



Submission to the Productivity Commission Inquiry into First Home Ownership

Abstract

This submission responds to the government's call for the Productivity Commission to investigate affordability and availability of housing for first home buyers. It has been developed in consultation with members and networks.

The focus of this submission is on ways to increase the supply of affordable housing options for people on low incomes, recognising that the whole housing system needs to be understood and addressed in policy terms. Issues include: structural changes to home ownership; the mismatch between housing supply and demand; ineffective housing assistance programs; and the lack of affordable housing where the jobs are.

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Table of Contents

1. Introduction	5
2. Overview	6
2.1 The lack of affordable housing	7
2.2 The need for government action	8
3. The housing policy context	9
4. The current housing 'bubble' – origins and outcomes	12
4.1 Boom and bust cycles	13
4.2 Economic consequences of property booms	17
4.3 Policy options to ease the boom and bust cycle in asset prices	18
4.4 Negative gearing and the taxation of capital gains	18
4.5 Prudential regulation	22
5. Improving housing affordability	24
5.1 Increasing the supply of low cost rental housing	25
5.2 Strengthening social housing	26
5.3 Rent assistance	27
5.4 Encouraging home ownership	28
6. Sustainable communities	32
6.1 Regional development	32
6.2 Land use planning	33
6.3 Land and betterment taxes	33
7. The way forward	35
ACOSS affordable housing proposals	35
References	38

1. Introduction

The Australian Council of Social Service (ACOSS) is the national voice for Australians affected by poverty and inequality and the peak body of the community services and welfare sector. ACOSS aims to combat poverty and help build an inclusive society that values the right of all people and communities to have the social and economic resources they need to control their own lives.

ACOSS contributes to policy development in a broad range of intersecting areas of national interest including employment, education and training; community services; economic development and taxation; income support; health; housing and regional development; rural and remote communities; law and justice; and Indigenous communities. In each of these areas we are involved in research, policy development, analysis, public education and advocacy. Our State and Territory Councils of Social Service (COSSes) cover many similar issues from a State and Territory perspective.

In line with our broad mission, a key priority for ACOSS is to increase the level of affordable housing for low income earners – in social housing, private rental and home ownership markets. All households, particularly low income and disadvantaged households, should have access to appropriate and affordable housing to ensure they are not excluded from economic and social opportunities. We consider that current policy settings are distorting both the home ownership and rental markets and effectively locking out low income earners. The flow on effects of this include entrenched unemployment and homelessness, a lack of labour supply (including ‘key workers’) and the long term polarisation of rich and poor groups in society.

This submission provides broad, national perspectives on Australia’s housing system and the suite of policy responses aimed at dealing with housing affordability issues. We discuss the current debate in relation to the housing ‘bubble’ and its immediate impact on housing affordability, but note the longer term problems with housing affordability which need to be addressed.

In this regard, ACOSS is concerned that the Terms of Reference for this Inquiry have a relatively narrow focus, in particular in relation to home ownership for lower income groups. While we acknowledge that home ownership is important, issues facing low and moderate income renters and social housing tenants cannot be overlooked, just as issues relating to home ownership for these groups cannot be considered in isolation. The private rental market has always been an important part of Australia's housing system, and along with social housing, has been a key provider of low income housing.

Where appropriate, we address the range of matters outlined in the *Issues Paper* on which the Commission seeks input. However it should be noted that issues relating directly to State and Territory jurisdictions are more legitimately for the COSSes to make comment on.

The key issues for ACOSS covered in this submission are: the equity effects of current housing wealth transfer; the impact of negative gearing and Capital Gains Tax (CGT) on house price inflation; the collapse of investment in low cost rental housing; ineffective housing assistance programs; and the decline in social housing. We call for an increase in the range and supply of secure, affordable and appropriate housing options for all Australians, particularly to those on lower incomes, and make a number of recommendations to achieve this.

2. Overview

Housing is a basic need - everyone needs shelter. Investments in housing are both financial and emotional and more often than not a key factor in the creation and sustainability of healthy communities. Wealth creation, costs of living, status, security and access to employment and services are all linked to housing choice.

Australia faces a number of challenges in relation to housing that require economic and social policy responses. These include: overheating housing markets, particularly in our major cities; a chronic mismatch between housing supply and demand due to a concentration of economic growth and employment opportunities in particular locations; a lack of affordable housing close to job opportunities for a growing number of people on low incomes; entrenched homelessness; and an unviable social housing system.

A key question is how do we ensure a sustainable housing system? This requires policies to both ensure adequate financial resources are going into the housing system, and that these are distributed in ways that achieve sustainable economic and social outcomes.

Key sections of the Australian housing market are seriously overheated, prompting talk of a housing price 'bubble'. This has made it harder for people to enter the market as first home buyers. Of perhaps greater concern in the short to medium term, it also puts economic growth and job generation at risk. The Reserve Bank (RBA) is rightly concerned about the current boom in housing asset prices. The housing and inner city office boom of the late 1980s was the precursor to Australia's most prolonged recession in over 50 years. We cannot afford to repeat that experience.

Housing booms and busts are a long standing feature of Australia's business cycle, but that does not mean that asset price bubbles are inevitable. Each one has its own triggers and underlying causes. The main trigger for the current episode is a boom in apartment and house construction in capital cities and coastal resorts. The underlying factors driving this include pent up demand, strong economic growth, declining share markets and consequential greater investment in housing, low interest rates, and a tax system that encourages inefficient investment in assets such as debt financed housing.

Of these factors, the one that is most amenable to a policy solution - without serious adverse economic and social effects - is to withdraw from new and intending investors the current cocktail of CGT concessions and negative gearing.

However, deflating the housing bubble will not resolve the structural problems that narrow the housing options of first home buyers and low income earners generally. We suggest that the current housing bubble is related to a longer term structural problem in

housing affordability. Any change to home ownership policies must not have a negative affect on the housing market in general, and specifically low income earners access to affordable housing. These markets are linked and the drivers for the 'bubble' are also contributing to the collapse of affordable rental housing.

Unlike other countries, home ownership and rental markets in Australia are blended and investment (particularly by developers) in one cannot be separated from the other. There is little point in exploring home ownership pressures without also looking at the way that increased demand for affordable private rental is driving overall housing investment.

2.1 The lack of affordable housing

One of the biggest problems low income Australian households face today is finding affordable, secure and appropriate housing.

Research by the Australian Housing and Urban Research Institute (AHURI) found that between 1986 and 1996 home ownership rates declined generally across all age groups in metropolitan regions and amongst lower aged households in non metropolitan regions. At an Australia wide level, home ownership for households in the 25-44 year old age group declined by 6.7%, more than twice the decline in non metropolitan regions and more than three times the decline in the aggregate home ownership rate.¹

However, for many, home ownership will never become a reality and subsequently they rely on the private rental market for accommodation. This may be for a short period of time or for their entire lives. For large numbers of people private rental is the most appropriate and desirable housing outcome.

Demand for low cost rental housing is rising at a time when investment in such provision has fallen to an all time low. There was a significant decline in private rental stock for people at the bottom end of the market between 1986 and 1996, resulting in an overall shortage of 150,000 units of stock for people on the lowest income level.² Forthcoming AHURI research indicates that this decline has continued through to 2001, with absolute declines in the stock of dwellings with real rents in the \$200-\$250 per week range in 2001, despite an overall growth in the total private rental stock.³

Consequently, the levels of housing stress in certain parts of the community continues to explode with households in the bottom 20% of incomes spending on average 64% of their income on housing costs.⁴

Secure, stable and affordable rental housing can provide most of the social benefits generally attributed to home ownership. It is only fair that at least some of the economic and social attributes owning your own home offers - stability; the ability to establish and maintain community networks; improved personal and family well being; tax breaks - be available to those who do not enter the home ownership market.

¹Yates, J 2002.

²Yates and Wulff, 2001.

³Yates, Wulff and Reynolds, 2003 (forthcoming report).

⁴Winter and Donald, 2001.

At the same time, the supply of low cost rental housing or 'social housing' has collapsed and the number of households needing it has continued to grow. This is made worse by the fact that State housing authorities are in such a precarious financial position that almost all funds under the Commonwealth-State Housing Agreement (CSHA) go into meeting a backlog of liabilities rather than adding to the supply of new housing.

The Commonwealth Rent Assistance (RA) program – which provides a supplement to income support recipients in the private rental market - is also increasingly being found to be inadequate in delivering affordability, especially in capital cities and other locations where jobs are more plentiful. This is not to say that the program isn't assisting with affordability, and many recipients would be worse off without this assistance. However, rents are rising and very few private rental properties are available at the low end of the market. More than 85,000 RA recipients are now living in housing stress, spending more than 50% of their income on rent.

Affordable housing is most needed in the places where the labour market is strong and where a broad range of essential services can be accessed. However, many working families are either living in unaffordable rental housing or barred from high employment locations because of the inability of the private rental market to meet their housing needs at an affordable price.

The lack of affordable housing reflects a basic failure in the relationship between housing markets, incomes, employment, investment and the tax and welfare systems. Contributing further is the lack of a national policy framework within which government activity in the housing system can be directed and coordinated.

