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Productivity Commission
LB2, Collins St East,
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INQUIRY IN TO FIRST HOME OWNERSHIP.

I place this submission before the Commission as a person who has an involvement in the land and house development industry. Professionally, I am qualified as a Civil Engineer, Building Surveyor and Town Planner, all of which cover facets of the industry. I have built three homes and currently run a Town Planning/Civil Engineering consultancy. With the pace of activity in the industry I have had limited time to allocate to a submission – therefore it is necessarily brief and lacks supporting reference documentation. My submission is from personal knowledge and others hopefully in an informed position. My comments are restricted to Victoria and reflect on my involvement in and to the northwest of Melbourne in particular.

1. *First Home Buyers Grant.* The introduction of the First Home Buyers Grant, while attractive as a short term adjustment after a sharp decline in building activity, was in my assessment, and that of all builders that I have spoken to recently, counter-productive, when considered in conjunction with other economic factors in operation. A major tax change such as the GST was going to take time to digest and that time should have been allowed. After a slump the returning wave of interest hit a development industry with a relatively low elasticity, and an industry where some exited as a result of the added complications of GST administration.

To have phased the grant out more quickly may have helped reduce demand pressures, but from a medium term perspective to introduce it was increasing demand abruptly when the suppliers of the house and land product had a reduced capacity. This was particularly so as under many of the borrowing arrangements, the grant provided an earlier entry to home ownership than otherwise would have been the case.

It is my view and that of most industry people I have dealt with, that while beneficial in the short term, the grant has now added more to the cost of houses and land than the value of the grant.

2. *Lower interest rates.* Lower interest rates alone have reduced the barriers to home ownership, and in the overall context, must be regarded as beneficial. However, in allowing an increase in demand that cannot be quickly responded too, the inevitable outcome has been a demand outstripping supply and pushing up prices. This aspect of the house and land cost increase was in itself probably unavoidable.
3. *Material costs.* Some underlying material costs have been a factor in Melbourne, and the particular example I am best aware of is crushed rock. Crushed rock is used as the major component in concrete (paths, building blocks/bricks, raft slabs, strip footings, kerb & channel), and also in asphalt, road pavements, some trenching backfill and as a bedding material. In the last two years in Melbourne the cost has risen from a typical \$13/tonne to \$21-22/tonne. While increased demand has been a factor, the takeover of some smaller quarries and consequent reduced competition has also been a factor. Given the importance of distance in limiting competition in this industry, a closer scrutiny of the anti-competitive practice of some takeovers/buyouts should be considered by the ACCC. I have also observed similar factors at work in the concrete pipe industry. I am unable to comment on other cost inputs to the industry, although a brother of mine, who is a builder, did recently tell me that most builders could accommodate up to a 20% drop in house costs per unit area and still remain in business (that may not hold valid unless prices show signs of declining soon).

4. *Local Government* requirements have risen steadily but the underlying statutory charges have not increased significantly and may have barely kept up with inflation over the last few years. Therefore, those charges cannot be seen as factor in the recent price rises. Local Government may have contributed in some areas by requiring higher standards for land development, but many of these are a reaction to community requests and in some cases have arisen from measures taken to reduce infrastructure damage that is particularly serious in newly developing areas. Many materials suppliers in the building industry and some builders are responsible for millions of dollars of damage annually in individual outer metropolitan municipalities as a result of delivery trucks damaging paths, signs, crossovers, dumping surplus concrete in drains etc. The building industry could contribute to lower costs if it could find a way to reduce damage to public assets.

Local Government restructuring has resulted in a loss of skilled technical staff, which has become increasingly apparent with the higher level of activity. New entrants in the Civil Engineering area rarely have adequate in-house technical support due to lower staffing levels which means that more bad and often costly decisions are made or additional costs are placed on the Consultants and developer who have limits to time and frustration. The lack of skills can also mean that decisions take much longer to be made, adding to developer/consultant costs. From a consultant perspective, our underlying costs in dealing with Local Government – many more phone calls, sometimes acting as a default mentor, chasing up time and time again for answers, have probably increased our costs by 10%.. I should hasten to add not all of these problems are due to Local Government – some are traceable to a reduction in total teaching time in Engineering tertiary courses, and perhaps the Educational philosophy at secondary schooling level, which I can only say seem to have resulted in some graduates who are very difficult to usefully employ as Engineers.

4. *Land supply.* One development (outer suburban) I am managing commenced in 1995 selling 35 lots per year at about \$38K per lot. The land was purchased at a cost of \$6K per lot equivalent, which was about 30% above then market values. That developer is now selling 140 lots per year at an average price of \$95K and we have been adding about \$5K to prices every 4-6 months. Unlike 1995, we can sell 90% of our release within 2-3 weeks.

