

16 October 2003

Inquiry into First Home Ownership  
Productivity Commission  
LB2 Collins Street East  
MELBOURNE VIC 8003

Dear Sir / Madam

This document outlines the views of the Master Builders Association of Western Australia (MBA) on first home ownership affordability, particularly in relation to new home buyers.

As you may be aware MBA is a major employer/industry association in the building and construction industry. It has a federal structure with around 23,000 members nationally. In Western Australia MBA is an autonomous state-based organisation. There are a number of state specific issues which we feel are better to raise in a separate submission to the one that you will receive from our national body, MBA Inc.

In Western Australia MBA has over 1,000 members. Around 65 per cent of our members are involved in the housing sector. Only builder members have voting rights on our Council of Management which is a distinguishing feature of our organisation compared to the Housing Industry Association (HIA). Most major project builders are members of both HIA and MBA. MBA has a particularly strong representation in the regional areas of the state with fully staffed branches in Geraldton, Albany, Bunbury and Kalgoorlie. With statewide membership coverage MBA feels comfortable in representing the views of the housing industry to the Commission's Inquiry into First Home Ownership.

The central theme of this submission is that any reduction in first home buyer affordability has been due to factors outside the control of the new home building industry. Rising land costs and higher prices of established homes have primarily caused a deterioration in affordability. But institutional and structural changes imposed on new home building by outside parties have led to a reduced capacity to meet first home buyer requirements.

## **CHANGING STRUCTURE OF WA HOUSING SECTOR**

The housing sector in Western Australia is unique in that building activity is highly concentrated with ten major project builders undertaking the majority of building work. Research conducted by MBA shows that in the year to September 2003, the top ten home builders claimed 58.1 per cent of the total number of contract built home approvals in the Perth metropolitan area. By value their market share was 53.5 per cent.

Reference to the table below indicates that this trend towards a higher concentration ratio has accelerated in recent years. The table shows that the market share of smaller builders has dropped steadily. Since 2000 the smaller builder market share has dropped from 53.4 per cent of the number of building approvals to 41.9 per cent for the year to September 2003.

By value the figures are 57.3 per cent and 46.5 per cent respectively.

**Smaller Builder Market Share – Percentage**  
**Perth Metropolitan Region**  
**September 2000 to September 2003**

<b>Year</b>	<b>By Number of Dwellings</b>	<b>By Value</b>
2000	53.4	57.3
2001	46.1	51.6
2002	42.9	47.6
2003 P	41.9	46.5

P = preliminary

(Smaller Builder is defined as outside of top ten builders)

*Source: Reed Construction Data*

Around 75 per cent of all housing activity in Western Australia is carried out in the Perth metropolitan area. However there is significant house building work being carried out in the South West, Great Southern, Mid West and Kimberley regions of the state. A number of major Perth-based builders have established offices in these regional centres, creating some discontent among country based builders who see their livelihoods threatened by the intrusion of Perth builders into their geographical area.

One reason for this emerging structural change has been the difficulties faced by many builders in obtaining adequate indemnity insurance. Many smaller builders have closed their doors or have been restricted by a maximum turnover limit on their business activities imposed by an insurance company. As housing indemnity is a prerequisite to the issue of a building licence by a local authority, entrepreneurship, business expansion and the entry of new builders in the housing market has been made more difficult.

Moreover the WA state government decision to cap insurance risk for the top three builders and underwrite risk in excess of \$10m has created a more favourable trading environment for the state's three largest builders. Given the difficulties and delays experienced by builders in obtaining insurance, it is not surprising that the market share of major builders has accelerated in recent years.

This structural change could have an influence on first home buyer affordability over the medium term. While it can be argued that economies of scale created by large system building will improve affordability, there is also a viewpoint that over time, reduced consumer choice and higher prices for first home buyers above what would otherwise have been the case may eventuate.

## **TRENDS IN FIRST HOME BUYER AFFORDABILITY**

As part of MBA Inc's submission to this Inquiry an internet poll of housing members was conducted during September/October 2003 to determine industry's view on the major causes of the recent reduction in first home buyer affordability. 168 responses were received which ranked factors according to their perceived impact on affordability. These responses are detailed in the table below.

(Rating 50 = neutral)

Land prices	91.3
State government fees and charges	80.5
Indemnity insurance	79.9
Land availability	76.7
Regulatory delays	73.4
Availability of trades	71.4
Local government fees and charges	70.9
GST	69.2
Excessive buyer expectations	67.3
Price of availability of materials	63.7
Infrastructure costs	60.4
Access to finance	39.6

It can be seen from the table that the major causes of reduced first home buyer affordability are factors mainly outside the control of the building industry. Escalation in land prices, reduced availability of indemnity insurance and regulatory delays at a state and local government level have been identified by MBA members as the major factors affecting new home affordability for first time buyers.