2.2 The need for government action

This submission suggests that although there are certain valued benefits conferred by home ownership that should be protected and promoted, urgent policy action is needed to increase the stock of affordable rental housing available to low income earners - whether it be in the public, community or private sectors.

Policy options are required to not only support home ownership for low income groups but also to allow home ownership benefits to be accessible to those households who are excluded from buying in the short or longer term. This requires increasing the supply of affordable housing more generally, including the provision of incentives to attract private sector investment in social and low cost rental housing. These options are explored in more detail later.

A number of options have been floated to improve first home affordability for low and middle income earners by, for e.g. the First Home Ownership Grant (FHOG) scheme. Introduced in 2000, primarily to offset the impact of the GST, the scheme functions more as a stabilisation and fiscal stimulation policy than a housing one - basically a counter cyclical measure. Around 306,000 payments of the one off \$7,000 grant were made between July 2000 and June 2002 - totalling almost \$3 billion in expenditure on the program.⁵

⁵ABS, 2003(1). Calculations based on 86% of recipients receiving \$7,000, the remaining 14% received \$10,000 or \$14,000.

It is true the grants did bring forward home purchase for some. However, it also had the effect of adding to the price escalation of properties we are currently experiencing and which is in fact diminishing home ownership opportunities for certain low income households.

A fundamental problem with this and similar options is that they are likely to have the effect of boosting demand for housing, and first home prices, still further. Public subsidies to make housing more affordable must be very carefully targeted and implemented to avoid this outcome, and aimed at people on below average incomes who would not otherwise be able to afford decent housing - whether rental or owner occupied. Further, they should be supported by action to expand the supply of affordable housing and improve access for low income people more generally, such as recommended in the Industry Commission 1993 report, *Public Housing*.⁶

Housing assistance schemes should also be underpinned by long term, consistent investment in policies to ease the imbalances in our urban development. While the focus thus far has been on our capital cities there is an urgent need to integrate housing, regional development and infrastructure issues into a coherent framework.

Housing plays a fundamental part of the social safety net, providing all Australians with affordable housing options will ultimately reduce expenditure in income support, health care and other community services. To this end supply side solutions in particular are needed across all housing tenures.

The next section discusses the current housing policy context and the need for a national framework to drive housing policy development and implementation in Australia.

3. The housing policy context

Although Australia is well housed in general, a fundamental and growing affordability problem has emerged in the housing system – a declining supply of housing for low income people across all kinds of tenures.

In its first report, the Affordable Housing National Research Consortium notes that since 1986 the number of low income urban households in ‘dwelling stress’ across Australia has grown from 90,000 to over a quarter of a million households⁷ - and suggests that on present trends, and in the absence of new policy measures to redress the situation, the number of stressed households will reach one million by the year 2020.⁸

It is well accepted there is a gap in housing affordability nationally. To date most of the attention has been on rising house prices and the possibility of a housing ‘bust’. There has also been some recognition that while this is increasing the wealth of existing home owners, their children may not be able to afford to buy.

⁶Industry Commission, 1993.

⁷This covers only the major capital cities; the number is higher when regional figures are included.

⁸AHURI, 2001.

This is substantiated by the decline in home ownership levels (for all households) from 68.1% in 1986 to 66% in 1996 and remaining relatively stable at 65.3% in 2001.⁹ It is likely that the FHOG contributed to the reversal of the decline in 2001, and we may well see a return to a general downward trend again by 2005.

Why have home ownership rates and the general affordability of housing declined? We suggest this relates to long term structural changes to home ownership patterns due to: changes in the structure and distribution of the population; changes in the nature of the labour market (including greater casualisation); increased inequality in household income levels; distortions in the tax system; inadequate and uncoordinated planning and development mechanisms, and a failure or decline of housing assistance policies.

Impacting on housing affordability more generally includes:

- The withdrawal of government home ownership assistance means there are currently very few schemes available to low income earners that effectively assist with the high cost of home ownership.
- The untargeted nature of the FHOG, which, while stimulating economic activity by bringing forward home ownership plans, has also fuelled price inflation and added to the affordability problems of non home owners.
- Negative gearing - our main private rental investment incentive - encourages investment in properties with capital gain potential and provides limited incentive for investment in low cost rental housing.
- There was a significant decline in private rental stock for people at the bottom end of the market over the last two decades.
- The decline in the effectiveness of housing assistance programs for low income earners, in particular the ability of RA to deliver affordability in many areas.
- Continued decline in spending on social housing despite rising demand, resulting in social housing responses which are now inadequate to meet demand.
- Housing stock which is unsuitable for current needs. For e.g., the ageing of the population is leading to increased demand for higher numbers of smaller dwellings and the growth in sole parent families results in demand for family homes near jobs and services.
- Changes in the nature of the labour market, including distribution and availability of jobs and higher levels of casual and part time work has resulted in a widening of the income gap between 'under employed' and 'over employed' households, a rise in the incidence of broken work patterns, and increased demand for the mobility that rental stock provides.

There are serious economic and social implications from the general decline in housing affordability, and a need to better understand how the decline of home ownership is

⁹ABS 1986, 1996 and 2001 (special matrix tabulations).

contributing to unequal access to opportunities and future wealth – all of which points to an urgent need for coordinated national action.

Rising house prices have been reinforced by the taxation treatment of investor and owner occupied dwellings, low interest rates, easier access to credit, and low inflation rates. These and other factors have led to a property boom that has effectively priced more and more low income earners out of both home ownership and private rental markets.

There is evidence that house price inflation has reduced both access to home ownership and affordable private rental options, particularly in 'global cities' such as Sydney and Melbourne. For e.g., at March 2002 the median house price in Sydney was \$350,000.¹⁰ With the median gross household income between \$700-\$800 per week¹¹, very few low income families would be able to raise a deposit or sustain the mortgage repayments.

As a result fewer and fewer people are benefiting from wealth creation and the retirement savings once provided by home ownership. This is a particularly serious scenario in the context of Australia's ageing population and their needs for secure housing in retirement. Further, increasing numbers of families are finding it difficult to maintain housing stability and are, as a consequence, likely to face higher risk of early discontinuation of education and diminished future employment prospects.

Despite Australia's low population replacement rate, if fewer people continue to access and benefit from the wealth creation of home ownership, it is logical that fewer of the next generation will inherit the wealth benefits of home ownership. This threatens not only to effect the wealth of today's generation, but also to compound and accentuate unequally wealth distribution across the next generation.

Australia is also beginning to face a problem, now very significant in other countries like the UK – the loss of 'key workers' in major regional centres (nurses and teachers are examples). Job rich areas are often associated with tight housing markets and a lack of affordable housing, while the converse is true of many job poor areas. For regional Australia in particular, economic decline results in diminishing access to health, education and other essential services. The significant loss of social infrastructure and institutions, combined with the loss of social and economic contributions by key workers to a community, is potentially devastating.

To address these issues we need a national housing strategy to drive change in housing policy at a national level. The underlying goal of such a strategy should be to ensure equity of housing outcomes for all, regardless of tenure.

The five guiding principles for such a strategy should be that housing for all Australians is:

1. Affordable.
2. Secure.
3. Accessible to labour markets, essential services and supports.

¹⁰Commonwealth Department of Family and Community Services, 2002.

¹¹ABS, 2003(2), Table 9.

4. Responsive to diverse needs.
5. Adaptable over the life course.

In order to achieve these principles, involvement of all housing sectors - Commonwealth, State, and local government, as well as the community and private sectors is needed. ACOSS recommends that key policies and action impacting on housing outcomes (from taxation through housing assistance to land use planning and regional development) be brought under the umbrella of a national housing policy framework.

At the Commonwealth level housing policy is currently located within the Family and Community Services portfolio, with a narrow focus on the RA program and funding for social housing programs. We recommend that housing policy be given a substantially higher priority and a broadened perspective within government if issues of housing affordability are to be seriously and comprehensively addressed.

Recommendations

R.1. A national housing strategy should be developed that involves all levels of government, non government organisations and the private sector to address key aspects of housing in Australian society. The Commonwealth should have responsibility for the development and national coordination of the strategy, against which the current housing system as a whole can be assessed. The Strategy should address deficiencies in both the supply of low cost housing and public subsidies for private and social tenants and consider both the broader environment, as well as specific housing related issues, as outlined in this submission.

R.2. A national advisory committee should be established to inform the implementation of the strategy, and develop housing affordability measures, including the setting of affordability benchmarks.

The next section discusses the drivers and implications of our overheated housing market and suggests some policy options to take the heat out of this market.

4. The current housing ‘bubble’ – origins and outcomes

The present property bubble, centred primarily on inner city apartments, has inflated home prices above levels justified by the normal operation of supply and demand. This has contributed to the housing affordability problems faced by first home buyers and to the longer term affordability ‘crisis’ for low income households and individuals in the rental market.

Like previous Australian property booms, it also poses serious risks for heavily geared investors, the economy, and jobs. It is partly this recognition that has driven the establishment of this Inquiry.

4.1 Boom and bust cycles

Just over a decade ago, construction came to an abrupt halt at a major building site in the centre of Sydney. The World Square site was to host the tallest office tower in Sydney, until a glut of inner city office space and a severe recession brought the project to a standstill. Now, the tallest apartment block in Sydney is rising on the same site.

