



Planning
Institute
Australia

**Inquiry into Affordability of First Home
Ownership**

Submission to the Productivity Commission

From the Planning Institute of Australia

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Contents

| | | |
|-------------------|---|-----------|
| <u>1.</u> | <u>Introduction</u> | 2 |
| <u>2.</u> | <u>Planning Issues</u> | 3 |
| <u>2.1</u> | <u>Liveable Communities</u> | 3 |
| <u>2.2</u> | <u>Constraints on Urban Growth</u> | 4 |
| <u>2.3</u> | <u>Increasing Prices, but Increasing Value</u> | 7 |
| <u>2.4</u> | <u>Planning processes</u> | 8 |
| <u>3.</u> | <u>Drivers of Housing Price Rises</u> | 13 |
| <u>3.1</u> | <u>House Prices</u> | 13 |
| <u>3.2</u> | <u>Housing Finance</u> | 15 |
| <u>3.3</u> | <u>Is there a Bubble?</u> | 17 |
| <u>3.4</u> | <u>First Home Buyers</u> | 19 |
| <u>3.5</u> | <u>Possible Policy Responses</u> | 23 |
| <u>4.</u> | <u>Conclusions and Recommendations</u> | 25 |

1. Introduction

The Planning Institute of Australia (PIA) appreciates the opportunity to make this submission to the Productivity Commission inquiry. We also appreciate the Commission's invitation to attend a roundtable on the issues on 23 September, and the opportunity to meet with Commission members on 1 October.

This submission addresses several issues which have been raised before the Inquiry, especially relating to the influence of planning matters on housing prices. We also consider some implications of the recent "stop start" housing industry on our members, and recommend that the Commission consider some policy mechanisms to smooth the impact of extreme volatility in the housing market. Such volatility has been a major factor behind the trends in affordability for first home buyers – and also has much wider implications for the economy.

The central argument of this submission is that the boom in house prices (up 50% in the last three years) is largely due to a rapid expansion in lending for housing, especially for investment. Key contributing factors are:

- The long term drop in interest rates
- Changes to capital gains tax rules in 1999

A lesser role may have been played by the Federal Government's First Home Owner scheme.

The submission notes concerns expressed by developers about delays in the planning process. While it disputes that these are a major cause of cost increases, it argues that such delays are likely in a housing market boom such as seen recently.

The current boom is causing broader problems than just for first home buyer affordability – overload on the planning system, and potential impacts on the general economy when the bubble bursts are just two. As the primary driver of all these is the housing investment finance boom, the submission recommends that the Productivity Commission investigate policy mechanisms to smooth impacts.

2. Planning Issues

The Commission's Issues paper refers (p16-17) to a number of impacts that planning policy and practice can have on housing affordability. In subsequent discussions, two issues in particular have been raised by the development industry:

- The impact of planning policies constraining urban growth, such as around Sydney and in the new Melbourne 2030 policy.
- The impact of delays in planning approval, increasing costs for developers.

2.1 Liveable Communities

The Issues Paper raises a number of questions about the impacts of planning controls on housing affordability. The following section acknowledges that such controls can have some cost impact. However, it is important to discuss such cost impacts alongside the goals of the policy.

To draw an analogy – tough measures to limit drink driving may increase demand for taxis – and hence lead to increases in the value of taxi licences. A simple increase in value does not negate the social goals of the policy.

The Planning Institute of Australia has developed a National Policy¹ around the concept of liveable communities, believing that

“settlement and land use patterns can have a significant impact on a host of national aspirations for the environment, the economy and communities” (p1)

The Policy raises a number of Priority National issues

- a. Australia's ecological integrity
- b. Metropolitan/country issues
- c. Competitive Australian cities in a global economy
- d. Inequality and social exclusion
- e. Affordable housing
- f. Greenhouse
- g. Healthy cities and regions

Considerable debate exists on these issues – and the Institute is keen to encourage this debate. We also acknowledge that the Commission's terms of reference for this Inquiry are already broad – and a full treatment of these additional issues would require considerable extra scope!

¹ Planning Institute of Australia *PIA Policy – Liveable Communities: A National Agenda* October 2000

Nonetheless, the Institute believes it is important that any costs associated with planning policies are not treated in isolation, but are considered alongside the goals of those policies. The next two sections discuss this point with respect to urban growth boundaries and sustainability.

2.2 Constraints on Urban Growth

The Issues Paper asks whether government policies may be holding back the release of new “green-fields” land on the urban fringe, and hence driving up costs.

Constraints on urban growth into greenfields areas have received publicity in both Sydney and Melbourne.

Unusual scenes accompanied land sales in Camden, in Sydney’s south west, on 11 October²:

The sleeping rough, the nervous excitement and the camaraderie of strangers in a line they could easily be mad fans queuing for the best seats at a show. Only here the price of admission is about \$300,000 and for some the wait has been longer than a week.

For almost a fortnight they have been arriving, sleeping in cars or in hastily bought tents, braving all weathers for the chance to grab a piece of freshly released land at Harrington Park, near Camden. . .

Harpak's [the developer] managing director, said the company was slightly uncomfortable with the notion of queuing for land, but “as the demand has increased, we try to sell in the fairest way we can”. For those who do not have time to camp out, a ballot is held for the remaining blocks, in which names are drawn from a barrel. The company avoids auctions because they tend to attract investors rather than families.

In Melbourne, a few days earlier, *The Age* reported³ claims that the cost of undeveloped land in outer suburban Casey has increased from \$200,000 to \$400,000 a hectare since last October, when the Government announced an urban growth boundary in its Melbourne 2030 document.

However, the article cited a range of opinions on the extent to which the planning control is responsible:

- “the researchers acknowledge that the boundary is only one factor in rising land prices: Professor Birrell said the Government's desire to have a compact city, green wedges and affordable housing was "simply not attainable".”

² Sean Nicholls, Lisa Pryor and Matt Wade “They're lined up on the blocks in the great land rush sprint” *Sydney Morning Herald*, 11/10/2003, p21

³ James Button “Land costs soaring on city's fringe” *The Age*, 7/10/03, p1

- “according to Gerrard Ellis, general manager of real estate group Oliver Hume, the boundary was responsible for a 20 per cent rise in land prices across Melbourne, with the trend sharper in the south-east”
- “Geoff Underwood, executive director of the Urban Development Institute of Australia, said the land price rises were linked to some urgent buying by companies trying to get a foothold within the boundary.”
- Michael Buxton, associate professor of environment and planning at RMIT, said that far from being a scarcity, there was "a massive amount of land available for development in Melbourne, unlike in Sydney"
- " Planning Minister Mary Delahunty played down the significance of the boundary, saying that other factors, such as low interest rates, flexible lending policies and the first-home-buyers' grant, were central to rising house and land prices in the past five years. “These increases have occurred all around Australia, and no one else has an urban growth boundary," she said.

In general principle, the imposition of planning controls limiting the supply of land for development is likely to increase the cost of available land. This has been documented in some detail for the Green Belts in southern England. For example:

such [Green Belt] land commands, in the south-east of England, around £2,500 (\$4,100) an acre for farming but as much as £500,000 an acre when released for new housing around booming towns.⁴

But such land costs are only one part of the equation. The new Victorian State planning guideline *Melbourne 2030*, argues the case for

“an urban growth boundary to better manage outward expansion. This is a tool to facilitate the achievement of a more compact city. It promotes sustainable development by directing growth to areas best able to be supplied with appropriate infrastructure and services and by protecting other valuable land from urban development pressures.”⁵

Two broad policy areas give further justification for the policy:

Policy 2.3 - Manage the sequence of development in growth areas so that services are available from early in the life of new communities

Fragmented urban growth in the growth areas could lead to significant extra financial, environmental and social costs, if infrastructure agencies dealing with multiple development fronts are forced to invest in new capacity before the existing capacity is efficiently utilised. Proper sequencing of development will avoid these costs.

