



SUBMISSION TO THE PRODUCTIVITY COMMISSION



INQUIRY ON FIRST HOME OWNERSHIP

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INTRODUCTION - COMPONENTS OF LAND AND DWELLING PRICES

A very wide range of factors influence the cost of housing, for all home buyers. This submission spans a wide range of those factors, but focuses on those on which Council is best placed to offer informed advice, especially on the cost of new urban land, which is relied on by many new home buyers.

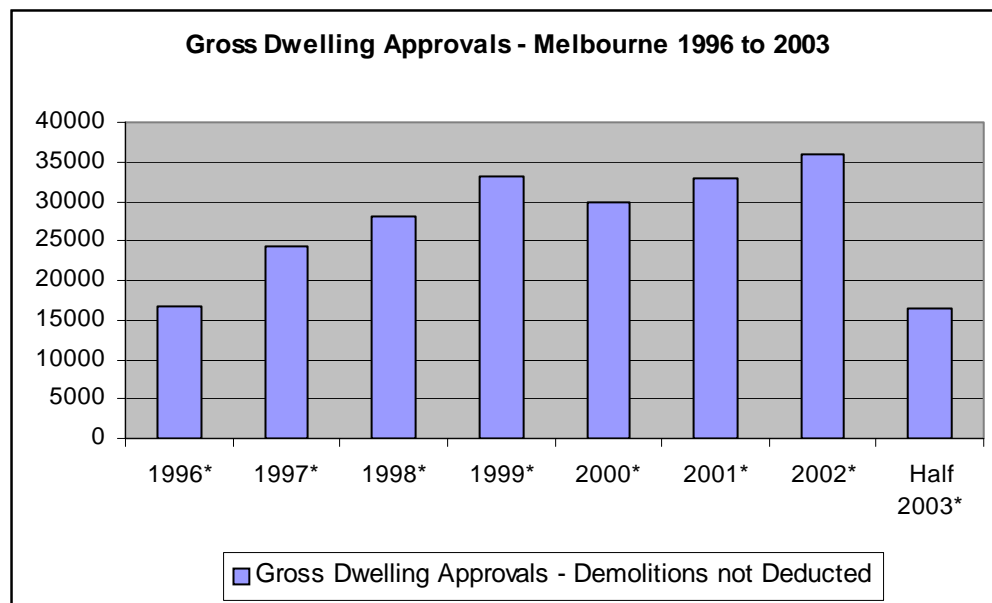
1. UNDERLYING COSTS

a) Land Costs

1.1 Basic raw land value for new development and redevelopment.

- The balance between supply and demand is by far the most volatile factor in urban land prices.
 - Rapid price increases, in particular, are nearly always associated with either:
 - Strong increases in demand, ahead of supply, as witnessed across all major Australian cities in 2001-03; or
 - Restrictions on supply, as occurs when infrastructure cannot keep face with demand, or when new public policies limit supply; or both.
 - Both factors are clearly evident in Melbourne generally, and Wyndham in particular:
- a. Demand for new urban land, based on dwelling approvals, has accelerated in Melbourne:

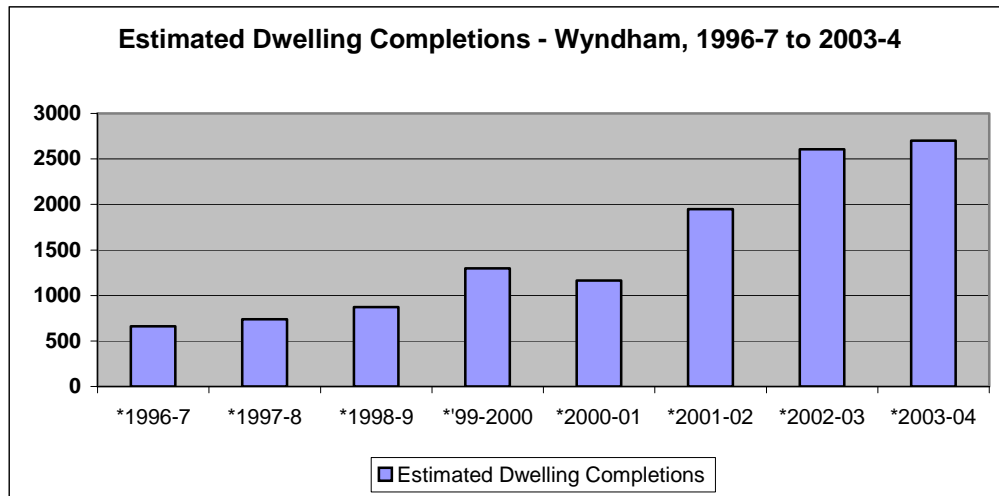
Figure 1: Dwelling Approvals – Melbourne, 1996-2003