The World Square project symbolises the property booms of the late 1980s and early 2000s. In the 1980s, the lead sector was inner city offices (and to a lesser extent owner occupied housing). Now it is inner city and coastal resort apartments.

These two property booms share in common the key features of asset bubbles. In both cases, asset prices have grown at a pace well in excess of underlying demand as investors have gambled on ongoing price increases and capital gains. Both property booms were fuelled by dramatic increases in borrowing (see Figures below).

In the late 1980s, it was the business sector that ramped up its debt levels - to a large extent to finance speculation in assets (mainly corporate takeovers and inner city offices). This time, Australian households are catching up with, or overtaking, the high household debt levels of countries such as the UK, USA and the Netherlands.

Although investment in owner occupied housing has also risen substantially over the past few years, the main driver of the rise in household borrowing is investment in rental housing. Over the past five years, borrowing for investment housing (including apartments) rose by an average of 21% per year, while borrowing for owner occupied housing rose by 13% per year.¹² Most of this growth occurred after 2001, following a 12 month pause in the housing boom after the GST was introduced in July 2000.

Overall, around 6% of all household disposable income is devoted to servicing housing debt, a higher level than during the housing boom of the late 1980s. This suggests that housing debt accounts for around 20% of the disposable income of those households that carry such debt.¹³

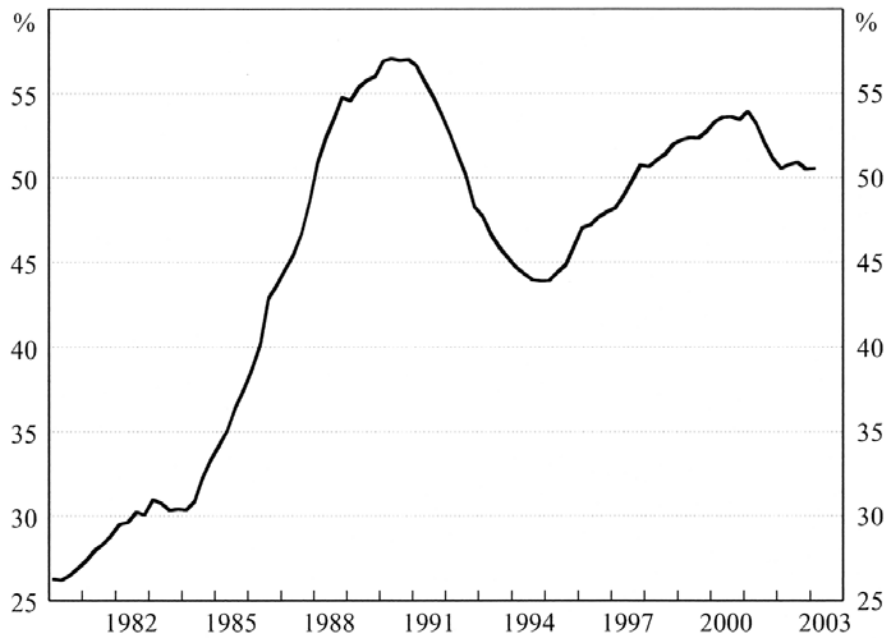
The figures below compare shifts in borrowing and investment patterns in the 1980s and 1990s.

¹²RBA, 2003.

¹³McFarlane I, 2003.

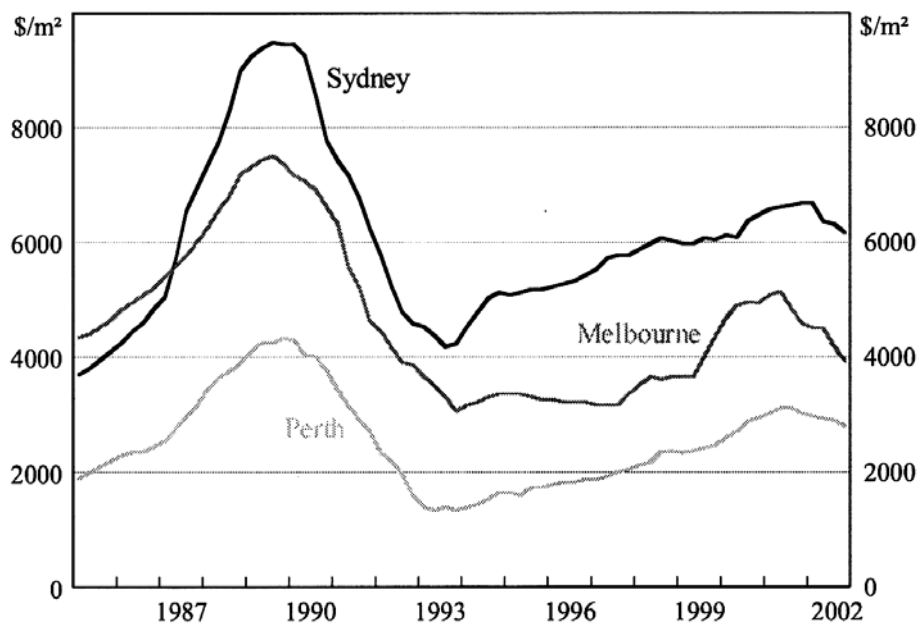
The property and borrowing boom of the 1980s

Figure 1. Business credit as a % of GDP, 1982-2003



Source: Simon, 2003.

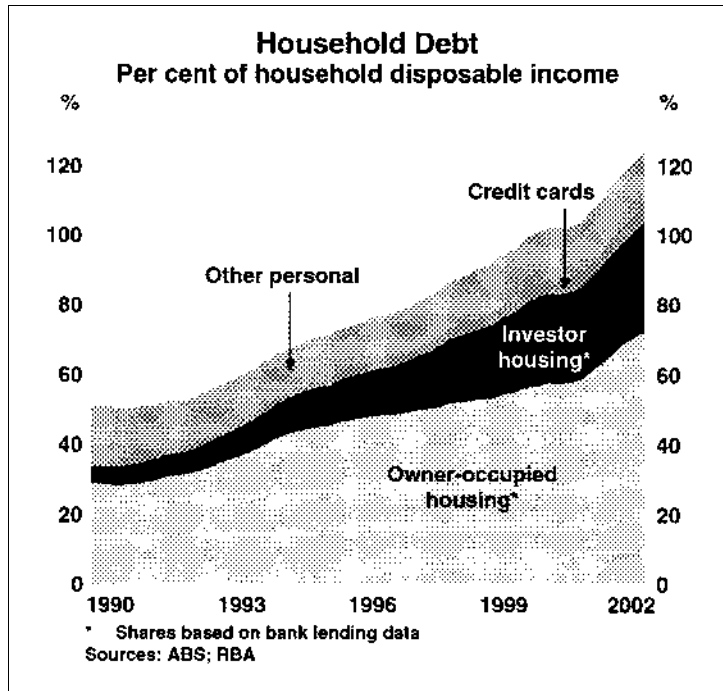
Figure 2. Value of prime office space



Source: Simon, 2003.

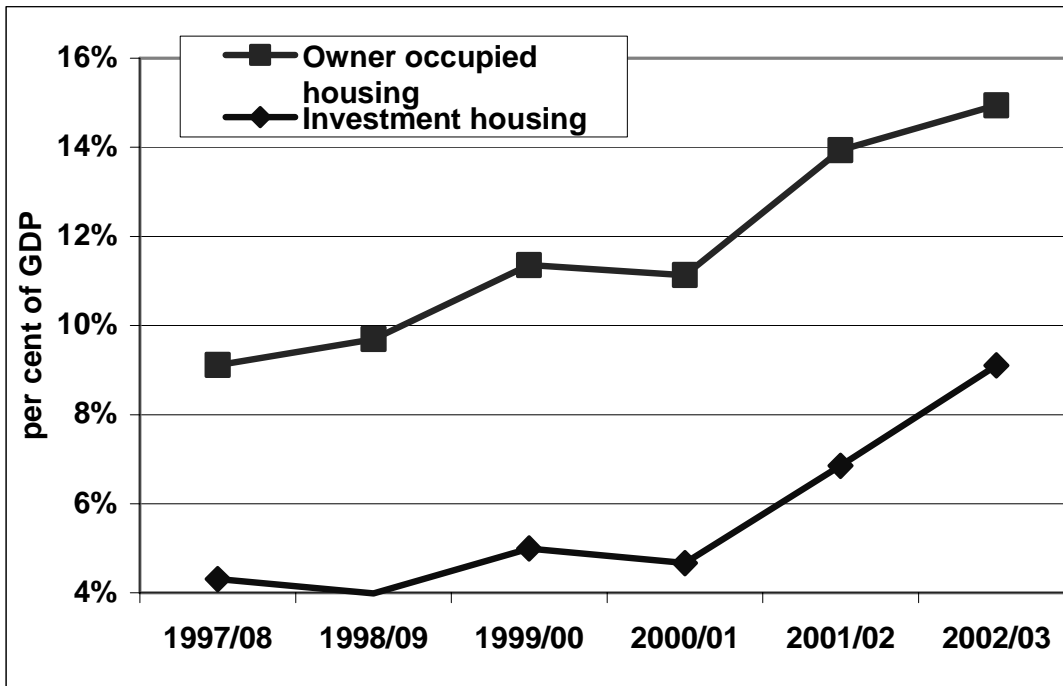
The property and borrowing boom of the 2000s

Figure 3.