New land will be released in growth areas in a timely fashion to facilitate coordinated and cost-efficient provision of local and regional infrastructure, such

⁴ *The Economist* “Belt Loosening” 22 January 1998. See also references on the UK Government planning website:

http://www.odpm.gov.uk/stellent/groups/odpm_planning/documents/page/odpm_plan_607843.hcsp

⁵ see <http://www.dse.vic.gov.au/melbourne2030online/>

as roads, public transport, water supply, sewerage, drainage, local parks, schools and local health and recreational facilities.

Policy 2.4 - Protect the green wedges of metropolitan Melbourne from inappropriate development

The green wedges accommodate agricultural and recreational uses, as well as a variety of important functions that support Melbourne. These include major assets such as airports, sewage plants, quarries and waste disposal sites – uses that support urban activity but which cannot be located among normal urban development.

“The green wedges include areas that have strong environmental and landscape value for Victorians - many of which are of State, national or even international significance. They provide important resources for recreation and tourism.”

Similar arguments have been advanced for the planning controls around Sydney. In the words of one PIA member, commenting on this submission:

“To the extent that housing has been rendered more affordable in the past through profligate use of land, the community is and will continue to pay a heavy cost in terms of the externalities of 'urban sprawl', namely car dependence, higher per capita travel demand, loss of sensitive natural environments, dispersed labour markets etc. Put another way, sound economics and good public policy demand that developers and home buyers are fully confronted with the external costs of their locational decisions, including environmental detriment. Urban Growth Boundaries are one way of 'internalising' these externalities in house prices.

In looking at the role of such planning controls, the PIA recommends that the Commission consider two key points:

- As argued here, any influence on land costs needs to be considered both in its social policy perspective, and in terms of related costs, such as those for infrastructure; and
- As is argued in detail in section 3.1 below, the influence of growth constraints on overall price rises in the last 10 years seems to have been small:
 - between 1994 and 2000, price rises were primarily a feature of Melbourne and Sydney – and Sydney’s prices, despite tougher planning constraints, grew less than did Melbourne’s prices in these years;
 - In the 2000 to 2003 period, the major Australian cities had similar 50% increases in house prices – whatever their differing planning constraints.

2.3 Increasing Prices, but Increasing Value

Aside from the issue of planning constraints, there have been increases in land costs in new subdivisions across Australia in the last decade.

A key part of this has been increasing value in the house and land package. This has come through elements such as improvements in infrastructure provision – and in design improvements such as energy efficiency. Both improve the long term functioning (and hence value) of the houses, but this is reflected in increased initial costs.

Again, in the words of a PIA member's response:

“Finished lot prices (and housing prices for that matter) are now higher than they used to be in large part because the quality of the product has improved. We know, for example, that the average new house floor area is now significantly greater than what it was 2 decades ago, including within the first home buyers sub-market. The same applies to finished lot prices. Finished lots now come with not only fully constructed drainage and road infrastructure, but with highly embellished parklands, local maternal and child health centres and other community facilities, shopping centres (which are often developed ahead of threshold viable demand levels), sporting facilities and so on. These have not been forced onto communities by planners, they are now taken for granted as 'standard equipment' in growth areas by the people buying into them. Indeed, many developers voluntarily go beyond the infrastructure prescriptions of the local planning policy in order to gain a marketing edge. In the past, affordability was assisted by the fact that initial buyers gained a very rudimentary product (often without made streets) and the infrastructures were brought on at a later time and paid for through recurrent charging mechanisms (like rates). The old approach has some appeal from a policy point of view, but it is unlikely to be acceptable in the market place today.

“Closely related to this, not only has the starting quality of housing in the first home buyers market in growth areas improved greatly, but the way in which infrastructure is paid for has been substantially reformed over the past 20 to 30 years from a largely 'community pays' (taxpayer funded) to user pays basis. This has been effected through development contribution plans and the commercialisation, corporatisation and privatisation of infrastructure agencies, causing them to recover costs using market based pricing strategies, rather than relying on cross-subsidies. The upshot is that buyers are more and more being required to 'pay for what they get', and this establishes some healthy price signals about the relative merits of purchasing a home on the fringe versus a home in an urban consolidation situation.

“In short, the planning system and parallel policies on infrastructure funding having acted to more accurately align housing prices with the infrastructure and environmental costs of producing the housing in question.

Another PIA member concentrated on the interaction between affordability and sustainability:

“The issues of sustainability should be integral to affordability - ie dwellings should be not only affordable now, but also in ongoing terms. . . As we move into higher standards of four and five star energy ratings, water saving devices et al within the domestic environment, the problem of up front affordability will increase. It is imperative that not only the four walls and roof, but also that the expenses for insulation, energy, water, glazing and appliances in our homes, which can vastly improve affordability over time, can be incentivised by modifications to the first home owners scheme.

“Another angle to housing affordability can be seen in the health levels within our communities. Some of the worst problems in terms of health emerge from suburban design - the urban design guidelines of the 1990s such as the National Green Streets program. This was the 1990s solution to affordability - build small lots with no gardens for social activity on the fringe of cities, within estates which had narrowed streets, provided no paved walking areas, had no definable urban centres and cul de sacked the community. The net effect is no-through-ways - the car dominates this world. Walking and cycling diminish to invisibility. Human health and social capital are severely affected. Whatever solution we find for the 21st Century, we need to have sustainability as our measuring stick - social, economic and environmental. How else are we going to ensure livable communities?”

A concluding point further qualifies the impact of these measures on recent price increases. As the Issues paper notes (p18, Figure 4), the prices of established dwellings (including land value) have increased significantly more than the prices of new project homes (excluding land value). It is not just input costs that are driving the price rises. This point is returned to in section 3.1 below.

2.4 Planning processes

Another issue of concern expressed by developers to the Inquiry has been delays in planning processes. The Issues paper notes (p16) this in a query about planning processes.