*Source: Department of Sustainability and Environment - Residential Land Bulletins.

- b. A major westward shift in Melbourne housing demand has seen a more dramatic growth in Wyndham dwelling approvals:

Figure 2: Dwelling Completions – Wyndham, 1996-7 to 2003-4



*Source: Wyndham City Council, Monthly Building approvals to October 2003, allowing an average of 6 months to completion, and minus demolitions and assumed abandoned permits. 2003-4 relies on estimated approvals in November and December, 2003.

- c. On the other hand, Melbourne 2030 reduced the extent of 'future urban land' set aside under the former Werribee Growth Area Plan by 37 square kilometres, on an interim basis, to enable its review.
- d. **As a result of (a) to (c), broad – acre urban land prices in Wyndham have soared, evidently by up to 100% in some areas, to over \$400,000 per hectare.**
 - This degree of increase can add over \$10,000 per lot to residential land prices, counting holding costs and margins, but contribute no value for purchasers.

1.2 Purchase costs, including legal, stamp duty etc

These costs are not addressed in detail in this submission, though some (like stamp duties) may be significant.

1.3 Professional consultants' fees and costs.

- These are relatively minor and competitively priced costs.

1.4 Approval and supervision – planning and subdivision.

- These are also relatively minor costs.

1.5 Headworks costs and charges towards hydraulic services such as trunk water mains and sewers are essential and aim to 'break even'.

1.6 Development contributions.

- New urban development generates major demands for a wide range of infrastructure.

generation of residents, who initially:

- Bear the brunt of inadequate roads, with growing delays due to insufficient capacity and high accident rates;
 - Also suffer if there are inadequate pre-schools, recreation and community facilities in the early years;
 - Need to work with local and other funding agencies to secure commitments; and
 - Commonly move on before the issues are addressed, or miss out because their children grow beyond relevant age groups.
- Urban growth areas normally offer the cheapest entry points for home buyers, and especially appeal to first home buyers. First home buyers and their young families are therefore most likely to suffer from failure to achieve timely delivery of essential urban infrastructure.
 - The costs to provide infrastructure, especially roads, are typically far higher if works are undertaken after serious needs arise, and the works are then constrained by existing usage, especially by heavy traffic.
 - Retrofitting of infrastructure can also severely disrupt business, other services and community activity generally.
 - Councils commonly lack the resources to adequately research needs to the degree of rigour necessarily required to achieve approval of development contributions schemes. In those cases, they remain limited to “catch up” processes, funding infrastructure if the shortages become pressing.
 - Early definition of needs and costs is vital to developers. It enables them to factor development contributions, like other costs, into their project evaluation, including their assessment of how much to pay for undeveloped land. If it reduces the prices paid for undeveloped land (discussed in 1.1 above), some of the costs would be offset against the “windfall” gains to original broad-acre land owners.
 - State Governments have typically been reticent about requiring development contributions for State infrastructure, even where they have suitable legislation, as in Victoria’s case. As a result, State roads, public transport, schools and other infrastructure tend to lag behind needs, ultimately cost as much or more, and burden the general taxpayer, rather than targeting those who generate the need.

1.7 Reservations – floodways, open space, etc.

- These needs must be well-defined at the outset, so they are factored into early planning, to minimise longer term costs. They are significant cost elements, but essential and not a major factor in cost changes from year to year.

Wyndham has agreements with the State Government on community use of school sports grounds and co-location of school and local sporting areas. The consequent economies have influenced lower open space standards and reduced development costs on open space.