Western Australia is unique in that it has one of the lowest costs of new building in Australia. Unpublished data from the Australian Bureau of Statistics (ABS) shows that the average cost per square metre of new housing approved in the Perth metropolitan area is around \$100 per square metre cheaper than in major eastern states cities. On a 200 square metre home this represents a saving of around \$20,000 compared with Sydney and Melbourne building costs. Moreover typical construction in Perth is double brick and tile, compared with brick veneer in most major eastern states cities.

Recent declines in first home buyer affordability have not been due to excessive increases in new home building costs. Increases in land prices and in the cost of established housing have been the major drivers of reduced housing affordability in Western Australia. ABS figures illustrated below show that between 1999/2000 and March 2003 the increase in established house prices in Perth was 31.9 per cent compared with a 15.9 per cent increase in the new project home price index.

#### **Housing Cost Increases – Perth 1999/2000 – 2002/03 (to March 2003)**

<b>Year</b>	<b>Project Home Price Index No. (1988/89 = 100)</b>	<b>Established Home Price Index (1988/89 = 100)</b>
1999/2000	114.8	125.9
2000/01	126.2	133.9
2001/02	128.8	145.5
2002/03*	133.1	166

\*(to March 2003)

Moreover the increase in new project home prices in WA over the period has been 4 percentage points lower than the eight capital cities weighted average and almost 18 percentage points lower for established housing.

The modest increase in new project home prices over this period is despite:

- The introduction of GST in July 2000 which increased prices significantly since house building materials were previously sales tax exempt;
- Up to trebling in the cost of home indemnity insurance premiums following the collapse of HIH Insurance and the withdrawal of Dexta from the housing indemnity market;
- The introduction of the First Home Owners Scheme (FHOS) of up to \$14,000 for first home buyers which would be reflected in part in higher new home prices;
- A sustained period of high building activity; and
- A steady upward movement in average house sizes (around 240 square metres) and quality of fit-out.

Rapid increases in established house prices have occurred for two reasons. First, the introduction of GST on new homes and not on established housing in July 2000 distorted relative prices between the two accommodation types. As occurred in New Zealand following the introduction of GST there has been a period of “catch-up” where established house prices rose and new house prices moderated until the relative price relationship was re-established.

Second, established house prices have risen rapidly due to poor targeting of the First Home Owners Scheme. FHOS was introduced as part of the GST compensation package for first home buyers for the effects of GST on housing affordability. However the grant was also made available to established home buyers who did not face this GST impost on purchase. It is no surprise to see that established house prices have risen strongly as part (or all) of this grant was factored into vendor price expectations.

## **LAND PRICES**

Land prices have accelerated in recent years as developers sought to recoup GST which they absorbed during the initial post GST downturn. Another factor issue which has inflated the rate of land price escalation has been the practice of the WA state government to impose stamp duty on the GST inclusive price of land rather than the GST exclusive price. This practice has led to a further stamp duty windfall and reduced home buyer affordability below what would otherwise be the case.

State government taxation policy has also affected the continuity of land supply in 2002/03. Amendments to State Tax legislation meant the removal of the land tax concessions to developers on 1 July 2003 by the state government. Many land developers reduced their finished stock of land at 30 June for tax planning purposes creating a temporary supply shortage. This practice is likely to continue each year to avoid payment of higher land tax on capital improved land. Taxation policy should not result in such artificial interruptions to supply which result from the incentive to run down land stocks at the end of each financial year.

Land prices and redevelopment projects are also heavily influenced by headworks charges imposed by various state government agencies. Industry has been concerned for some time about the transparency and lumpiness of these arrangements, in particular for water and sewerage headworks charges. The impact of these up front headworks charges contributes heavily to total development costs and has a significant impact on affordability, particularly for home buyers on modest incomes. Developers are also complaining about the scope and extent of levies and charges which are being imposed by various government agencies.

State government environmental policies such as “Bush Forever” which sterilise land from being developed reduce the amount of land available for future consumption and drive up the cost of raw land.

## CYCLICAL TRENDS AND GOVERNMENT INTERVENTION

One of the key issues for consideration is whether the recent decline in home buyer affordability is due to temporary and cyclical factors or more permanent structural factors.