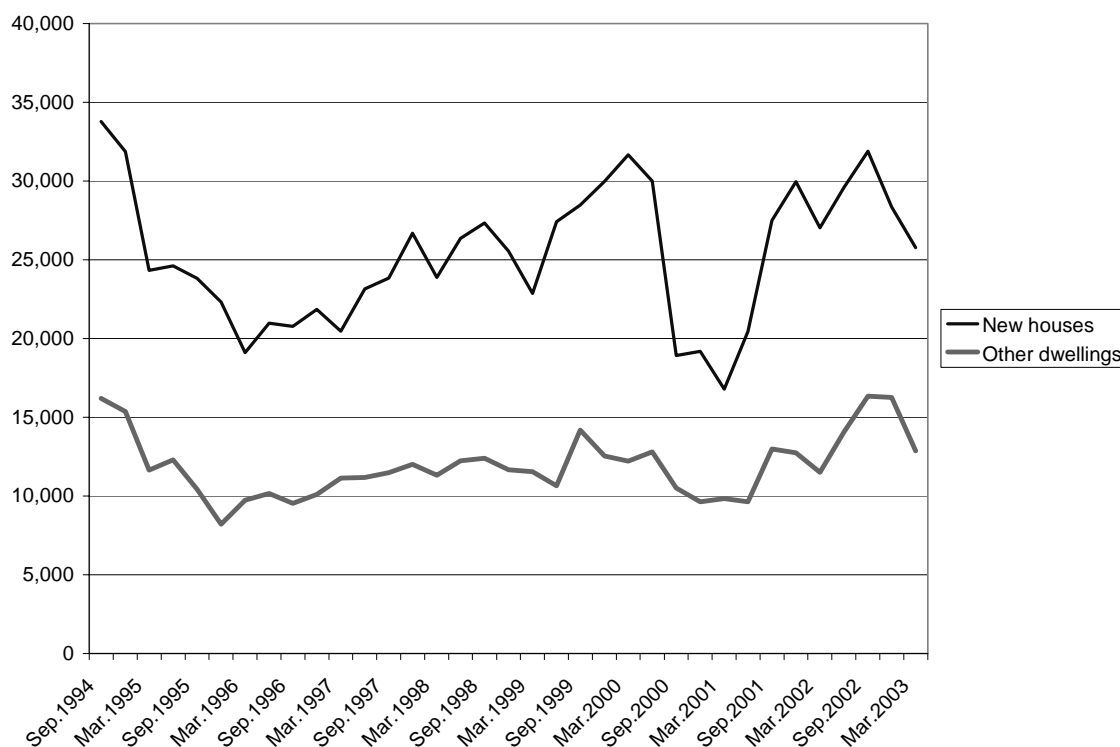
As the Issues paper notes, these controls

“are designed to protect a host of legitimate public and private interests by ensuring that certain conditions are met before a planning permit is granted by the local council.”

Complaints about planning delays seem to be cyclical. In the hothouse atmosphere of a housing boom, developers are keen to get product to market and ensure successful sales. However, such pressures in themselves create some problems for orderly processing of planning and development applications.

Graph 1 shows the “stop-start” nature of the housing industry, evidenced in quarterly new dwelling commencement figures for Australia.

Graph 1: New Dwelling Commencements, Australia, Quarterly



Source: ABS Building Activity, 8752.0

An indication of the impacts of this “stop-start” activity is given in performance indicators for planning and development services published by the Department of Local Government in New South Wales⁶. The Department published four key performance indicators in this area:

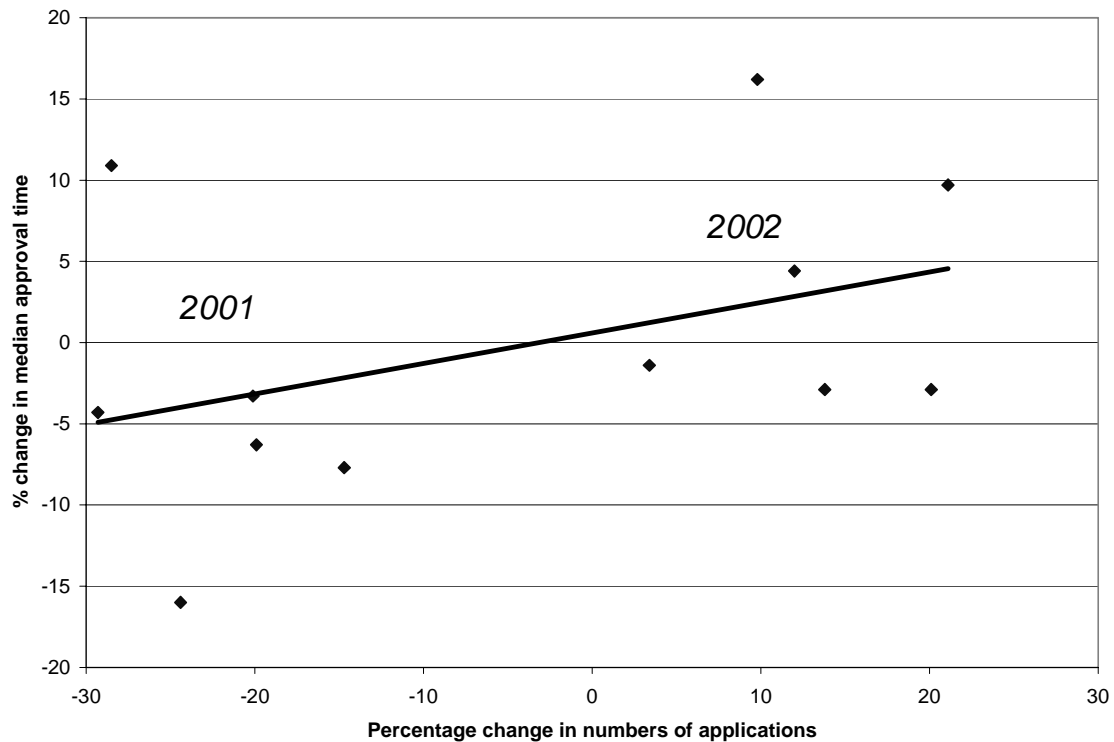
- Number of development applications determined
- Mean time in calendar days for determining development applications
- Median time in calendar days for determining development applications
- Legal expenses to total planning and development costs

⁶ data is available at

http://www.dlg.nsw.gov.au/dlg/dlghome/documents/comparatives/com0102_Planning.pdf

For the council groups seeing the most development activity⁷, Graph 2 compares the annual changes in 2000 to 2001 and in 2001 to 2002.

Graph 2: Changes in approval times and development approvals, NSW



Source: NSW Department of Local Government, Council Performance Indicators

Consistent with the national patterns shown in Graph 1, these groups of NSW councils saw marked declines (averaging -20%) in development approval numbers in 2000/01. With this decline, most groups reduced the median time taken to grant a development approval.

The following year, 2001/02, saw a strong upswing in building activity, with the numbers of development approvals climbing some 10 to 20%. Three council groups saw slight further declines in median approval time, but others took more time to handle the approvals.

Any system has trouble coping with alternate peaks and troughs. Were the industry to follow a smoother path over time, planning authorities can adjust to that medium term work load, and it is likely that delays will be less frequent.

⁷ The graph shows six data points for each year, for councils in inner and developed Sydney (groups 2 and 3), Sydney fringe (groups 6 and 7), major regional centers (group 5) and regional urban centers (group 4).

Other factors, beyond peaks and troughs which may be impacting planning authorities include:

- An apparent labour market shortage of qualified town and regional planners
- Complexity and layering of regulatory requirements (federal, state and local) which must be administered and complied with at the local planning level

Substantial anecdotal evidence exists that there is a shortage in the professional planning labour market. The drivers of this are unclear and may in part be associated with the current peak of activity. However, there appear to be more substantive underlying issues which have been exposed in work done by the South Australian and Victorian governments.

Sufficient concern about this issue has been expressed by the heads of planning agencies around the nation (known as the Planning Officials Group) for state agencies to have collectively funded the Planning Institute of Australia to undertake a national Inquiry into Planning Education and Employment. This Inquiry will draw together existing work undertaken by a range of bodies in each jurisdiction, a study to produce nationally comparable data. Submissions have been sought from universities, all levels of government, planning practitioners and industry stakeholders.

The results of this Inquiry will be available in draft form by mid-December with a final report being released in mid-February 2004. The terms of reference and a discussion paper have been released and are available on the PIA website www.planning.org.au.

Creative ways of dealing with this issue, both in educational terms – eg looking at technicians to assist qualified strategic planners – and more immediately ameliorating the shortage - eg widening the door for qualified planners wishing to migrate to Australia by increasing migration “points” for the profession - and other recommendations are likely to flow from this Inquiry.

