 30 per cent of income, based on a conventional 25 year loan.

Data source: Data supplied by HIA.

Figure 2 (2,8)

Figure 4 First home purchases — Australia, 1991-92 to 2002-03



Note The number of homes for which finance was provided to first home buyers.

Data source: ABS (*Housing Finance for Owner Occupation, Australia*, Cat. no. 5609.0).

1. The Poverty of Public Policy

The housing affordability index is now somewhere where it was in December, 1989, that is at the beginning of the last recession. The question is whether any new public policy is going to rescue housing affordability before the onset of another recession. That government had no effective public policy in 1989 for the ‘housing bubble’ is evident in the now well-known adage of Paul Keating “the recession we had to have”.

The present utter poverty of public policies to cope with declining housing affordability is obvious from the sad set of suggestions that have come forward. The reality is that this is we do not need more interminable discussion. We have an unresolved social problem whose outcome is only too likely to be the kind of personal disaster seen last time in the 1990 recession.

The reason that the problem of housing affordability is so intractable is because it involves a dysfunctional social institution: private property in land. There is no housing problem. As the Housing Industry Association shows houses are built relatively well and cheaply in Australia. The term *housing problem* and *housing affordability* are popular because neither society nor government dares face the real problem.

2. The Land Problem

Both the Productivity Commission *First Home Ownership* (1) and the Housing Industry Association *Restoring Housing Affordability* (2) draw attention to the rapid rise in land prices as a factor in declining housing affordability.

The Productivity Commission refers to it in a survey of issues related to worsening housing affordability. The Housing Industry Association paper isolates it as especially important. It begins

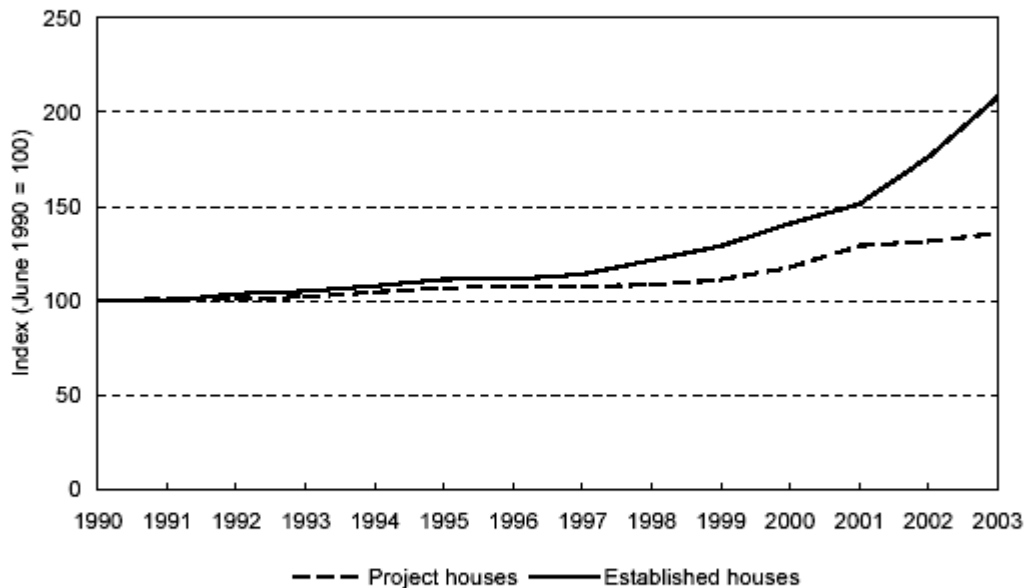
“Rampant increases in the price of a block of land for new housing are strangling housing affordability. The impact on new housing costs of spiraling land prices is most starkly manifest in Sydney, where a typical block of land has doubled its share of the average new house price over the past 25 years and now absorbs the majority of the home purchaser’s dollar” (1, 1).

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However, it then immediately afterwards traces the situation to a combination of government taxes, infrastructure charges and other levies on new housing. The fact that “spiralling land prices” cannot be traced to such taxes and charges is evident from *Figure 3*.

Figure 3 (2,18)

Figure 4 Prices for established houses have risen more rapidly than the cost of building new homes



Note The project houses price index does not include the price of land on which the home is built. The price index for established houses includes the price of land. The project houses index is a component of the established houses price index.

Data source: ABS (Selected Housing Price Series, June Quarter, 6416.0).

The problems the housing industry cites are really chronic problems that have persisted since the late 1970s. Figure 3. shows that the most rapid increases in property prices have occurred among old housing stock. And it is here that the land component has risen the most. Here, taxes and charges cannot explain this wider and more acute problem.

The Housing Industry Association also mentions as a principal cause of poor housing affordability “artificial shortages of land for development” (ibid.). But, again, this has to do with new housing that we now know is more still affordable than ‘old’ housing. Nonetheless, there is an artificial scarcity that affects *all* residential land.