1.8 Construction costs, including standards

- Construction standards, especially on local streets, have been widely addressed in past studies, and are as restrained as acceptable to address community needs, so have minimal effects on price changes.
- Developers' estate presentation has markedly improved, but at minimal cost to affordability.

1.9 Marketing, etc.

- Minor part of housing costs.

1.10 Sales – including legals, agents.

- Minor, competitive part of costs.

1.11 Administration.

- Mostly minor costs.

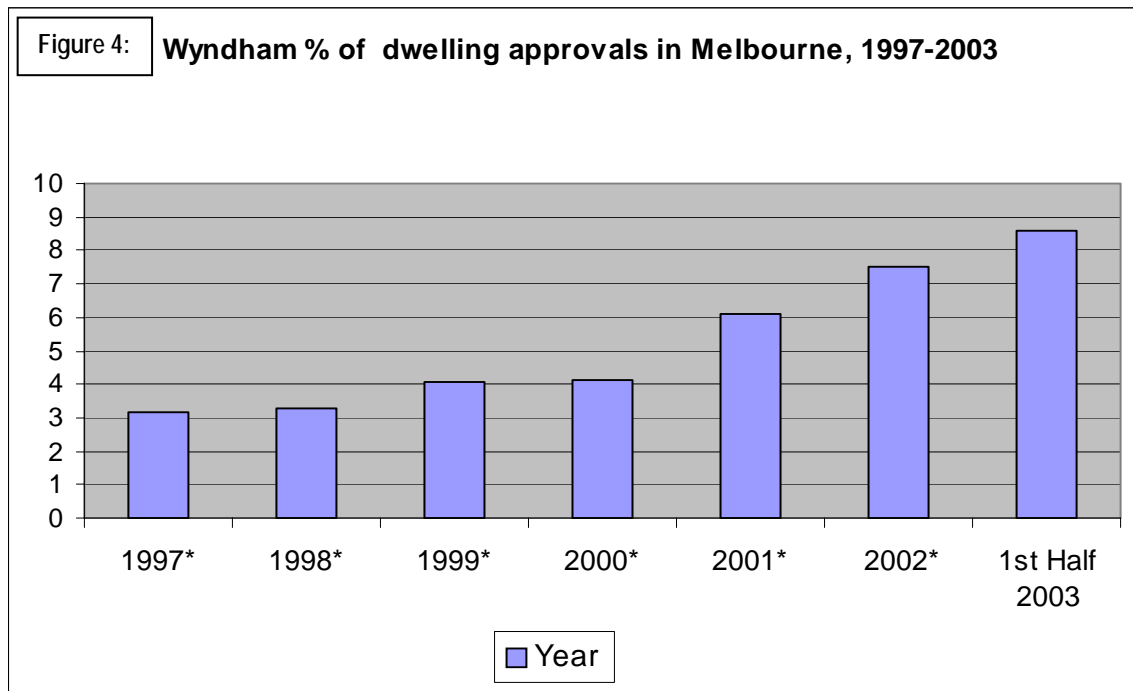
1.12 GST

- GST is a significant one-off contributor to land costs, but is not further contributing to percentage movements in housing prices in 2003.

b) Building Costs

1.13 Wyndham as a focus of new home building, especially by first home buyers

- Wyndham is contributing an increasing share of new housing in Melbourne:



*Source: Department of Sustainability and Environment - Residential Land Bulletins [6 months of 2003-04].

Several factors are believed to be influencing this trend, including:

- Affordability of land and housing in Wyndham.
- Relative proximity to Melbourne.
- Transport improvements.
- The emergence of a selection of attractive new communities, and
- Early commitment to roads and community infrastructure, based or development contributions and confidently marketed by developers and their agents (See A1.6 above)

First home buyers are the dominant purchasers of new dwellings in Wyndham, especially in the more affordable estates.

1.14 Design costs.

- A minor part of most housing costs.

1.15 Approval costs.

- Also a minor part of housing costs.

1.16 Construction (including project management).

- **Inner urban housing construction** involves a high ratio of redevelopment, often in large, multi-dwelling buildings. Issues associated with these have less effects in Wyndham.
- **Outer urban dwelling construction** is generally a competitive, efficient industry. In boom conditions, the major costs added to dwelling construction relate to inflated costs of labour and some materials, due to shortages.