Regulatory layering is the subject of one of the reviews currently being conducted in NSW as part of a wider examination of planning in that state initiated by Minister Knowles. The planning profession has considerable concern about the ever-increasing requirement for consultation with state and federal agencies or compliance with varied regulatory requirements before final development application approval. For instance, each state jurisdiction has legislation aimed at the protection of endangered species, local government often has requirements set out in its own regulatory framework, and Commonwealth environment law also imposes reporting and compliance in the case of endangered species.

There may well be a case for microeconomic reform of the regulatory frameworks impacting on local government planning.

There may also be a case for re-examining the positive impact of policy initiatives to improve planning processes. One example here was the LARP program which was funded by the Commonwealth and matched locally to encourage local government to

review and improve planning processes. Such issues are discussed at greater length in the submission to this Inquiry from the Australian Local Government Association, which refers to various initiatives under way by State Governments to encourage improvements to both planning controls and planning approval processes. We also refer the Commission to the work of the Development Assessment Forum, and in particular its recently released “Comparative Performance Measurement and Benchmarking of Planning and Development Assessment Systems”.⁸

As is demonstrated below, the recent boom in investor finance for housing has been a major contributing factor to the housing boom – both in prices and levels of activity.

⁸ See http://www.daf.gov.au/whats_new.htm

3. Drivers of Housing Price Rises

As the Commission notes in its Issues Paper:

“While the rise in housing prices has led to concerns about affordability, especially for first home buyers, the evidence on affordability is controversial” (p1)

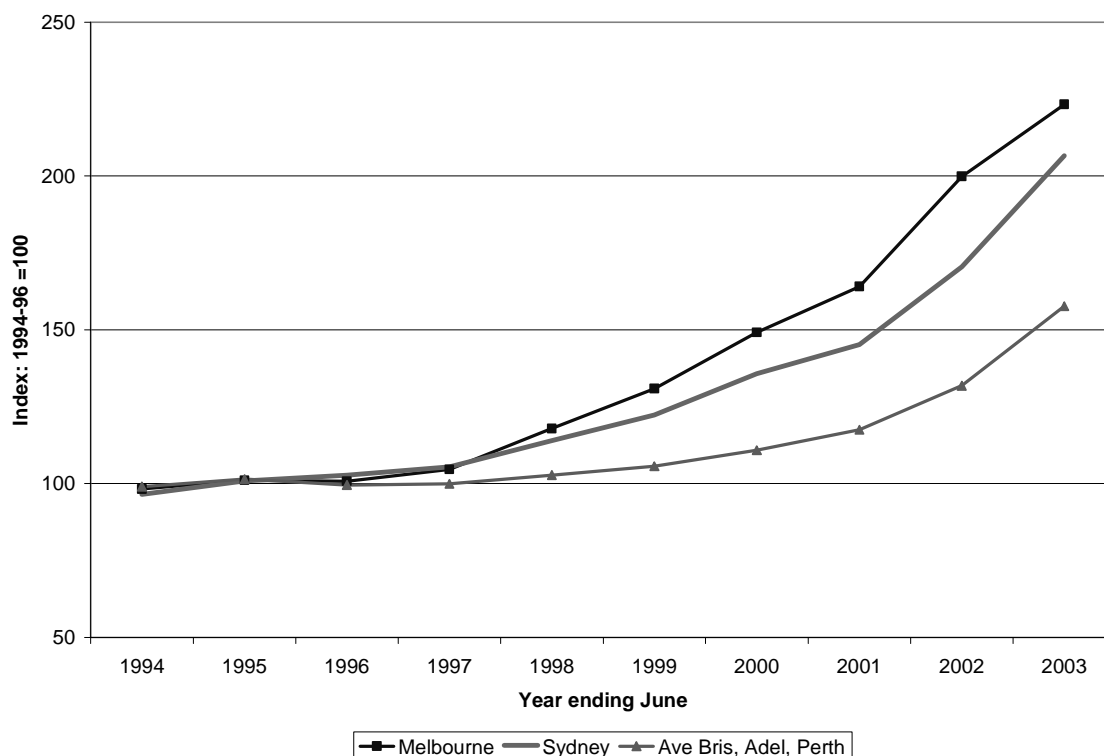
and

“The Commission will seek to identify the key influences on recent trends in housing prices and affordability, and assess the scope for government action to lead to better market outcomes.” (p2)

The previous section, in reviewing planning issues, has argued that they do not appear to have played a major role in recent house prices rises. This section discusses the trends in house prices to identify the key underlying factors.

3.1 House Prices

Graph 3:Price Indices, Established Houses, 1994-2003



Source: ABS House Price Indexes: Eight Capital Cities (catalogue 6416.0)

Graph 3 shows movements in the ABS Indexes for established house prices from 1993/94 to 2002/03 for Melbourne, Sydney, and the average for the next three major cities (Adelaide, Brisbane and Perth – whose prices have moved in similar ways over this period)⁹.

The graph shows two periods:

- From 1993/94 to 1999/2000, the story of Australian house price rises was essentially a story told in Melbourne (up 50%) and Sydney (up 35%). The other three major cities saw an increase of only 11% - similar to the rate of inflation.
- From 1999/2000 to 2002/03, the major cities have seen house price inflation of an amazingly consistent 50% (Perth was the only laggard, at 31%). It is worth noting that similar increases have also occurred in smaller centers – and, indeed, appear to have been outpaced in “Seachange” locations.

As the Commission’s Issues Paper notes, a range of explanations have been advanced for these price trends – and, indeed, it is probable that a number of factors contribute to the end result. Nonetheless, the key factors in these two periods appear to be:

- From 1993/94 to 1999/2000, as evidenced by strong employment growth, economic recovery from the severe recession of the early 1990s was concentrated in Melbourne and Sydney. This, together with falling interest rates and increases in housing finance (both documented below), pushed up housing prices in the two major cities;
- From 1999/2000 to 2002/03, the consistent increases across Australia indicate the major factor was a national phenomenon. The key elements here were the sustained low interest rates since the late 1990s, and the associated rapid growth in finance for housing.

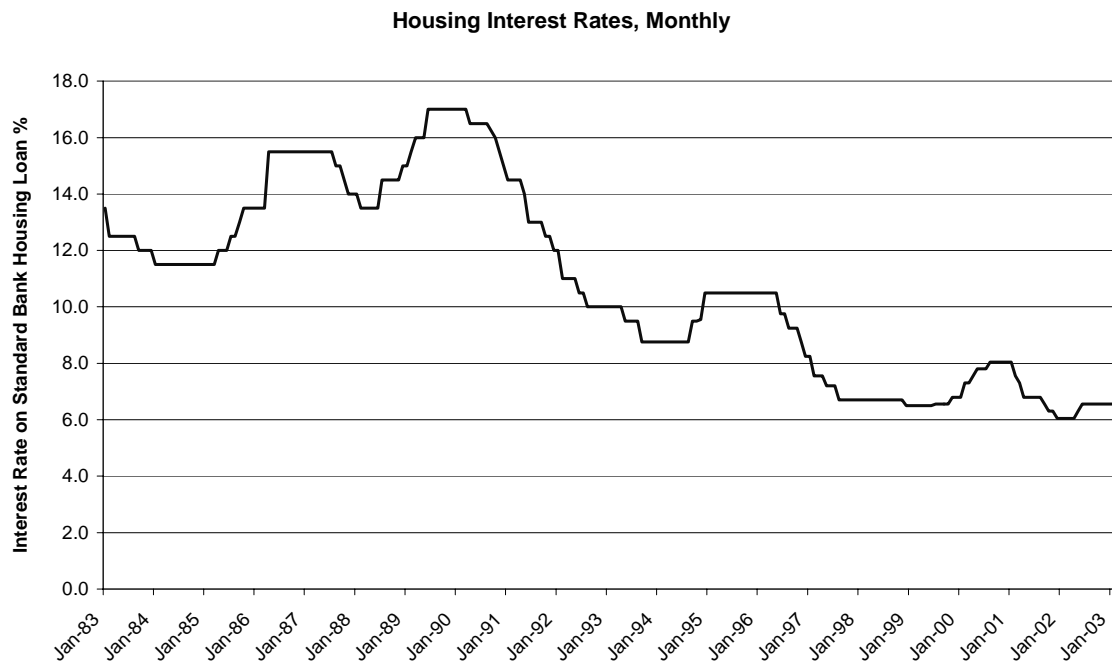
The following section discusses movements in interest rates, housing finance and prices.