3. Urban Rent

We need to take a little time to understand this *artificial scarcity of land* and the way it contributes to what we fondly call “asset inflation”. We must disentangle it from the healthy effects of *increased locational advantages*. A brief outline of urban rent theory will enable us to see the difference between these factors.

The rent of a piece of land is determined by the excess of its productivity over productivity of marginal land. The cause of excess *productivity* is differential community development; in other words what we as a community contribute to the value of land.

Since residential land is not productive land in the ordinary sense let us say that the rent of a block of residential land is determined by the excess of the *gratifications* it affords to the landholder over those available on marginal residential land.

No rent exists when there is freely available land, but rent exists at the margin where there is a scarcity of land. In an enclosed society such as Australia there is of course some rent at the margin.

Thus,

$$\text{Rent} = a \text{ scarcity (or monopoly) rent} + a \text{ locational rent.}$$

4. Rent from Advantages of Location

Table 1 gives ample evidence that land price is a function of the size of cities.

Table 1 (1,7)

Share of Land in New House Prices

	1976-77 (a)		1992 (b)		2002 (b)	
	New House Price	Land %	New House Price	Land %	New House Price	Land %
Sydney	\$49,010	32%	\$189,800	44%	\$338,150	60%
Melbourne	\$63,200	24%	\$169,000	24%	\$276,200	37%
Brisbane	\$46,280	21%	\$164,690	39%	\$234,300	49%
Adelaide	\$53,970	16%	\$125,970	26%	\$177,430	32%
Perth	\$57,640	22%	\$115,730	32%	\$163,340	42%

Sources: (a) Report of the Committee of Inquiry into Housing Costs, 1978
(b) Sample of Builders and Developers

Generally higher earnings in the larger cities stems from their higher productivity (their locational advantages) over smaller cities and towns. These higher earnings (and greater employment opportunities) are a vital part of the advantage of the larger cities. Overall, higher demand comes from this larger supply of advantages.

5. Rent from Land Scarcity

Any claim that residential land is *naturally* in short supply is misguided. The reason is that we are not looking at land as a whole but at the possibility of using more of it for housing. Since residential land is one of the highest forms of land use there cannot be any natural scarcity of it.

The *artificial* scarcity of land adds to land value. The Association argues that land scarcity cannot be simply defined in terms of the non-release of marginal or ‘green-field’ land. There is a general scarcity of land.

A *Daily Telegraph* report in early October, 2003, disclosed that there were 108,000 vacant buildings in Sydney. The number is surprising given the “bubble” in property prices.

The Association argues that it is appropriate to use the term land monopoly to describe this situation of scarcity. The applicability of the term is clear if we examine the principle that causes such high prices to be paid for housing:

Housing costs will tend to absorb any surplus disposable household income.

In other words, in a situation of scarcity the land market tends to behave as a monopoly market. Limited supply makes land price tend toward one determined solely by demand. And, as Australians highly value home ownership, that price tends to be all that they are capable of sparing from disposable income.

This scarcity is always present where land is taken into private ownership. However, in a land “bubble” (as occurred 1985-89 and has occurred since 1997) the price of land clearly detaches itself from its locational rent. Home buyers continue to bid for it under these circumstances. They are further encouraged to do so by the growing urge to speculate (fondly called “investment”), by any assistance offered by government, and when there are low interest charges.

6. Land Speculation

As much as it is ignored an acute wave of land speculation periodically ravages our economy. As economic activity increases, as it has done in Australia for several years now, the price of land naturally rises with it to reflect the increasing locational advantages of intra-marginal lands and the general expansion of businesses onto less productive land.

There then forms an expectation that this rise will continue. A pursuit of the profits from this rising market begins and a “bubble” forms - a gap between the rent a property will fetch and its capitalized or selling price.

Land is withheld for “ripening” (that is, awaiting the growth in ‘capital gains’) and scarcity occurs especially around the margins of cities and in the CBD. Of equal significance is “investor” activity.

Investor activity (speculation) is reflected in increases in borrowing by investors. After October, 2000, investor borrowing rose more than borrowing by home buyers (2, 10). Such activity eventually draws in many quite small investors. As is indicated these tend to crowd out first home buyers who tend now to drop out of the market.

There is some evidence (2, 14) that increasingly unrealistic imposts upon businesses for land may threaten economic activity. Share prices have fallen 6% in the two years since June, 2001 (2, 14). That may have caused the “crash” in October, 1987. If so investment in property is even more attractive. More investment is diverted into speculation and the “bubble” grows bigger.

Banks and home finance companies are quick to respond to the demand for credit. Since 1985 they have been ready to help bridge the so-called deposit gap, the gap between disposable income and the income needed to qualify for the loan being sought. Thus, persons who will find it difficult to support a mortgage obtain one. Since the 1970s home purchasers have become two income households in order to maintain both the mortgage and their standards of living. But that, too, has only fuelled property prices further.

Extra demand forces the “bubble” becomes to expand further. In the meantime the trend is for the double-income family to delay plans for a family. This exacerbates the troubles of one-income couples trying to own a home and start a family.