I am also involved with a nearby development where the land was purchased in early 2003, and has a slightly better location. That land has a raw land cost of \$29K per lot. There is a very real risk that by allowing the extended housing “boom” that there has been a fundamental lift in underlying raw land costs, establishing a higher starting cost for all residential development. *In itself this is probably the worst single factor, as it increases underlying costs for development significantly* compared with most other factors. To deflate the raw land cost is probably not an option in other than the in the long term. My observation is that it is only in the last 12-18 months that the raw land cost has surged significantly. This surge has also coincided with a large increase in inquiries from people wanting to subdivide land, particularly for dual occupancy, often with almost desperation to get in to the market.

Zoning restrictions have been cited as a factor in the price increases. In the areas I operate, at the best that would be marginal if judged on years of land supply available. In some cases however, if the land is in too few hands (large holdings, few owners), then years of supply is not an adequate indicator of supply adequacy.

5. *Industry capacity.* The land and housing industry has a reputation for boom and bust cycles, that has not helped it to sustain an adequate resource of labour and equipment inputs to respond quickly to an increase in demand. Putting it simply, you cannot create more Civil Engineers or Town Planners, builders or even plant operators without a lag time of several years. If you push skilled people out of the development industry with: increases in tax regime complexity; higher professional indemnity and public liability; increased works pressures (bad in Local Govt); increased costs for tertiary courses, inadequate remuneration, then you reap the consequences. I have Civil contractors who are finding it almost impossible to get good labourers. I have had delays in power, telecommunication and gas reticulation installations because of labour shortages, which in turn have delayed subdivision completion.

I have read a recent comment that the predicted labour skills shortage will be overcome by continuing technology improvements. While there is some truth in that, some of the newer products and standards required (often driven by consumer claims for faulty workmanship), result in a demand for higher skill

levels. It is more likely other factors may operate in the longer term to reduce housing and hence skill requirements.

As a Civil Engineer/Town Planner, many of the staff I have had working for me have advised others to go to alternative less demanding and better paid areas rather than enter the Engineering field as the rewards are poor compared with many other areas. The most obvious and related area is the Real Estate industry, where there have been major income increases, where many in the industry can command significantly higher remuneration, with lower industry entry costs than those who are key players in ensuring efficient production of land and housing.

6. *Cost drivers.* There is little doubt that most players in the development industry have taken an increased but widely varying profit share in the last few years. The main increase that I am sensitive to, as a Project Manager, has been the increased cost of selling thorough Real Estate agents at a time when less effort is required to achieve sales. I have recently terminated a Real Estate selling agreement and employed a sales representative “in house” on a project, with results that indicate better vendor service and a reduction in sales costs of around \$1500 per lot.

Other drivers are significant but to a lesser degree in percentage terms. Of the labour inputs, all trades have seen significant increases, and my own fees have increased for comparable developments by 25-30% in a steady manner, over the last five years. However, a softening of demand will reduce, through competition, some of these costs.

7. *Taxes.* I have commented on the impact of the GST – that is behind us and now no longer a material factor in this inquiry.

Contrary to some suggestions that taxes should be cut to reduce costs, I can see no merit at all in such a suggestion when demand is high. To do so whether it be a State or Federal tax, would be counterproductive and defies conventional economic theory.

As an active participant in the development industry (as a land developer), the main impediment I see is the costs of land tax once development is under-way. I have no argument with a land tax on “raw” land, but once the land is being developed, the tax does contribute to the cost budget of the developer in a very real way, with a potential to add \$1500 per lot to base costs.

Adjustment to taxes such as stamp duty, GST, capital gains and land tax, should only be considered in an assessment of their overall role in the tax mix and in light of what other taxes might replace them. Any adjustment downwards should only be made at the right time in the economic cycle, but not out of consideration for housing costs alone.

From an overall perspective, the only tax, apart from the GST introduction, that has had an impact that has accelerated the house and land prices, has been the reduction in capital gains tax. An increase in capital gains would certainly take some over-investment out of the market and improve equity. A dispassionate observer may see some benefit from some fiscal policy adjustments directed at avoiding providing additional financial resources an overheated housing market, but that is probably too late in the current cycle.

8. *Product Standards.* While reference to the past is frowned upon, reflection can help put matters in perspective. My first house cost (house and land) about 4 years graduate Civil Engineer salary in the mid 1960's, but it was only 110 sq.m. living area and had only a partly constructed road at the front. There has been immense and successful marketing applied to encourage more consumption of housing, in a way that is probably counter-productive to many consumers and the environment. Notwithstanding, current houses are much bigger, have better appliances, roads and public municipal facilities. However, despite these improvements, the balance has clearly worsened in the last few years.
9. *Superannuation.* I have more encountered more persons in the last 1-2 years who see the need to establish a viable superannuation fund for their retirement as being best served by investing in property development, than in the whole of the previous eight years I have been a consultant. This change has undoubtedly been accelerated by the decline in returns from the share market, but also by changes in retirement rules and

capital gains tax. I have insufficient information on what the impact may be and can only express the feeling that it is significant.

Conclusion. I owe to my children to put this submission in. Through circumstances not of their making they now find it a very hard grind to buy a house and they are well-qualified professionals. They see a transfer of money to those who already have with little effort for reward. It is not a pleasing outcome and is not encouraging capital deepening towards a smarter future economy.

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