⁹ The graph concentrates on the major five housing markets, for ease of presentation. The Commission’s Issues paper notes (p4) movements in all capital cities. While there is some volatility in price trends in the smaller capital cities, their movements are similar to the Adelaide Brisbane Perth series shown in Graph 3.

3.2 Housing Finance

Graph 4 shows the long term decline in interest rates during the 1990s.

Graph 4: Housing Interest Rates, Monthly



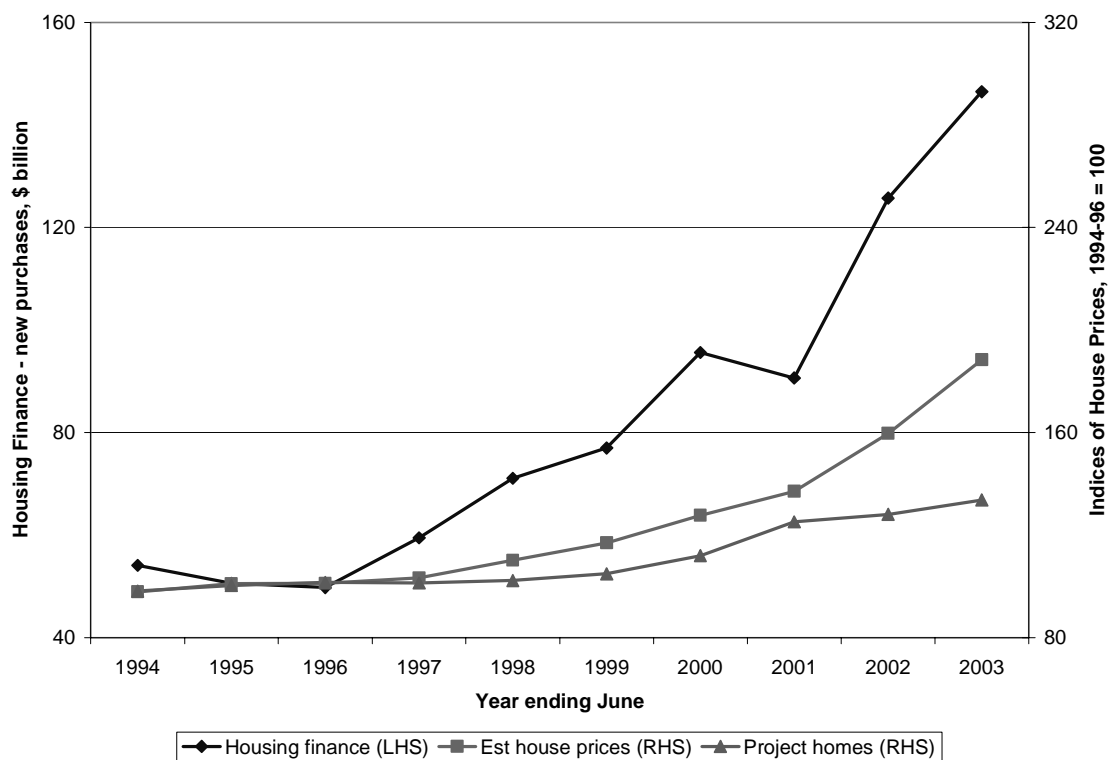
Source: Reserve Bank of Australia Standard Housing Loan Interest rate

As the Governor of the Reserve Bank of Australia argued in March this year, the main reason why the overall household debt to income ratio has risen strongly is

“interest rates have fallen: mortgage rates halved between the second half of the 1980s and the past five years. As a result, a household which borrowed up to the point where debt servicing equalled 30 per cent of gross income (a common yardstick used by banks and other mortgage lenders) would be able to nearly double the size of the mortgage and still make the same monthly repayments as before” (p2)

This increased borrowing capacity is reflected in Graph 5.

Graph 5: Housing Finance and House Prices



Sources: ABS Lending Finance (5671.0), House Price Indexes (6416.0)

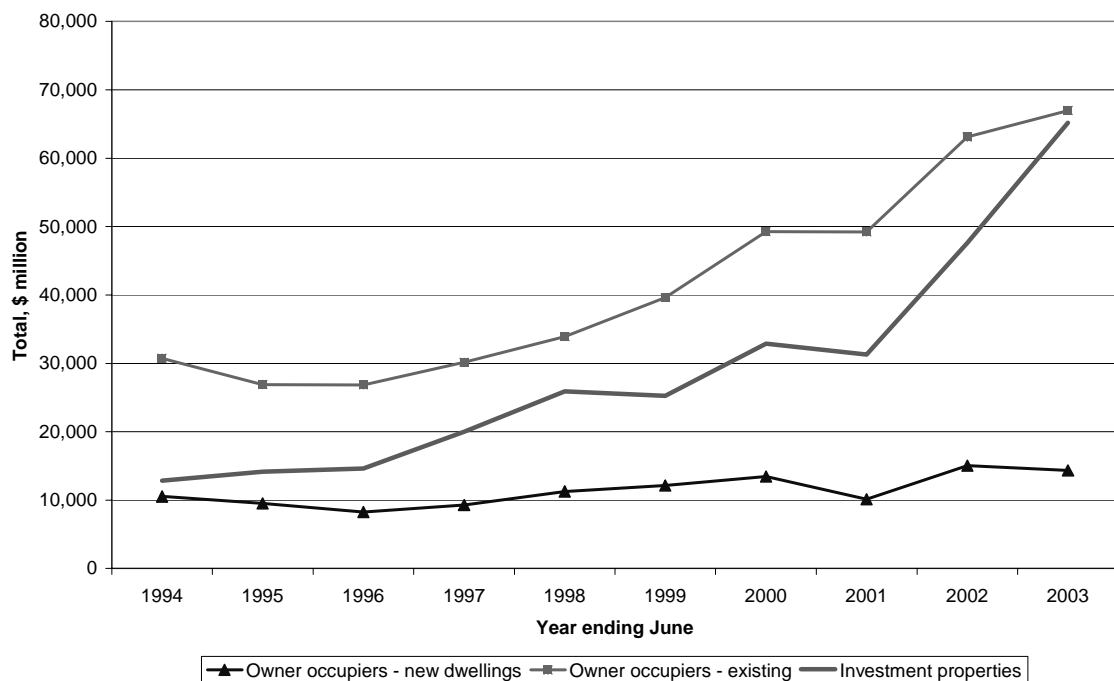
This graph compares the total finance available for house purchase with the trends in prices for existing houses and for project homes (new houses). This graph shows two key trends:

- The growth in housing finance¹⁰ (84% 1994 to 2000, then 53% 2000 to 2003) is substantially above the growth in established house prices, suggesting that finance availability is the key factor behind prices growth;
- The growth in new house prices (excluding land, 12% 1994 to 2000, then 19% 2000 to 2003) has been well behind the growth in established house prices (including land, 28% 1994 to 2000, 47% 2000 to 2003). This indicates that the critical influence is coming from the general housing market, rather than from the cost of new housing.