1.17 Connection costs.

- Connections to services are essential, and have minimal impacts on overall costs.

1.18 Marketing costs.

- Again, these are small costs.

1.19 Sale costs.

- Legal, agent, and related costs are small overall, and competitive.
- Stamp duties (paid by purchaser) may be substantial, but there is widespread, lawful avoidance on new dwellings through buying off-the-plan.

1.20 GST.

(See above, 1.12)

2. MARKET DRIVEN COSTS

By the biggest factor in the recent surge in housing costs has been the boom in land prices, which is largely market driven, as supply has failed to match demand:

a) *Land Costs*

2.1 Lot sizes

- Community aspirations for lot sizes do appear to be steadily declining, despite a small percentage of buyers who continue to seek “rural-residential” and low density residential lots over 1,000m².
- Factors influencing this trend include:
 - Removal of most minimum lot size standards, and promotion of smaller lots;
 - Promotion of consolidated housing forms;
 - Falling household sizes;
 - Focus on quality, versus quantity, in private open space;
 - Increasing acceptance of double-storey options for housing and prices;
 - Competition for scarce space and therefore higher land prices.
- Wyndham has supported these trends, and encourages developers to optimise lot yields, including support for “terrace” lots in suitable areas in many new subdivisions

2.2 Density of multi-dwelling developments

- Density of multi-unit developments is a sensitive community issue, commonly raising valid points for and against applications.
- Multi-unit housing helps to meet needs for diversity in housing stock, address declining household sizes and achieve better utilisation of urban infrastructure and resources. Therefore it needs to be encouraged in both established and growth areas, where compatible with the character, amenity and privacy of surrounding housing.

2.3 Receptiveness to multi-unit housing, etc.

- It needs to be understood that if the vast majority of lots in a locality are relatively small, they will not lend themselves to multi-unit/infill housing later. This long term inflexibility may increase the need to provide early diversity in growth area housing types.

2.4 Market growth/decline.

This is a major factor in trends in housing affordability. It is driven by issues such as:

- Immigration/emigration to and from Australia, Melbourne, and individual communities;
- New household formation and household sizes; and
- The supply and demand for rented dwellings. Investors’ demands for lettable properties have been argued as a factor in driving up residential prices. However, if the supply of rental accommodation outstrips the needs of tenants:
 - Vacancies will rise, and
 - Rentals will flatten or decline.

Whilst both factors are evident at present, it is submitted that:

- These factors will combine to inhibit over-investment in rental housing;
- Vacancy rates are still modest, except in some inner-urban areas, and far too few to constitute such a major withdrawal from the metropolitan market as to seriously drive up prices; and
- Rental housing is an essential component of the housing market, and any softness in rentals is good for tenants, improves their housing affordability, and may discourage some tenants from adding more heat to demand for owner-occupancy, releasing some pressure on its affordability.

2.5 Purchasers' ability and willingness to pay.

This is a major factor in demand, driven by:

- Required and available savings;
 - Borrowing ratios acceptable to buyers and lenders, (fuelled by banks' desire to build market share in housing);
 - Interest and repayment rates;
 - Market trends and perceptions of the future (possibly fuelled by several other factors, such as those above, plus employment, promotional prospects, etc).
- Interest rates are clearly a crucial factor in housing affordability. Falling and generally low rates:
 - Clearly enhance short to medium term affordability;
 - Benefit all existing home buyers, as well as future ones;
 - Enable renters to move to ownership, so increasing home ownership rates;
 - Enable people to afford higher quality housing and fittings; and
 - Therefore drive up standards and prices, especially in desirable locations.

However, by encouraging heavier borrowing, especially in periods of sustained price growth, low, falling interest rates can encourage over-commitment for periods when interest rises.

- If that causes falling sales and prices, many people can be left with heavy payments on properties in which they have negative equity, as in 1990-02.
- First home buyers are often more exposed to these risks, as they often begin with limited equity, commit to heavy repayments, and may suffer loss of income and/or increased costs as children are raised.

b) Building Costs

2.6 (See 2.1 above re: lot sizes).