Source: *Household debt, what the data show*, RBA 2003.

Figure 4. Lending commitments for housing (per cent of GDP)



Source: RBA Bulletins.

In both the late 1980s and early 2000s, the drivers of the property boom were a prolonged period of strong economic growth, a decline in the share market (which diverted investment into property), a fall in interest rates, an easing of credit, and distortions in the tax system.

One view holds that this rapid growth in home prices and household debt is no bad thing, because both the wealth of the owners and the supply of housing have increased.

If the present rental property boom were fuelled simply by growth in household income and demand for the housing on offer, there may be less cause for concern. However, much of the increase in rental housing investment over the past two years appears to have been due to speculation against future increases in asset prices, rather than an accurate forecasting of demand. There is a glut of relatively high cost inner city apartments in Melbourne and Sydney. At the very least, this means that substantial resources have been wasted on assets that will not be used for many years (inner city apartments), while, a growing number of aspiring first home buyers will be (at least temporarily) locked out of the market.¹⁴

Of further concern is the fact that speculative building booms are often followed by busts. In that event, prices are likely to fall. In the current low inflation environment, this would mean significant absolute reductions in house and apartment prices. Many highly geared investors and home buyers would come under severe financial stress. Some of the first home buyers forced to defer their purchase may then be able to enter the market, but this depends on what is happening in the wider economy at that time - especially to interest rates, employment and household incomes.

In sum, in a boom driven by speculation on asset prices rather than underlying demand for housing, the winners are those with access to finance who time their investment right (when prices were rising), and those who trade in property (e.g. real estate agents and financiers). The losers are those investors who enter the market too late, and home buyers who have to postpone or abandon their purchases.

A more general point is that when house prices boom, owners and investors only 'win' *once they realise their capital gains* (sell the property). Even then, this only really occurs when they trade down, usually at or after retirement. The reason for this is that if house and apartment prices rise sharply across the board, it will cost them more to trade up than would be the case in the absence of price rises.

Tenants are potential winners in the short term, because vacancy rates usually rise, and rents often fall, in those sectors where the overheating occurs. However, while there is evidence to suggest that this has happened in the upper echelons of the market, especially in inner city locations, there is little to suggest that low income earners have enjoyed lower rents. Rental housing investment has not 'boomed' at the lower end of the market.

In theory, the effects of lower rents and higher vacancies at the top end of the market may trickle down to the lower end, but there is an offsetting factor. Some of their fellow tenants are delaying their first home purchase, due to the higher prices. It is therefore

¹⁴In a building boom, there is also usually substantial wastage of labour, because builders are unable to plan their projects with the same efficiency as they can when the sector is growing at a more even pace.

likely that both low and middle income tenants would benefit from a more steady and consistent rate of growth in housing investment and asset prices.

In overall terms, speculative booms and busts in the housing market have an adverse effect on first home buyers and tenants, and the significant proportion of investors who gear excessively or get their timing wrong. These groups would generally be better off if house prices grew in a more even and predictable way.

4.2 Economic consequences of property booms

A more worrying effect of recent asset price booms here and overseas is the difficulties they pose for successful management of the wider economy.¹⁵ In most OECD countries, asset price inflation has supplanted wage inflation as the key direct risk to the longevity of economic 'booms'.¹⁶ The RBA is understandably reluctant to raise interest rates to deflate asset 'bubbles'. Interest rate increases are a blunt instrument to address a problem that is (at first) confined to one sector of the economy, and whose duration and outcome is hard to predict.

Property booms and busts can have a profound effect on the economy, and consequently, the exercise of macroeconomic policies. In the late 1980s, the office and housing boom was a one of a number of triggers for the hike in interest rates from 11% to a peak of 18% in the space of just two years.¹⁷ This led to the severe recession of the early 1990s, and loss of hundreds of thousands of jobs. The Deputy Governor of the RBA indicated recently that the property boom was a consideration in its decision to hold interest rates steady in the middle of this year in the face of (apparently) worsening international conditions.¹⁸

The RBA may be forced to raise interest rates over the next 12 months to bring property markets to heel.¹⁹ This would heighten the risk of a serious downturn or recession, once the 'bubble' bursts. That was one outcome of the 1980s boom.

However, interest rates are unlikely to rise as dramatically as they did in the 1980s, since the RBA is conscious that today's more highly geared households - both investors and home purchasers - are much more sensitive to even slight increases.²⁰ Even if interest rates are not substantially increased, a housing slump could force many highly geared home buyers and investors to curb their spending to allow their debt levels to unwind.²¹ The danger is that these households will reduce their spending at a time when economic

¹⁵In Australia, the Netherlands and the UK, the principal problem is housing prices. In the US, it was share prices.

¹⁶Asset bubbles were a topic of the RBAs annual conference this year. During the last asset bubble in the late 1980s, the Bank also paid close attention to asset price booms and the expansion of credit that fuelled them. See McFarlane, 1989 and 1990.

¹⁷Another consideration was the rise in Australia's current account deficit. However, many commentators now argue that raising interest rates resulted in an increase in the value of the dollar, undermining the competitiveness of Australian export industries.

¹⁸Stevens G, 2003. The decision to keep interest rates on hold may have been correct. However, we need to consider the effect of the bubble on monetary policy in the event that international economic conditions deteriorate.

¹⁹The bank is signalling its reluctance to do this. See Gruen D, 2003 and McFarlane I, 2003.

²⁰This increase in the average level of household gearing is the result of readier access to credit and higher property prices. See McFarlane I, 2003.

²¹If they decide to sell in a declining market many would still face outstanding debts without a stream of rental income to finance them.

growth is likely to be flagging. This would exaggerate the effect of the business cycle. The effect could be long lasting, as excessive household debt levels could take a number of years to unwind.²²

The property boom has reduced the RBAs room to manoeuvre in both directions. It has constrained the Bank from easing interest rates in case the boom gathers pace. It will also constrain it from raising them too quickly because this could trigger a sharp slump in economic growth.

4.3 Policy options to ease the boom and bust cycle in asset prices

Access to affordable housing (including first home ownership) would improve, and the risks to the wider economy would be eased, if housing bubbles could be averted, or at least prevented from growing for too long.

Given the risks involved in using higher interest rates to deflate a housing bubble, it is worth pursuing other policies to this end. Unfortunately, it is very difficult at this late stage in the bubble's development to deflate it without provoking a housing bust. Nevertheless, there are some policy options that could be pursued at this stage, and it is important to develop new strategies to prevent or ease future asset price bubbles.

The RBA has already begun to publicly warn of the dangers of speculative investments. Apart from this strategy two other broad economic policy options are:

- Removing or easing tax distortions that encourage over investment in property and excessive debt levels during booms.
- Improving prudential regulation.

We discuss each of these in turn.

4.4 Negative gearing and the taxation of capital gains

Negative gearing arrangements, together with the hasty decision to cut CGT rates on personal incomes by half from 2000, have added fuel to the present investment property boom. Negative gearing has also directly contributed to the burgeoning level of household debt.

The tax system is biased in favour of speculation in asset prices financed by debt. This happens in three ways.

First, capital gains are taxed at half the normal marginal tax rates in the hands of individual tax payers and trusts, and only when the property is sold. It is often argued that CGT discounts are necessary to 'encourage investment'. However, it does not

²²A major reason for the sluggish recovery from the 1991 recession was the need for the corporate sector to unwind its high debt levels. These may have been sustainable during the boom, but they were no longer so once demand for goods and services fell. This was a major factor behind the severe round of corporate 'down sizing' in the early 1990s. This time household debt is of greater concern.

encourage all forms of investment in a consistent way. Low rates of tax on capital gains bias investment decisions in favour of assets that rise in value, such as property, shares, and collectables. Income in the form of ordinary business profits, dividends or interest is generally taxed at the relevant marginal rate.

In 2000, the main tax concession for capital gains was changed from indexation of the cost base of an asset (a form of tax inflation adjustment) to a 50% discount on nominal capital gains. The arguments advanced in favour of this dramatic change were poorly developed.²³

One argument was that the change would encourage more efficient investment in assets because 'lazy' investments that yielded low returns over long timeframes would no longer be rewarded by indexation. On the other hand, investments that yielded returns well above the rate of inflation would be rewarded by more generous tax breaks.

Advocates of the change argued that, in theory at least, it would shift investment away from property and towards more risky investments such as information technology start ups. This was always doubtful. Overseas evidence suggests that CGT rates are unlikely to be a major determinant of the formation of venture capital for purposes such as IT start ups.²⁴

The subsequent decline in the share market, particularly in IT stocks, meant that this theory was not tested. However, the tax change is likely to have boosted, not reduced, speculative investment in real estate. There are two reasons for this:

- Many real estate investors are relatively unsophisticated. As such, they are likely to find a 50% discount in taxes on capital gains more attractive than the retention of indexation because it is simpler and appears on the face of it to be more generous.
- Most property speculators *expect* large capital gains in both the short and long term. That is their main motive for investing in property in the first place. Whether or not this expectation is realised, they are therefore likely to find a 50% discount on tax on capital gains more attractive than the previous indexation arrangements.