A further important element is shown in the following graph, looking at the components of finance for housing.

¹⁰ The housing finance totals used here exclude refinancing of existing loans, and finance for additions and alterations.

Graph 6: New Housing Finance



Source: ABS Housing Finance (5609.0)

Over these years:

- Finance for owner occupied new dwellings climbed from \$10.5 billion in 1994 to \$13.5 billion in 2000, and then grew only modestly to \$14.3 billion in 2003.
- Finance for owner occupied existing dwellings grew more strongly, from \$30.7 billion to \$49.3 billion and then to \$67 billion;
- Finance for investing in housing grew phenomenally – more than doubling from \$12.8 billion in 1994 to \$32.9 billion in 2000 and then doubling again to \$65.2 million in 2003. Investment finance's proportion of total new finance also grew strongly, from 24% in 1994 to 45% in 2003.

3.3 *Is there a Bubble?*

The house price rises of the past few years have encouraged considerable comment that these price levels are unsustainable, and a crash is just around the corner.

For owner occupied housing, Age columnist Alan Kohler recently disputed this contention¹¹. Using a similar argument to the reserve Bank Governor, Kohler cited a paper by Saul Eslake, ANZ Bank chief economist:

“The mortgage that a couple of average weekly earnings could afford, based on spending a steady 25 per cent of their gross income on loan repayments, has gone from \$136,000 in 1992 to \$297,000 this year. Over the same period, the median house price has gone from \$141,000 to \$315,000 – almost exactly the same increase. In other words, it’s not a bubble – yet.”

Kohler qualified this however for investment properties

“Investment growth is more complicated and possibly more worrying. An important force behind the boom of the past five years – if not the main force – has been the panic of baby boomers as they realize they don’t quite have enough retirement savings.”

Kohler’s (and Eslake’s) point about loan repayments is disputed however by *The Economist*. The Commission’s Issues Paper notes two articles in *The Economist* on the international housing price boom. The magazine returned to this issue recently¹²:

“A survey in *The Economist* in May predicted that house prices would fall by 10% in America over the next four years, and by 20-30% in Australia, Britain, Ireland, the Netherlands and Spain. Prices have since continued to rise, so have we changed our mind? On the contrary: if house prices become more overvalued, they are even more likely to fall.

“Many readers reject our gloomy warnings about a more widespread fall in house prices. They argue that lower interest rates make buying a home cheaper. This increases the demand for owner-occupation and so, it is argued, justifies higher prices. [However], interest rates are not that low in real, inflation-adjusted terms. Initial interest payments may seem low in relation to income, but because inflation is also low it will not erode the real burden of debt as swiftly as it used to. So in later years mortgage payments will absorb a bigger slice of a borrower's income than when inflation was higher.”

| | 2003, latest | mid-2002 |
|---------------|--------------|----------|
| Australia | 18.1 | 18.9 |
| Britain | 17.8 | 19.8 |
| Spain | 17.5 | 15.8 |
| Ireland | 14.7 | 5.2 |
| France | 10.3 | 8.0 |
| Belgium | 9.9* | 8.1 |
| Italy | 8.8 | 9.5 |
| Sweden | 7.6 | 5.3 |
| Canada | 5.8 | 5.3 |
| United States | 5.6 | 7.2 |
| Netherlands | 2.7 | 6.3 |
| Germany | -3.5* | 1.6 |
| Japan | -4.8 | -4.5 |

*2002 04

Sources: Bulwien; ESRI; Japan Real Estate Institute; Ministerio de Fomento; Nationwide Building Society; Nomisma; OFHEO; Stadim; government statistics

¹¹ Kohler, Alan “Baby boomers looking at retirement will keep property prices high” *The Age*, 30 September 2003, Business, p2

¹² “Hot property” *The Economist* 13 September 2003, p66

The initial Economist survey¹³, comparing the extent of housing ‘bubbles’ in different countries did not explicitly consider one important factor – the rate of economic growth. As Australia has grown considerably faster than most other OECD countries over the past decade, significant house price rises are to be expected.

If the commentators differ on the extent of a bubble in the owner occupied market, there is an emerging consensus about the investment market. In a March article, *The Economist*¹⁴ referred to:

“clear danger signals, notably the large number of people buying houses in the expectation of big capital gains. Those buying properties to let, rather than to live in, accounted for more than 40% of all new mortgages approved last year. In the big cities a glut of rental properties has caused an increase in vacancy rates; rents have started to fall. . . Australia's housing market could be as much a victim of irrational exuberance as America's stockmarket has been.”

The existence of this investment bubble has had profound effects on the market for first home buyers – and also has some important implications for possible policy responses.

3.4 First Home Buyers

The 2002 Australian Yearbook¹⁵ included a Feature Article – “Recent trends in construction and first home buyer finance”, which noted:

“The 38 months from January 1999 to February 2002 saw considerable movements in the trend series for construction of dwellings finance and the first home buyers component of housing finance commitments, with large swings in both series coinciding with changes in government policy concerning tax, First Home Buyers (FHBs) and dwelling construction activity.”

When the New Taxation System (TNTS) was introduced in July 2000, a new First Home Owners Grant (FHOG) of \$7,000 was payable to all first time buyers of a home, either new or existing. The grant was introduced to compensate for an anticipated increase in house building costs associated with the implementation of the GST.

The FHOG was foreshadowed many months in advance. As a consequence, many FHBs delayed demand for housing finance in the early months of 2000, before flooding back into the market in July 2000.

The introduction of the GST had wider effects on housing, with considerable building activity being brought forward to commence prior to July 2000. Building activity then slumped in the latter part of 2000. In response, the Federal Government on 9 March 2001 extended the FHOG to provide an additional \$7,000, but only for building or purchasing

¹³ Survey: “Castles in Hot Air” *The Economist* 29 May 2003

¹⁴ “Lucky Country” *The Economist* 6 March 2003

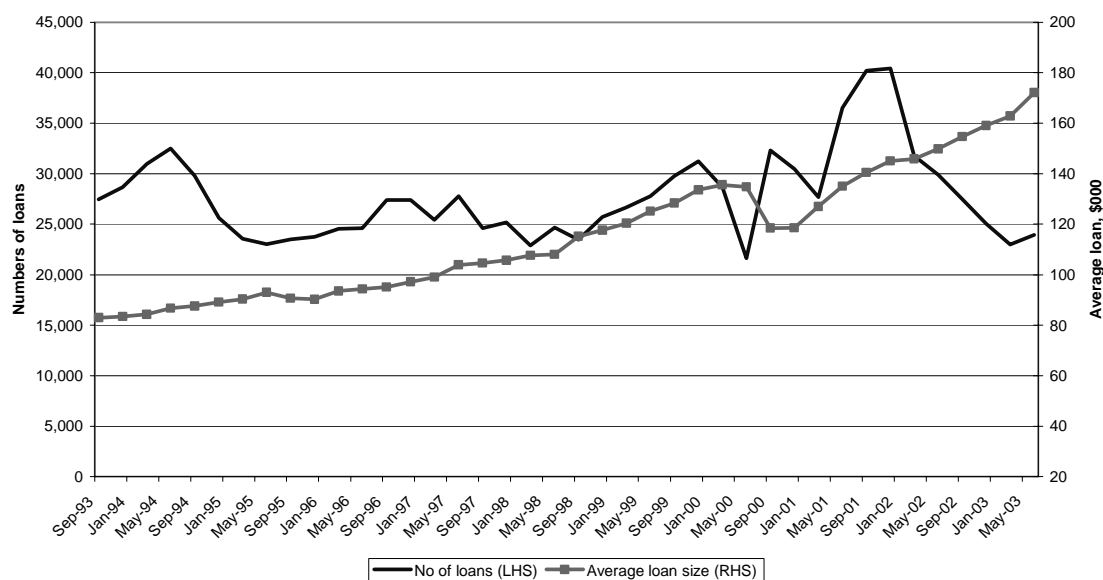
¹⁵ ABS *Yearbook Australia* (catalogue 1301.0) 2002

a new dwelling. This announcement was not foreshadowed, and the effects of the new grant occurred from May 2001.