2.7 Tastes

There have been significant shifts in tastes and increasing expectations of housing over the last decade, affecting:

- Room sizes, types and numbers;
- Dwelling sizes;
- Ceiling heights;
- Storeys, with a shift towards two storeys;
- Garage and storage areas;
- Fittings;
- Finishes; and
- The degree of completion, with developers promoting services to complete front landscaping and other details.

2.8 Private regulations (covenants) are now applied to most new housing, embracing:

- Minimum sizes of dwellings;
- Materials, and
- Bans on further development or multi-unit development.
- **Minimum dwelling sizes** of 180-250m² (19.4-26.9 squares) are now commonplace. This:
 - Far exceeds the needs of many households;
 - Increases housing costs for those seeking smaller, detached dwellings;
 - Freezes out multi-dwellings, even separate "in-law" units;
 - Therefore limits housing options and choice for those with less resources;
 - Fosters a mentality that anything smaller is sub-standard; and
 - Effectively freezes out single household public housing.
- **Bans on multi-dwelling development**, in particular, can restrict long term options. (As noted earlier, reduced lot sizes can have this effect anyway, on a more practical basis).

2.9 • **Industry capacity**, especially in trades (and some materials). (See above, under 1.16)

2.10 • **Public liability and other insurance costs** will undoubtedly be addressed by others.

2.11 • **GST** (above)

3. SUPPLY CONSTRAINTS

3.1 Physical restraints.

In Melbourne, the major physical constraints on the availability of land relate to areas available for development or redevelopment within 20-25 kilometres of the CBD, or further out along rail lines. This mainly affects the scope for redevelopment to meet demands in established areas.

3.2 Infrastructure availability/limits.

In growth areas in particular, infrastructure constraints may severely constrain land release. In Wyndham, for example:

- Water supply constraints have retarded industrial development in Truganina, and until recently, residential development at Wyndham Vale; and
- Arterial road constraints are currently retarding residential development south of Leakes Road, in Tarneit and Truganina, and threaten to do so in Point Cook.

In the Leakes Road case, development contributions will eventually fund much of that road's upgrade from a dirt track. However, an \$8 million upgrade is needed before traffic is directed onto it. Council is examining means to fund the works and recoup much of the cost from development contributions. This will help to remove a major, looming log-jam to housing land supply and provide a clear example of development contributions actually reducing price pressures, in addition to the primary objectives of timely, cost-effective road development, funded by those who need it.

3.3 Industry capacity.

- Industry capacity constraints also drive up delays and the direct costs of professional consultants, construction works and materials in periods of high demand.
- Council estimates that this factor has added roughly 20-30% to the cost of delivering new residential and industrial land in Wyndham in the last 5 years, and perhaps 10% to total new urban land prices.
- It is therefore a much smaller cost component than the massive surge in undeveloped land prices, discussed in 1.1 (a) to (d) above, though still significant.

3.4 Policy constraints.

- Planning policies on issues like the extent of urban areas and the rate of land releases can have major affordability effects, especially if policy changes coincide with and reinforce strong or weak markets. (See Section 6 on the need for urban containment).
- In Wyndham, Melbourne 2030 appears to be a major factor behind the escalation of broad acre property prices, reported above, for zoned residential land. Its effects are due to:
 - The interim Urban Growth Boundary (UGB) taking about 37 square kilometres off the former Werribee Growth Area Plan, subject to review;
 - The coincidence of this action with strong demand; and

- The high rate of subdivision and housing development, sufficient to absorb all unzoned land within the UGB in 15-18 years. (Melbourne 2030 relied on the projection that Wyndham has 45 years' supply, although this forecast is now being revised downwards).
- Establishment of a "Smart Growth Committee" to supervise the review of the growth area plan and the scheduling of land releases should result in some relief to current pressures in Wyndham, if its work does lead to significant releases at its conclusion, scheduled for late 2004. Meanwhile, the more limited interim release in November, 2003, will help.

3.5 Land withheld – speculation, private reasons.

- Some zoned or agreed urban land will be withheld from the market by current owners, for speculative, private or business reasons, especially if they have a beneficial use of the land.
- Businesses, like manufacturers, will also hold land for long term development or (in the case of some major industries) to retain buffers around hazards or odour sources.
- Planning needs to allow more releases to cover for these factors, to minimise price impacts.