Perhaps partly because of this trend for the first time this year the building of units surpassed the building of houses. The number of occupants per dwelling is certainly steadily falling (2,12). However, its speculative aspect cannot be ignored.

Developers pursue this scarcity rent by crowding sites with high rise developments and multiple-occupancy housing. By multiplying the number of dwellings on a site they are well placed to take maximum advantage of the rising price of land.

Council ‘up-front’ levies are (naturally) greater where “leapfrogging” of the “development frontier” occurs. This “leapfrogging” occurs because marginal lands tend to be ‘locked up’ by speculators. These speculators include property developers who at the same time complain that it happens!

New investment in housing increases vacancy rates and, thus, “There is some evidence that renting might currently be a ‘good deal’ for people in some locations” (2, 11). That is, monthly mortgage repayments often exceed rents for the same housing. At the same time rental yields on houses in Australia fell from 5.5% in March, 1994, to around 3.4% in

June, 2003. Rental yields from flats also declined from about 6% to just over 4% (2,10). What that shows is that the land “bubble” has enlarged.

7. The Effect of Taxes

Local Councils have got into the act since the late 1970s, imposing intrusive ‘up-front’ infrastructure charges and other levies on developers in order to capture some of the capital gains for themselves as revenue. The housing industry might legitimately complain of these barriers if it were not for the fact that it has a vested interest in retaining speculative profits!

The Real Estate Institute (NSW) and the Housing Industry Association have attacked state and federal taxes such as Land Tax, Capital Gains Tax, GST and, especially, Stamp Duty. The latter merits a brief discussion.

This complaint from real estate agent is amusing since it is they who keep such ‘incidentals’ to themselves as far as possible when selling property. Many purchasers therefore are only dimly aware of it and they can be quite annoyed when, near the time of settlement, a substantial sum has to be paid.

If buyers were better informed about this ‘best kept secret’ housing prices would be lower. The reason is that Stamp Duty as a direct tax would then be subtracted from (rather than added to) what buyers had available to purchase property. Sadly, the government is as reluctant as real estate agents to inform purchasers about Stamp Duty.

8. A “Single Tax”

The growth of locational rent (quite natural) associated with increasing economic activity spawns an ever-increasing and artificial scarcity rent. This is the “bubble” in the selling price of property. What causes this locational or differential rent to be transformed into land price, and what causes scarcity rent is the same. *Rent is privately owned and sold.* To summarise:

$$(1) \text{ Rent} + \text{Private Property in Land} = \text{Land Price}$$

$$(2) \text{ Rent} + \text{Private Property in Land} + \text{Scarcity Rent} = \text{“Bubble” Land Price}$$

Any tax imposed upon land price is capable of reducing it. This is because it reduces what buyers have available to spend upon land. If differential rent were captured by the public land would not be for sale and land price would be eliminated.

Thus, the need for taxation would be reduced or disappear. Such a measure of course is the so-called “Single Tax” proposed in *Progress and Poverty* (1879) by Henry George (1839-97).

Since urban rent is due in the main to our community presence and activities, its collection by the community satisfies the test of *equity*. And, because such a *holding charge* on land ensures the effective use of valuable land and replaces the taxation of productive efforts, its public collection satisfies the tests of both *efficiency* and *simplicity*.

When almost any increase in local rates or land tax draws out a parade of widows, orphans, and old aged pensioners mobilized by large vested interests (who own our valuable sites and licences to our natural resources), there is no wonder that any constructive debate about this proposal, regrettably, is very limited. And, given the real source of this opposition, it is understandable that even a politician who sees its logic is shy. Why divide your party and ruin your career? What is more important the public see the ownership of land as needful to secure both “their” land and their wealth.

9. The Future?

Despite appearances, be assured, what we have here is *an historic problem* that, sooner or later, will either be faced or it will destroy our society. Given the poverty of public policy the deleterious effects of land price and land speculation upon the community can only ever be “papered over”. At best, only some cosmetic changes can be made. Meanwhile at least three outcomes from this “bubble” for the wider economy are possible.

(1) *Minimal Disturbance*: commercial and industrial rents and land prices will be insulated from the “bubble” and not incapacitate production. In this case the so-called housing “bubble” will continue. It may then “stabilize” itself for a time on a higher plateau of residential land values leaving fewer able to afford homes.

(2) *Moderate Disturbance*: the pricking of the housing “bubble” may be so disruptive that the relative collapse of the building industry will bring about a vicious circle of declining demand and supply. In that case there will be a mild recession.

(3) *Serious Disturbance*: the rise in commercial and industrial rents and land prices (and interest charges) may follow those in the housing market and so redistribute income toward rent-holders that production will be discouraged. In this case there will be a recession and many home buyers will become unemployed and lose their homes. Banks will foreclose but still carry large unpaid debts. Rents, land prices, interest charges and wages will temporarily fall. Again, it will be “the recession we had to have”.