On 1 January 2002, the FHOG was scaled back so that a lesser amount of \$3,000 was granted for new dwellings, in addition to the \$7,000 available to all FHBs. This also led to some activity being brought forward into late 2001, to attract the higher level of the grant. In February 2002 both the construction and first home buyer series saw sharp falls in activity.

These swings in policy, and responses from First Home Buyers, are indicated in the following graph, showing the numbers of new loans for first home buyers, and the average value of those loans.

Graph 7: Finance for First Home Buyers, Quarterly



Source: ABS Housing Finance (5609.0)

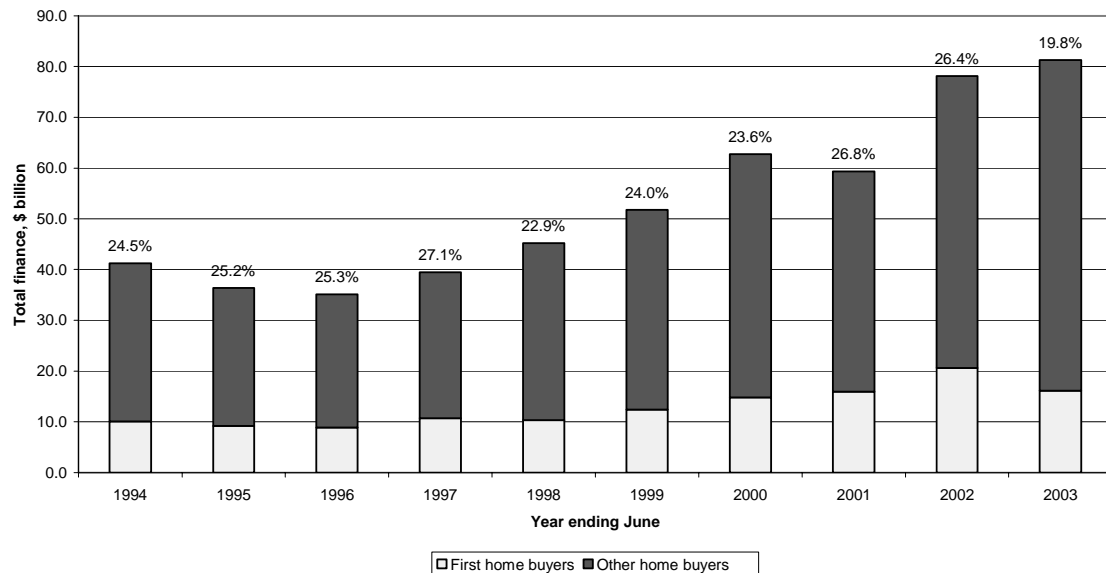
This graph shows a fairly steady, slightly rising, trend in new loans up to early 2000. As noted above, a fall in new applications occurred as people waited for the FHOG to be introduced, and there were subsequent swings up and down in the series around the dates of policy changes. The graph also shows that the average value of new loans fell immediately after the start of the Grant, but then resumed its upward trend.

There also appears to be a logical correlation between this data and the new dwellings commencement data show in graph 1 of this submission.

The 2002 *Yearbook* noted that loans for new housing fell at the start of 2002, with the scaling back of the Grant. This fall continued in subsequent months, reaching a low point in mid 2003 – and this was doubtlessly a factor in the rising concern about affordability for first home buyers that led to the Commission's inquiry.

This trend is also apparent in the next graph, which compares finance for housing purchases¹⁶ between first home buyers and other home buyers.

Graph 8: Home Finance: First and Other Home Buyers



Source: ABS Housing Finance (5609.0)

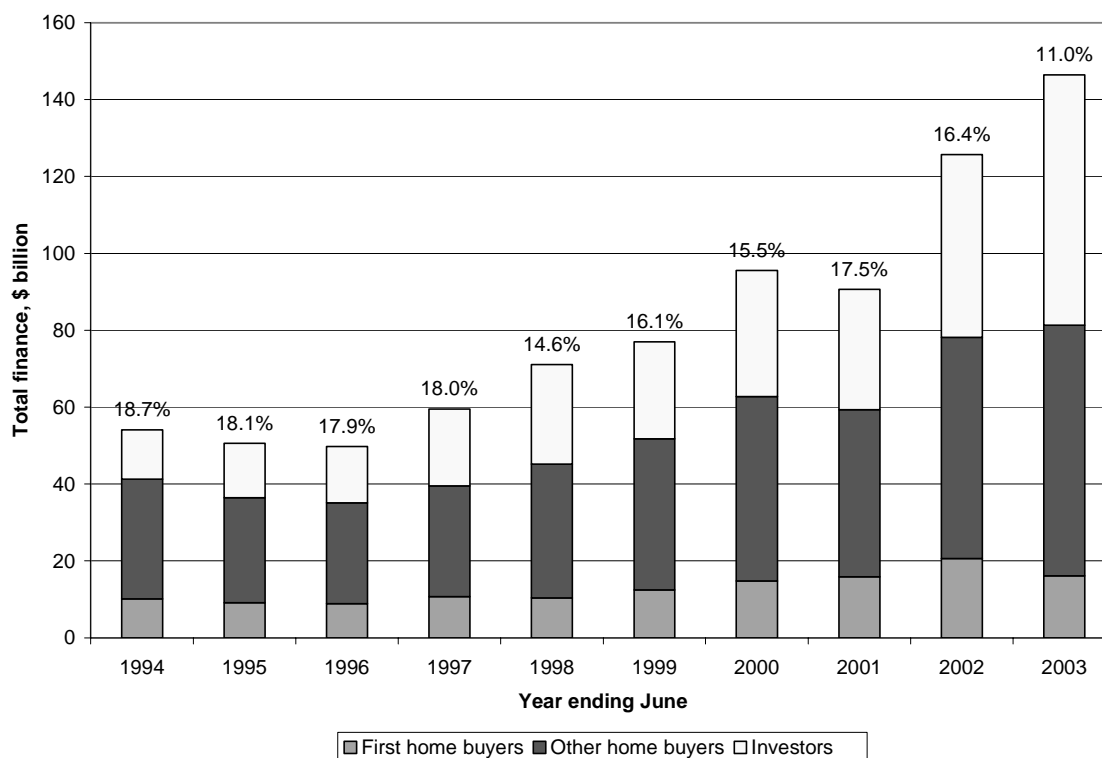
The percentage figures shown on the graph are loans for first home buyers as percentages of total loans for owner-occupiers purchasing dwellings. Historically, first home buyers have received around 25% of the total loans. This figure has varied over the past few years:

- In 1999/2000, the FHB percentage fell, as FHBs waited for the introduction of the Grant, while other home buyers brought purchases forward prior to GST;
- In 2000/01, with the introduction of both GST and the FHO, loans to FHBs climbed significantly, while the value of other loans fell. The FHB percentage consequently rose, to 27%;
- In 2001/02, loans to both FHBs and other buyers increased significantly, reflecting increasing house prices;
- In 2002/03, while loans to other buyers continued to rise, loans for FHBs fell significantly, down from \$21 billion to \$16 billion. The FHB proportion fell below 20% for this first time in this decade.