In regard to owner occupied housing, the exemption of the principal residence from CGT has also inflated property values. This advantages existing home owners (especially those who intend to 'sell down') at the expense of first home buyers.

The second critical factor is negative gearing arrangements. Their importance in encouraging property 'booms' is clear from the very prominent place given to negative gearing over many years in the advertising of tax and property 'consultants'. Schemes to minimise tax in this way have been particularly targeted to residents of middle and high income suburbs.

The principal tax avoidance technique 'sold' through such schemes is the ability to deduct interest and other costs against wages. Negative gearing works as a tax avoidance technique because of its link with the concessional tax treatment of capital gains. If

²³Indeed, the issue of CGT was not even part of the original terms of reference of the Review. It was added to its remit well after the Review commenced, and its major discussion paper (containing no reference to CGT cuts) was published.

²⁴Poterba, 1989.

capital gains were taxed at the same rate, and at the same time, as other income, then allowing people to deduct investment expenses against other income would not be problematic.

However, a fundamental principle of sound tax policy is that deductions should be matched with a stream of income. Many of the worst threats to the integrity of the tax system come from schemes that exploit a mismatch between expenses and income.²⁵

Investors in assets that generally appreciate in value (property, shares and collectables), who receive most of their investment income in the form of capital gains, can deduct their investment expenses (especially interest expense) from the moment they purchase the asset, at their marginal rate of income tax. However, if the income from these investments mainly takes the form of capital gains, it will not be taxed until the asset is sold and even then at 50% of the relevant marginal tax rate.

This mismatch between the tax treatment of expenses and income greatly exaggerates the tax bias in favour of investment in property, shares and collectables. It also encourages these investors to finance their investment with higher levels of debt.

In regard to investment property, negative gearing has encouraged the practice of purchasing a series of properties rather than just one. The advantage of this strategy from a tax standpoint is that net returns from the investor's property portfolio are consistently negative. This means that the investor continues to use their investment 'losses' to reduce their tax. Although the portfolio is probably not really making a loss at all (due to capital gains), the capital gains are not taxed until the properties are sold, which could be many years later.

Easing these tax distortions would lower the rate of growth in debt-financed investment in property and shares during economic booms. Over the longer term, it should also ease asset price inflation and the resulting 'crowding out' of first home buyers.

This implies a lower overall level of rental property investment, which may have adverse implications for tenants. However, this is unlikely to significantly affect low income tenants because the investment encouraged by these tax distortions is generally towards the top end of the market, where the anticipated capital gains are greater. As argued above, such investment is generally of little benefit to tenants at the bottom end of the rental housing market.²⁶

Any adverse effects on the supply of affordable rental housing for people on low incomes would be more than offset if a significant part of the revenue savings (currently approximately \$2 billion per year) were devoted to a tax credit for new investment in low cost rental housing, as proposed later in this submission.

Easing these tax distortions should also moderate asset price inflation and property speculation during economic booms, reducing the risk that asset bubbles will form in the first place. It should also discourage excessive and inefficient borrowing, and have a positive long term impact on housing affordability.

²⁵McIntyre M, 1991.

²⁶Wood, Flatau and Watson, 2002. Moreover, removing these tax distortions should improve the *efficiency* of rental housing investment. E.g. there should be less vacant inner city apartments.

One option is to tax capital gains in the same way as other income. There is no sound reason to tax capital gains at a lower rate than other income, and removing the 50% discount is feasible.²⁷ The main problem with this option is that this would mean taxing gains as they accrue. In the case of investments in property, this would create cash flow problems for many investors, unless they could find a way to convert part of their accrued capital gains into cash income.

Since it is the *combination* of CGT concessions and negative gearing that does the damage, a second more feasible option, at least over the medium term is to curb negative gearing. Deductions should be matched more closely to income by only allowing passive investors in property, shares and collectables to deduct losses associated with these investments against the income derived from them. If these assets do not yield a positive return until they are sold, then the losses could only be deducted against the capital gains realised on their sale. Losses could be quarantined against income from each investment, or from all of the tax payer's investments of this kind.²⁸ In effect, negative gearing would be abolished for these classes of 'passive'²⁹ investments.

This tax change should only apply to new investments, and the refinancing of existing investments. Otherwise, it would create cash flow problems for existing investors and the impact on the market may be too sudden. This does not necessarily mean that the policy would take many years to 'bite'. Most negatively geared investments achieve positive returns within about five years. It would be important to ensure that existing investors cannot continue to take advantage of negative gearing arrangements by refinancing, either to purchase another property or to increase their interest expense.

The standard criticism raised against the abolition of negative gearing is that when this was tried in 1985 it led directly to a collapse of rental property investment and an increase in rents.

The only published academic research that examined this episode was by Babcock and Browett.³⁰ Contrary to the claims of the real estate industry, this found that:

- The downturn was confined to two capital city rental housing markets - Sydney and Perth.
- The main causes of the decline in rental housing investment in these markets were the increase in interest rates and the share market boom of the mid 1980s.
- The reintroduction of negative gearing in late 1987 coincided with the reversal of these trends. The share market crashed and interest rates fell.
- These factors, in turn, contributed to the subsequent property boom.

We do not argue that the removal of negative gearing would not have any adverse effects on rental housing or other property markets. However, in the 1980s episode, it was not the *major* factor responsible for the decline in investment in the Sydney and Perth rental property markets.

²⁷Indeed, under the present tax arrangements, companies do not enjoy this concession.

²⁸The latter treatment is more generous, especially to large investors.

²⁹This term is used to describe investments that are not part of the direct conduct of a business.

³⁰Babcock and Browett, 1993.

The introduction of a tax credit for new investment in low cost rental housing, as advocated below, would help ease any adverse effects of the proposed tax change on rental housing markets.

The *timing and scope* of such a change is critical. When the previous government abolished negative gearing for rental property in 1985, it discriminated against one class of investment assets (rental property). It also introduced the change a few years too early.

Ideally, negative gearing should be abolished in the 'mid point' of the business cycle, at a time when asset markets are beginning to heat up. This has two advantages:

- Any adverse effects would be swamped by the business cycle.
- The tax change should take some of the heat out of asset markets when the business cycle reaches its peak.

The ideal time in this cycle to abolish negative gearing would have been in conjunction with the business tax reform package. If this had been done a year after the introduction of the GST, it would have had virtually no adverse impact on asset markets and the present housing cycle would have been significantly smaller. Another advantage would have been to link the removal of this tax shelter with income tax reductions, thereby reducing political resistance to this measure.

Now that this opportunity has been missed, the timing may not be right to abolish negative gearing. Property markets appear to have (almost) reached their peak. If it is desired to use tax changes to take some of the heat out of an asset price bubble, then it may be feasible to suspend negative gearing arrangements for 12 months for new investments, signalling in advance that it will be restored afterwards. This would be complex to put into effect, but less dangerous than using higher interest rates to achieve the same end.

However, negative gearing should, in the medium term, be abolished for shares, property and collectables.

Recommendation

R.3. In order to ease growth in property prices and associated household debt, negative gearing arrangements for new passive investors in property, shares or collectables should be suspended for 12 months and reassessed in the longer term.

4.5 Prudential regulation

Another strategy that could help stem the present rental property bubble is tighter prudential supervision of lending through a range of agencies.

Two areas of risk should be closely examined.

First, it appears that some investors have been able to entirely avoid the payment of deposits on their investment loans. Of particular concern are fraudulent price quotations (where the lender is misled about the actual price of an asset) and the use of deposit bonds, to avoid the need for investors in rental property to lodge a deposit. These

strategies enable 'property pushers' to coax low and middle income earners into risky investments. Another concern is the failure of financial institutions to undertake their own property valuations.

Second, important parts of the market are unregulated. The major weakness at the present time is inadequate regulation of real estate investment 'consultants' who combine the functions of estate agent, investment consultant, and often, financier.

This creates major conflicts of interest, putting many less sophisticated investors at risk. No government agency has yet taken primary responsibility for this sector, despite its enormous growth in recent years. Consultants are free to make exaggerated claims to lure investors into seminars and into investment products in which they have a financial interest, and to avoid proper disclosure of those interests.

Urgent action should be taken to address these flaws in the regulatory system. Recent interventions of the Australian Competition and Consumer Commission (ACCC) and Australian Prudential Regulation Authority (APRA) against property 'consultants' are welcome, but legislation is probably required to give a single government agency the lead role in regulating this sector.

In the extreme circumstance that an asset price bubble that poses a serious threat to economic stability (as was the case in the property bubble of the late 1980s) there is a case for fine tuning prudential rules to curb excessive borrowing and speculative investment.

In particular, tighter restrictions of the use of debt to finance investments in a targeted asset market could be considered.³¹ This is contrary to the general trend towards rationing credit on the basis of price (interest rates) rather than quantity or sector. However, as argued above, raising interest rates across the board to stem an asset price bubble carries serious risks.