In WA in 2003/04 the rapid growth in housing activity has been accompanied by simultaneous expansion in the commercial building and renovations sectors. With each sector of the building industry currently expanding rapidly, resource constraints have emerged which have contributed to an increase in building costs.

Outlined below is the value of work done in the residential, non-residential and alterations and additions sectors in Western Australia between 1999/2000 and 2002/03 (est).

### Value of Building Work done by Industry Sector

#### Western Australia 1999/2000 to 2002/03 (\$m)

Year	New Residential \$m	Alterations / Additions \$m	Non-Residential \$m	Total \$
1999/2000	2,507	282	1,210	3,999
2000/01	2,084	248	1,064	3,396
2001/02	2,368	286	1,044	3,698
2002/03 est	2,800	300	1,450	4,550

Source: ABS, MBA

From the table it can be seen that in 2002/03 the estimate of \$4.55 billion total building work done was 23 per cent higher than in 2001/02. While the residential sector was 18 per cent higher in 2002/03, a 40 per cent expansion in the non-residential sector was also recorded. Work yet to be done is also accelerating. In March 2003, the value of work yet to be done was \$1.5 billion representing about 4 months work on hand. The simultaneous expansion of all building sectors is unusual. Policy adjustment to measures which affect home buyer affordability should not be based on these unusual circumstances.

The Western Australian housing industry has an excellent track record in coping with periods of high demand. The activity levels currently being achieved in new home construction are strong but not exceptional by historical standards. Industry resilience in adjusting to exceptional circumstances is well known and market forces can usually sort temporary cyclical problems out without the need for "ad hoc" government intervention. History would suggest that much of the volatility in housing activity has been caused by particular government policies. For example the 1985 original First Home Owners Scheme was the precursor to a boom in building activity while in July 2000 the introduction of GST initiated a rapid industry downturn which followed a pre-GST boom.

Volatility in first home buyer affordability trends is less likely with a smooth and steady level of building activity rather than large fluctuations in the building cycle induced by "ad hoc" government policy changes.

Notwithstanding these comments there appears to be a number of structural issues which have affected and are likely to adversely affect home buyer affordability in the future which need government attention.

In the short-term the First Home Owners Scheme could be fine-tuned to provide a more equitable and efficient means of assisting first time buyers, in line with the original objectives of the Scheme.

- ◆ FHOS could be directed to the new home market only where the GST impact is felt. Established home prices have been driven up by extension of FHOS to non-GST affected sectors.
- ◆ Funds saved by this change to FHOS could be directed to new home buyers by differentiating the size of the FHOS grant by the cost of construction and or house/land package. Higher FHOS payments would apply in regional areas, or in capital cities with higher costs of construction.
- ◆ FHOS should be indexed to take into account the increase in building costs (and GST payable) since July 2000, and include an automatic adjustment for future price increases.
- ◆ FHOS should have the flexibility to be paid up front or as a monthly subsidy on housing repayments.

At a state government level there are also a number of options that should be considered. Firstly the threshold levels of home purchase above which Keystart finance for low income earner loans is not available should be increased to take account of rising building costs, particularly in regional areas.

Over the long term, policy must also address:

- ★ Supply constraints imposed on productivity due to the ageing workforce in major building trades. For example in the bricklaying trade many contractors are aged over 40 years and are physically less able to operate at previous levels of productivity. Moreover the demise of large bricklaying teams towards smaller operating units is also affecting output. Training and immigration policies need to provide for a steady supply of new building tradespersons.
- ★ Planning regulations and delays at a state and local government level. There is an increasing trend in WA for building plans for single detached housing in Western Australia to require planning approval. The bureaucratic processes slow down the response time for an industry to meet the high levels of housing demand at affordable prices.
- ★ A long term solution to the home indemnity insurance issue to ensure the continuation of a competitive housing industry.

## **CONCLUSION**

Western Australian new first home buyers have been less affected than buyers in other states by the decline in affordability. Reduced affordability has been more pronounced in the established housing market, and has been in the past due in part to sub-optimal targeting of the First Home Owners Scheme.

New home builders prefer a steady flow of building work. Better targeting of the First Home Owners Scheme, and removal of supply side constraints imposed by outside forces (for example, insurance companies, state, federal and local governments) will allow the new home building industry to continue to meet rising first home buyer demand at an affordable price.

Should you have any questions about this submission, kindly contact the undersigned.

Yours faithfully  
**MASTER BUILDERS ASSOCIATION OF WA**

Gavan Forster  
**DIRECTOR HOUSING & ECONOMICS**