Both this and the previous graph showed significant drops in FHB activity in 2002/03. The key factor behind this is shown in the next graph, which includes new loans to investors as well as the above two categories.

¹⁶ As above, this graph excludes refinancing of existing loans, and also excludes finance for additions and alterations.

Graph 9: Finance for Dwelling Purchase



Source: ABS Housing Finance (5609.0)

The percentages on this graph show loans to first home buyers as a proportion of total finance for dwelling purchase, including both owner-occupiers and investors:

- In the mid 1990s, the FHB proportion of total finance was about 18%;
- As the value of loans for investment increased, from 1998 onwards, the FHB share fell, with some volatility, influenced by the factors discussed above;
- However, in 2002/03 the FBH proportion slumped, from 16% to 11%.

This last pattern continued into 2003/04, as the Sydney Morning Herald noted on 11 October:

“the number of first home-buyers taking out loans wallowed near record lows in August as surging home prices lock young buyers out of the market.”¹⁷

The above discussion argued that loans for investment were the key factor in house price rises in the last few years. The dramatic increase in investment loans in the last year has also had impacts on other purchasers:

¹⁷ Sean Nicholls, Lisa Pryor and Matt Wade “They’re lined up on the blocks in the great land rush sprint” *Sydney Morning Herald*, 11/10/2003, p21

- Loans to non-FHB owner-occupiers have continued to rise, albeit at a slower pace than investment loans. It appears that such buyers, with equity already in the housing market, have the capacity to increase their loan size, and hence compete with investors;
- However, first home buyers, without existing equity, and apparently already stretched by the high prices, have dropped out of the market.

3.5 Possible Policy Responses

A key task in this Inquiry for the Productivity Commission is to “assess the scope for government action to lead to better market outcomes.” (p2)

This submission has argued that the key factor driving the housing price increases has been the investment boom, encouraged in its turn by both sustained low interest rates and by the changes to capital gains tax introduced in 1999. That investment boom, as well as driving up prices, has to some extent crowded out first home buyers – and has also created problems for the orderly processing of planning applications, with attendant delays.

A fear frequently expressed recently is that the Reserve Bank will increase interest rates to slow down the housing investment bubble. While the Bank did not change interest rates in its mid October announcement, its 2003 conference, in Sydney on 18 and 19 August 2003, concentrated on 'Asset Prices and Monetary Policy'.¹⁸

Similar debates have occurred internationally over the last year, with *The Economist* in January¹⁹ noting the dissenting views of the Chairman of the US Federal Reserve:

Alan Greenspan has offered the fullest defence of why central banks should not react when asset prices climb rapidly. First, he argues, you can never tell a bubble from a more justified increase in asset prices. Second, interest rates are a blunt tool. A small rise in rates may have no effect; an increase big enough to pop an incipient bubble could cause a recession. Mr Greenspan thinks it is safer to wait for a bubble to burst by itself and then to mop up its after-effects by easing monetary policy, aggressively if need be.

The article noted further contributions about how monetary policy should respond to asset-price changes:

“Central banks can no longer ignore surging asset prices by insisting that monetary policy should focus only on consumer-price inflation. Swings in asset

¹⁸ The Reserve Bank website indicates a book, containing the conference papers and discussion, will be published in late November 2003.

¹⁹ “Still Bubbling” *The Economist* 16 January 2003

prices can have big long-term consequences for inflation [and for levels of economic activity generally]”²⁰

If monetary policy may be too blunt a tool with which to attack housing price bubbles, are more specific policy tools available?

The investment boom in housing is encouraged by a number of factors:

- Investors, suffering from share price falls in the past three years, seeking more security in “bricks and mortar”. Movement between investment asset classes is a cyclical pattern, and debates exist over how effective policy interventions can be in this situation;
- The availability of negative gearing on housing investment. However, a simple abolition of negative gearing does not appear to be appropriate, especially in view of the adverse impact on the rental housing market in Sydney in the late 1980s when this policy was tried.
- The changes to capital gains tax rules in 1999, which mean that investors pay tax on only half the capital gain realized on eventual asset sales²¹.

The Planning Institute notes that there have been considerable debates on these issues, with various suggestions to fine-tune the tax treatment of both negative gearing and capital gains. The PIA does not feel itself in a position to argue a comprehensive policy to address all the points raised in these debates. We consider however that the scope of this Inquiry gives considerable scope for the Commission to review these issues, and to develop new policy options.

At a more microeconomic level, in December this year the PIA will have available the draft outcomes of its national Inquiry into Planning Education and Employment (funded by the Planning Officials Group). Recommendations will be based on new national data on the apparent failure of the labour market (and as a feeder to that education) to meet the demand for qualified planning professionals, and may include calls for Government action.

It has also been suggested that the number and complexity of planning regulatory requirements has increased and that a programs such as LARP might be reconsidered as a basis for effecting planning process reform. The intersection and relationship between State and Australian Government regulatory compliance demands at the local level might also be considered.

²⁰ The article refers to recent papers from the Bank of International Settlements (www.bis.org/publ/work114.htm); the Deputy Governor of the Bank of England (at www.bankofengland.co.uk/speeches/speech181.pdf) and the European Central Bank (at www.ecb.int/key/02/sp021205_1.pdf)

²¹ The changes to the capital gains tax rules were more complex than frequently described. The new regime of individual (non-corporate) taxpayers paying tax on half of any capital gain replaced the complicated previous regime in which taxpayers paid tax on any capital gains greater than the general rate of inflation since the purchase of the asset. In a moderate inflation environment, the two measures may produce similar outcomes. However, in the last few years, with high asset value increases, and low CPI increases, the new regime is undoubtedly more favourable to individual taxpayers than the old regime.

4. Conclusions and Recommendations

From the analysis of this submission, the Planning Institute of Australia makes three broad conclusions, with implications for the Commission's development of policy responses.

Conclusion 1: The key driver of recent price rises (with impacts on affordability for first home buyers), is the boom in housing finance for investors. The strength of the boom has also had implications for timely development approval processes.

Recommendation: That the Commission develop and discuss suggestions for policy changes which will fine tune the current investment climate for housing.

Conclusion 2: Planning policies have played a relatively minor role in recent house price increases.

Recommendation: That in considering the price impacts of policy initiatives such as urban growth boundaries and energy efficient housing, the Commission also notes the policy contexts and benefits from such initiatives

Conclusion 3: That scope exists for continuous improvement in planning design and processes.

Recommendations: That the Commission:

- Note the anecdotal evidence of a shortage of qualified planners impacting the planning process, to be supplemented by the current PIA inquiry
- Develop suggestions for reforms to reduce regulatory complexity at the local planning or implementation level and/or improve local government capacity to cope
- Note initiatives to improve performance, such as in the Development Assessment Forum and in the previous LARP program.