Recommendation

R.4. A single government body should take primary responsibility for regulating the property investment consultancy sector. This should be legislated if necessary. This regulatory body should conduct an urgent investigation into the scope of this sector, its marketing techniques and claims, and the extent to which its practitioners breach prudential requirements. The body should prepare and widely disseminate information in plain English on the risks faced by investors who borrow to invest in property and shares. A national publicity campaign should be launched to publicise this material.

This section has focused on the role the current housing bubble has played in decreasing housing affordability and the need to avoid boom and bust cycles in the property market. The next section looks at housing affordability for low income households in particular and what is needed both in demand and supply terms to improve housing outcomes for these groups over the longer term.

³¹E.g. when the US share market bubble was inflating, some US market economists advised the government to tighten debt to asset ratios for borrowing to finance the purchase of shares.

5. Improving housing affordability

Improving housing affordability across all tenures, especially for low income Australians, requires both supply and demand side responses.

Households in the lowest 40% of the income bracket face steep barriers to home ownership, especially saving a deposit. Adequate provision of low cost rental stock is critical to the needs of this group. Government policies can help lower these barriers to some extent. However, there are limits to the effectiveness of such policies. Realistically they can only assist a minority of low income earners without either a very high cost to government or high risk of default, or both.

By 1996, three out of every four low income households renting in the private market in our capital cities - more than 227,000 households - were living in housing stress.³² For these people, high levels of housing stress severely hampers their ability to find and maintain work, to adequately support their families, to save, or to eventually purchase a home of their own.

Housing is an essential part of the social safety net. As such it has important links to wider social and economic policy objectives. Housing Ministers have, as recently as this year, affirmed their commitment to creating a sustainable housing system that will support community development and the renewal of public housing estates as well as broader social outcomes in health, education and labour market reform.

Problems of affordability and shortage of low cost housing will be further exacerbated if policies continue to focus demand side solutions alone. A key priority for the long term is to shift the pattern of residential development away from major metropolitan centres. If this is not done, the cost of housing for people living in our major cities must rise, or their quality of life and environmental standards fall. Increasing housing subsidies for home buyers and tenants in major cities will not resolve these problems.

ACOSS is particularly concerned to ensure that supply side issues are adequately addressed. This includes expanding the provision of social housing and options to encourage private sector investment in the supply of low cost rental housing.

Recommendation

R.5. A government subsidy stream to support the viability of, and investment in, social and affordable private rental housing should be introduced. The Commonwealth should establish an 'Affordable Housing Innovations Fund' with matching contributions from the States and Territories, to test the most efficient and effective models to deliver affordable and sustainable housing.

³²AHURI, 2001.

5.1 Increasing the supply of low cost rental housing

ACOSS, the Affordable Housing National Research Consortium, the Housing Industry Association and National Shelter and others have developed a range of proposals designed to deliver growth in investment in low cost rental housing.

The strategies include achieving an effective mix of public and private investment (with sufficient incentives to maximise this investment) and a wide range of housing investment options. These include:

- Ongoing and increased public investment in rental housing for the most vulnerable households.
- Redirection of current private rental investment into low cost rental housing through changes to existing tax expenditures on such investment.³³ In particular, part of the revenue from the abolition of negative gearing, and all of the revenue from the abolition of depreciation allowances for rental housing could be redirected toward a new tax credit specifically for investment in low cost rental housing.
- Encouragement of investment from the capital markets through a housing bond. A cost effective option would be a Commonwealth bond, distributed to social housing providers through either a special purpose intermediary or through the community housing sections of State housing authorities.³⁴ The Commonwealth would also be in the best fiscal position to increase government borrowing in this way, particularly since current models suggest that the cost to government will be minimal.
- Exploration of mortgage lending to not for profit managers of rental housing. This is the market with the largest potential to fund significant long term additions to housing stock. Any large scale mortgage lending to social landlords should underpinned by the establishment of an effective regulatory framework including assurance of financial viability, performance management, and quality improvement.
- Redirection of some development profits (derived from betterment taxes) through development bonuses and inclusionary zoning, to investment in the supply of low cost rental housing.

An appropriate legislative and regulatory environment is also needed to both enable the development of a range of low cost housing options such as those suggested above and to regulate the use of government subsidies in private investment and partnerships. As discussed in the previous section immediate action could be taken to improve incentives for investment in low cost rental housing.

Recommendation

R.6. Investment in low cost rental housing should be strengthened in areas of greatest need by replacing the current depreciation allowance for rental housing with a tax credit (the credit would meet 4% of construction costs).

³³See Wood, Flatau and Watson, 2002.

³⁴AHURI and the Allen Consulting Group, 2001.

5.2 Strengthening social housing

Public and community housing has provided secure and affordable housing for many low income Australians since the 1950s. Not only is it a cost effective way to meet government housing objectives, but it 'provides secure, non discriminatory access and other benefits which are denied to many low income and disadvantaged people in the private rental market'.³⁵

In 2001-02 an estimated 383,000 households lived in public rental or community housing provided under the CSHA, with a further 223,290 waiting to be allocated housing.³⁶ Many of these people have applied for social housing as a result of housing stress in the private rental market.

Over the past decade there has been a substantial shift in the provision of housing support away from the supply of low cost social housing towards 'in the pocket' financial assistance through income support supplements (e.g. RA). In the 10 years to 2003-04, Commonwealth spending on the RA program increased by 7% in real terms to \$1.92 billion while base grant funding to the CSHA decreased by 54% to \$1.28 billion.³⁷

Originally designed to accommodate working families, over the last 20 years public housing has become increasingly rationed to the most disadvantaged only. Being on a low income is no longer the main criteria for public or community housing eligibility. Most new tenants are in receipt of Centrelink payments, and increasingly this form of housing is targeted at the elderly and people with a disability. This has led to a reduction in income for State housing authorities, higher levels of social and economic exclusion of tenants, increased management costs and an increased need for estate reconfiguration.

Public housing is carrying significant unfunded maintenance and redevelopment liabilities, and the system faces a severe cash flow crisis. As a result virtually no new stock has been added nationally over the past 10 years (in fact stock has declined from 6.2% of total housing stock in 1994 to 4.7% in 2001³⁸). In 2001-02, only 37,000 households were newly allocated public housing.³⁹

The public housing system was not designed to cope with large numbers of tenants with high and complex needs. The combination of increasing numbers of low income people with high and complex needs located in areas of high social and economic disadvantage is a recipe for social dysfunction and entrenched intergenerational disadvantage.

Investment in social housing is widely considered to be a cost effective measure over the longer term. This view was supported by the Industry Commission in its 1993 inquiry into public housing.

Levels of publicly provided housing in Australia are currently well below international benchmarks. It is imperative that urgent action is taken to increase the supply of appropriate social housing. The Affordable Housing National Research Consortium has

³⁵Industry Commission, 1993.

³⁶Australian Institute of Health and Welfare, 2003.

³⁷ACOSS and National Shelter, 2003.

³⁸ABS, 1996 and 2001.

³⁹Australian Institute of Health and Welfare, 2003.

recommended the development of social housing stock through public, community and private partnerships, based on transparency and accountability for performance in housing management, community sustainability, tenant participation, asset value and financial viability.

Recommendations

R.7. Governments should progressively increase the level of social housing, through both the CSHA and by facilitating an effective mix of public and private investment options to allow for:

(i) the upgrade and renewal of housing stock, including maintenance;

(ii) increased supply of new stock.

R.8. The operational viability of State housing authorities should be addressed by strategies to improve the gap between income streams and operational effectiveness. This could include reform of public housing financing structures; achieving a wider tenant profile; attracting new finance for more housing; a separate, additional subsidy; and extending RA to public housing tenants.

R.9. Introduce measures to ease the excessive targeting of social housing.

R.10. Governments should develop a range of government and non government housing management models to provide the capacity for flexible responses to diverse local circumstances, and to drive innovation.

5.3 Rent assistance

The private rental sector can provide many individuals and families with advantages not found in social housing or home purchase. For instance, people can move to be closer to employment; can modify their housing choice due to changes in family composition; and downsize or upgrade as income levels change.

For people on income support, the RA program provides financial assistance to improve the affordability of private rental accommodation. The supplement currently assists around 1 million Australians, and unlike social housing there is no waiting list.

However, the disadvantages of the private rental market, particularly for low income people, are that:

- current rates of RA do not enable affordability in appropriate locations (that is, where jobs and services are more plentiful);
- even if RA was increased, or the threshold for the maximum rate paid increased, a significant shortage of affordable rental housing for low income people would remain;
- RA is not generally available to students over 25 years in receipt of Austudy payment or people on low wages. It therefore has limited impact on the housing affordability issues faced by mature age students and many low income workers;

- discrimination based on factors such as: level of income; race; and marriage status; blocks many people from accessing rental accommodation. Landlords and real estates agents' reliance on tenant databases and 'black lists' exacerbates this problem.

The government maintains RA thresholds and maximum rates have been adjusted in line with changes in the cost of living. However, with the current maximum rate for a single person with no children set at \$94.40 per fortnight this does not reflect the reality of today's private rental market. With home owners seeking returns for their rental investments, rents have escalated beyond the means of most low income households.

Recent ACOSS and National Shelter research⁴⁰, using various data sources, shows RA is limited in its capacity to provide housing affordability because of rising rents coupled with the inadequate supply of low cost private rental. Further, RA fails to make housing affordable to a very high proportion of income support recipients, particularly in Sydney and Melbourne, under any affordability measure used. Almost 85,000 RA recipients spend more than 50% of their income on rent. This is well above international benchmarks of affordability, generally considered to be below at least 30% of income.

Currently payment levels and rent thresholds are uniformly applied across Australia. Given these findings, there is a case for consideration of regional variations in RA payments to take into account significant regional variations in rents across Australia. The research shows renters receiving RA are likely to be found in lower rent areas overall, but that these are also areas of lower employment opportunities.

Recommendations

R.11. In the short term steps should be taken to ameliorate the unaffordability of private rental accommodation and to fix anomalies in the RA program by:

- (i) raising the maximum RA payable by at least \$10 per fortnight; and*
- (ii) extending access to RA to students over 25 years on Austudy payment and to families with dependent young people on Youth Allowance.*

R.12. In the longer term, the efficacy of the RA program in delivering housing affordability to low income Australians should be reviewed. Such a review should examine regional variations in rent and the option of introducing a 'zoning system'; the effectiveness of the program to assist people to 'move to where the jobs are'; and the setting and monitoring of targets and standards in relation to affordability, quality, and security of tenure.

R.13. All levels of government need to work together to guarantee adequate legislative protection for private rental tenants, and to develop core principles for good private rental market management which include the regulation of 'bad tenant' databases.

5.4 Encouraging home ownership

Home ownership remains an important pathway to wealth creation and stability for many low income people. It is legitimate that governments should look at ways to

⁴⁰ACOSS and National Shelter, 2003.

smooth the pathway to home ownership, amid the raft of other housing policies to improve affordability.

However, while some States and Territories provide targeted schemes to assist with home purchase these vary in their scope and accessibility, and are generally confined to one off deposit assistance or mortgage relief to low to moderate income households. Negative past experiences with more generous schemes have made many State and Territory governments wary of large scale involvement.

At the Commonwealth level the main form of assistance has been the FHOG. Some of the problems inherent in the untargeted nature of this scheme, and the subsequent limited benefits for low income households were discussed earlier.

Rethinking these and many other options to enable home ownership should be on the table including: stamp duty concessions for low income earners; shared equity proposals such as those proposed by the Prime Minister's Home Ownership Taskforce; and measures to increase opportunities for savings by low income earners.

One option to assist middle income earners to save for a home deposit is to allow early access to superannuation, within strict limits, for long term saving purposes other than retirement.

ACOSS opposes policies that would allow people to withdraw part of their superannuation savings for a home deposit *and not for other purposes*. This would discriminate against the majority of low income earners, who have a limited capacity to secure a home deposit even if they could draw down part of their superannuation. A further problem with such proposals is that they would increase the existing tax bias in favour of investment in housing.

However, there is a strong case for broadening the purpose of superannuation to meet long term saving needs other than retirement, *including housing*⁴¹:

1. The Superannuation Guarantee forces low and middle income earners to devote too much of their current income to retirement. Together with the current Age Pension, it will finance a retirement living standard for many low and middle income earners that is well in excess of their average living standard throughout working life.⁴²
2. A long term saving vehicle is required to assist people to meet other needs over the life course, including home purchase, child rearing, and further education and training in mid life. This would help underpin our system of compulsory saving, and encourage a 'savings culture' among sections of the community who would otherwise be unlikely to save for the long term. Ideally, this should be integrated with the superannuation system, to keep it simple for consumers and to restrict the overall level of tax concessions for saving enjoyed by high income earners.⁴³

⁴¹See ACOSS, 2002.

⁴²See Tinnion and Rothman, 1999 and King A, 2002.

⁴³Tax concessions for saving should be directed mainly to low and middle income earners. Overseas countries experience with separate tax effective long term saving vehicles, such as the UK and US, is that high income earners are the main beneficiaries of the associated tax concessions by claiming concessions for both superannuation and other savings

ACOSS has developed a proposal to broaden the superannuation system into a lifelong saving scheme that also meets other long term saving needs. Its key features include:

- an entitlement to draw down a fixed proportion of accrued superannuation savings (for e.g. up to one third), up to a global pre retirement limit of around \$50,000 for any purpose, after saving for at least five years;
- a more rapid increase in the preservation age for retirement savings to 60 years (and ultimately to 65 years);
- restrictions on large lump sum retirement benefits, for e.g. a prohibition on lump sum benefits above the present tax free threshold (approximately \$110,000);
- subject to the above entitlement to withdraw savings for other purposes, an increase in the proportion of earnings required to be saved through superannuation, say from 9% to 12%;
- reform of tax concessions, to replace the existing flat 15% tax on employer contributions, and other tax concessions for contributions, with a rebate that provides more benefit per dollar saved by low income earners than for high income earners;
- subject to the above change to tax concessions for contributions, withdrawals from superannuation accounts within the above 'caps' for pre and post retirement benefits to be tax free.

A number of these key features are designed to minimise any adverse effects on retirement incomes arising from early access to superannuation for other purposes. Indeed, the proposed system would be more economically and politically sustainable than the present Superannuation Guarantee because it would not force people to save excessively for a single purpose.

Housing would be one of many purposes for which people could withdraw part of their superannuation savings before retirement. Economic modelling suggests that this would particularly benefit middle income earners who would be capable of sustaining a home loan if they are helped to save for a deposit.⁴⁴

Under the ACOSS lifelong savings scheme, a typical middle income earner in their thirties could withdraw \$10,000 to \$20,000 for a home deposit, provided they have made no previous withdrawals. This would 'use up' around 20% to 40% of their overall entitlement to withdraw superannuation savings prior to retirement.

Modelling also indicates that allowing early access to by low income earners superannuation (within modest limits) would have little impact on their future

purposes. High income earners have little need for financial incentives to save, so these subsidies involve large deadweight costs.

⁴⁴Real Estate Institute of Australia, 1996.

retirement incomes.⁴⁵ This would involve some additional cost to government, but in the scheme proposed by ACOSS this would mainly benefit those who need the most help - low income earners.

Recommendation

R.14. A life long savings scheme should be introduced that broadens the existing superannuation system to allow people to withdraw part of their superannuation savings, within strict limits and only after those savings have accrued for at least five years, for any purpose including home purchase.

5.4.1 Stamp duty

In contrast to the FHOG, where uniform legislation has been passed, eligibility to stamp duty concessions and/or rebates vary between the States and Territories. It can be argued that tax treatment in regards to stamp duty is largely dependent on which State or Territory a home purchaser lives in, rather than their income or level of disadvantage.

In NSW, for e.g., the FHOG provides exemptions or concessions on stamp duty (and mortgage duty) for first home buyers or people purchasing land upon which they will build their first home. Eligible first home buyers in the Sydney metropolitan area do not pay duty on homes costing up to \$200,000 or on vacant land values up to \$95,000. Exemption limits of \$175,000 for houses and \$80,000 for vacant land apply in the remainder of NSW. Thereafter a sliding scale of concessions applies up to a limit of \$300,000 for homes in metropolitan Sydney (\$140,000 for vacant land) and up to \$250,000 (\$110,000 for vacant land) in other parts of NSW.

These stamp duty concessions for first home buyers are based on the property value, rather than the income of the home purchaser. No income or assets test is applied to stamp duty concessions in NSW, Queensland, Northern Territory and South Australia. Western Australia has a rebate scheme for first home buyers that is not subject to means testing.

This contrasts with some other States and Territories where stamp duty concessions are targeted at particular forms of households. In the ACT and in Victoria, concessions are available to first home owners with at least one dependent child, which means that single people with housing affordability problems do not enjoy the same treatment as those with children.

⁴⁵The reason for this is that higher Age Pension payments would automatically 'compensate' for much of any reduction in superannuation benefits, due to the operation of the pension income test. See The Treasury, 1997.

6. Sustainable communities

6.1 Regional development

Much of the recent discussion about the affordability and accessibility of home ownership has focused on the capital cities, and in particular on Sydney and Melbourne. Logic suggests that one way to ease the pressure on overheated metropolitan markets would be through shifting housing demand to other parts of Australia. This could be of particular benefit to those centres where population has been declining.

Housing plays a key role in regional development. Currently, a lack of suitable housing is contributing to regional disadvantage.⁴⁶ For many regional communities, housing is currently part of the problem, rather than fulfilling its potential to be part of the solution. Integrating housing and economic regeneration strategies has much appeal in these circumstances.

Given this, regional development policies need to take as their starting point a recognition of the economic and social interdependencies of housing, employment, transport, social participation, community infrastructure and regional identity.

The traditional approach to regional development has been one of attracting and growing business opportunities, including emerging markets in tourism and education. Whilst an active economic development strategy might provide the building blocks of regional development, in that it provides much needed jobs and potential economic growth, the sustainability of any economic development will be also influenced by other social and economic factors including housing availability and affordability, transport and the provision of community infrastructure including education and training. Thus, a community and social strategy is needed to complement the economic strategy.

These strategies need to be well coordinated across the three tiers of government and would require a new focus on job creation, community infrastructure (including transport) and the supply of affordable housing across all tenures.

There are also significant regulatory and taxation barriers to private sector investment in infrastructure in regional areas. It is imperative these be removed in order to encourage nation building projects that will benefit both current and future generations. As part of this the option of establishing an 'economic zones' approach to tax rebates to replace the existing zone rebate system could be explored.

In the absence of this holistic approach to regional development, we may see some temporary shifts in demographic patterns as urban dwellers are forced to leave the cities to seek out more affordable housing. This pattern would be either unsustainable, or merely add to housing pressures in the regions. Without sustainable employment, adequate social infrastructure and a full range of housing opportunities (including social housing) the potential of regional development to alleviate the housing affordability crisis will be minimal.

⁴⁶AHURI, 2003.

Recommendation

R.15. The Commonwealth government should develop a new national Regional Development Fund to increase its overall level of annual investment in physical infrastructure (housing, rail, roads, public transport, water infrastructure, telecommunications, gas and electricity). Through the Fund, and jointly with the States and Territories and local government, the government should invest differentially in regions according to their need. This should also be subject to a 'state of the regions' indicator, with the first priorities being areas of relative need.

6.2 Land use planning

Although planning is a State, Territory and local government responsibility, the Commonwealth government is a key stakeholder in affordable housing. If we are to secure affordable housing solutions for the increasing number of Australians living in housing stress we need to complement existing government strategies.

A coordinated approach to planning and development across all three levels of government needs to be part of the debate about affordable housing. We need to develop a series of workable planning and development obligations that will promote social cohesion and economic stability through the provision of affordable housing without fear of a backlash from developers.

Affordable housing and planning benchmarks could help to create certainty for developers and reduce the likelihood of ad hoc approaches to developer contributions and planning gains.

Recommendation

R.16. Structures that support integrated planning and provide a sound research and evidence base, such as the indicative planning council, should be rejuvenated.

R.17. Commonwealth, State and local governments, in consultation with key stakeholders, should develop a set of affordable housing benchmarks to be included in State and Territory and locally based planning mechanisms.

6.3 Land and betterment taxes

The major tax operated by State and Territory governments is land tax. Rates vary across the jurisdictions and contribute to State and Territory revenue. Generally speaking, land taxes are fair and efficient taxes. They take account of the benefits to property owners of public investment in community facilities and services and encourage efficient use of land.

However, a major weakness of most State and Territory land taxes is that all land used for owner occupied housing is exempt, including land in expensive areas. Some State and Territory governments have addressed this deficiency by imposing land tax on the most valuable properties.

While our networks are not aware of any specific research into the impact of land taxes on investment in low cost rental housing, significant work is needed to determine the

capacity of land tax reform to promote affordability. Any reform of land taxes should satisfy an affordability benchmark – that is, that tax reform would have to promote affordable housing in a very significant way.

One possibility is the introduction of land tax concessions for investors in affordable housing. In particular, we suggest modelling how many units of affordable housing would be generated through such an exemption. Robust mechanisms for locking in investment to ensure provision over the long term would be an integral part of any potential reform in this area.

Research should also be undertaken to investigate the value of shifting the State and Territory taxes away from home purchase entry costs (e.g. stamp duty) towards taxes that can be spread over the life of a mortgage, such as a progressive land tax on all properties.

Betterment taxes are levied in recognition of the situations where rezoning permits the private property owner to reap a capital gain. There are a number of arguments to support the introduction of betterment taxes directed at increasing the supply of low cost housing:

- They have the potential to forge a meaningful nexus between taxation, development, affordable housing and community infrastructure without jeopardising economic development.
- Communities should obtain some benefit as a result of the rezoning. Currently land owners and developers generally enjoy all the wealth generated through rezoning.
- Costs imposed on the local community as a consequence of development could be taken into account.
- Part of the revenues raised could be directed to affordable housing and related infrastructure.

Given the substantial profits enjoyed by some land owners and developers, particularly in inner city areas where large former industrial sites are being converted into housing developments, a well designed betterment tax would have limited impact on beneficial property investment. Further, exemptions could be provided to developments that are genuine regeneration projects in economically stagnant areas, for e.g. in some regional areas. In designing any betterment tax, care must be taken to limit potential negative flow on effects such as house price inflation.

Recommendation

R.18. Governments should review land tax and stamp duty, and consider the introduction of betterment taxes to improve the equity of State and Territory property taxes and to encourage efficient investment in affordable housing.

7. The way forward

The problems Australians now face in accessing appropriate and affordable housing through a range of tenures are generally acknowledged. However, only fundamentally new approaches will allow us to respond to the impacts of the changing housing landscape in Australia.

ACOSS considers that a whole of government approach is required to develop policies and strategies to ensure a continuing supply of low cost housing, linked to the various services and supports required by individuals and families. In this regard, we call on the Commonwealth to take a leadership role by implementing the range of recommendations proposed in this submission.

The changes suggested in this submission will not immediately benefit those locked out of the home ownership market. However, policies to improve home ownership opportunities for those who want and can afford it, cannot be considered in isolation.

The gamut of demand and supply side issues, and the social and economic implications of different policy interventions, need to be considered as part of a policy whole. This must be steered through the Commonwealth government, be supported by appropriate structures, and drive dialogue and reform at the State, Territory and local government levels.

ACOSS affordable housing proposals

R.1. A national housing strategy should be developed that involves all levels of government, non government organisations and the private sector to address key aspects of housing in Australian society. The Commonwealth should have responsibility for the development and national coordination of the strategy, against which the current housing system as a whole can be assessed. Strategy should address deficiencies in both the supply of low cost housing and public subsidies for private and social tenants and consider both the broader environment, as well as specific housing related issues, as outlined in this submission.

R.2. A national advisory committee should be established to inform the implementation of the strategy, and develop housing affordability measures, including the setting of affordability benchmarks.

R.3. In order to ease growth in property prices and associated household debt, negative gearing arrangements for new 'passive' investors in property, shares or collectables should be suspended for 12 months and reassessed in the longer term.

R.4. A single government body should take primary responsibility for regulating the property investment consultancy sector. This should be legislated if necessary. This regulatory body should conduct an urgent investigation into the scope of this sector, its marketing techniques and claims, and the extent to which its practitioners breach prudential requirements. The body should prepare and widely disseminate information in plain English on the risks faced by investors who borrow to invest in property and shares. A national publicity campaign should be launched to publicise this material.

R.5. A government subsidy stream to support the viability of, and investment in, social and affordable private rental housing should be introduced. The Commonwealth should establish an 'Affordable Housing Innovations Fund' with matching contributions from the States and Territories, to test the most efficient and effective models to deliver affordable and sustainable housing.

R.6. Investment in low cost rental housing should be strengthened in areas of greatest need by replacing the current depreciation allowance for rental housing with a tax credit (the credit would meet 4% of construction costs).

R.7. Governments should progressively increase the level of social housing, through both the CSHA and by facilitating an effective mix of public and private investment options to allow for:

- (i) the upgrade and renewal of housing stock, including maintenance;
- (ii) increased supply of new stock.

R.8. The operational viability of State housing authorities should be addressed by strategies to improve the gap between income streams and operational effectiveness. This could include reform of public housing financing structures; achieving a wider tenant profile; attracting new finance for more housing; a separate, additional subsidy; and extending RA to public housing tenants.

R.9. Introduce measures to ease the excessive targeting of social housing.

R.10. Governments should develop a range of government and non government housing management models to provide the capacity for flexible responses to diverse local circumstances, and to drive innovation.

R.11. In the short term steps should be taken to ameliorate the unaffordability of private rental accommodation and to fix anomalies in the RA program by:

- (i) raising the maximum RA payable by at least \$10 per fortnight; and
- (ii) extending access to RA to students over 25 years on Austudy payment and to families with dependent young people on Youth Allowance.

R.12. In the longer term, the efficacy of the RA program in delivering housing affordability to low income Australians should be reviewed. Such a review should examine regional variations in rent and the option of introducing a 'zoning system'; the effectiveness of the program to assist people to 'move to where the jobs are'; and the setting and monitoring of targets and standards in relation to affordability, quality, and security of tenure.

R.13. All levels of government should work together to guarantee adequate legislative protection for private rental tenants, and to develop core principles for good private rental market management which include the regulation of 'bad tenant' databases.

R.14. A life long savings scheme should be introduced that broadens the existing superannuation system to allow people to withdraw part of their superannuation savings, within strict limits and only after those savings have accrued for at least five years, for any purpose including home purchase.

R.15. The Commonwealth government should develop a new national Regional Development Fund to increase its overall level of annual investment in physical infrastructure (housing, rail, roads, public transport, water infrastructure, telecommunications, gas and electricity). Through the Fund, and jointly with the States and Territories and local government, the government should invest differentially in regions according to their need. This should also be subject to a 'state of the regions' indicator, with the first priorities being areas of relative need.

R.16. Structures that support integrated planning and provide a sound research and evidence base, such as the indicative planning council, should be rejuvenated.

R.17. Commonwealth, State and local governments, in consultation with key stakeholders, should develop a set of affordable housing benchmarks to be included in State and Territory and locally based planning mechanisms.

R.18. Governments should review land tax and stamp duty, and consider the introduction of betterment taxes to improve the equity of State and Territory property taxes and to encourage efficient investment in affordable housing.

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