4. HOLDING COSTS

- 4.1 The time from purchase to sale may be several years, especially for companies keeping substantial "land banks" for future development.
- 4.2 Interest or opportunity costs can add large margins to holding costs, especially if premium prices are paid to secure land in boom times, and growth then declines.
- 4.3 Land tax and other charges, plus maintenance costs, can amplify holding costs.

5. PROFIT MARGINS

- 5.1 In stable markets, companies can build in reasonably defined profit margins, as an essential component of land prices.
- 5.2 Rapid inflation can amplify short-term profits but these will often be rolled into land banking. Effects of land banking on prices paid vary, but they will normally be strongly upward as booms peak.

6. THE URBAN CONTAINMENT ISSUE

a) *Need*

- 6.1 **Infrastructure costs of urban sprawl**, especially at low densities, are massive, as well-documented by various studies. They require major public investments in transport, health, education, sporting and community infrastructure to service growth areas. The \$6,000 per lot that Wyndham requires to be contributed, as noted in Section 1.6, is little more than half the cost of locally funded infrastructure, and State costs can be greater.
- 6.2 **Dispersed development also has major impacts on:-**
- Intra city travel lengths and costs,
 - Times for commercial and private travel within the cities,
 - Consequential costs to users – commercial and private,
 - Contributions to pollution and congestion, and
 - Liveability.
- 6.3 **Water consumption** is generally much higher in lower density cities. (In Melbourne, low density “green” municipalities are amongst the heaviest per capita water users).
- 6.4 **Agricultural areas can be disrupted by urban sprawl** and the introduction of people whose interest in residential amenity conflicts with many farm practices.

b) *Best Response*

- Governments therefore do need to ensure that urban growth is managed and shaped to ensure that cities function effectively and use resources economically.
- They also need to protect environmentally and economically sensitive areas, resources and infrastructure from urban encroachment.
- Conversely, they need to ensure that:
 - There is ample scope for at least 15-20 years’ development, and
 - Major infrastructure is planned even further ahead, and routes are protected if required.
- Strategies do need to be reviewed regularly in the context of current government policies, but a high value needs to be placed on certainty of future direction so all elements of the community can invest and plan ahead with confidence.

c) *Risks*

- 6.5 Cost pressures emerge if supply is retarded, as evident from Section 3. Outer growth areas are vital relief valves when demand and price pressures are high, as in 2001-03. In this climate, major reductions in supply can accelerate inflation of land values and cause “panic” buying by both developers and individuals.

- 6.6 First home buyers are the worst affected by these pressures as they don't have existing properties to benefit from inflation of property prices.
- 6.7 Pressure for redevelopment in established areas may undermine qualities valued by existing communities and cause a backlash. ("Save our Suburbs" in Victoria is a good example).
- 6.8 Major land releases, however, can cause a 'scramble' to acquire major holdings, as in Melbourne in the early 1970's, followed by a destructive crash if acquisitions are largely debt-funded and far exceed development needs for many years.

d) Need for a Measured Response

- 6.9 Long-term planning is therefore a key to defining and managing growth.
- 6.10 It is essential to increase land releases as markets hot up, to minimise impacts on affordability and weaken the destructive elements of "boom and bust" cycles.

7. OUTLOOK

- Warning signs of the end of the boom are evident in weakening inner urban apartment markets and Reserve Bank moves on interest rates.
- High inner-urban vacancy rates appear to be mostly sectoral and may simply dampen investor ardour.
- However, sustained booms in both construction rates and prices must ultimately encounter demand constraints.
- The widespread belief that the boom won't end is being addressed by the Reserve Bank and many commentators and appears to be waning, as suggested by lower auction clearance rates.
- First home buyers are possibly standing back already, as alleged by some commentators, encouraged by low rentals and concerns about interest rates.
- However, dwelling approvals are still very strongly in the more affordable growth areas. 355 new dwellings were approved in Wyndham in October, 2003; an all-time high, over 20% above the previous peak in July 2003.
- First home buyers may be forced to rely even more on growth areas if price or interest rate rises continue to restrict affordability.

Interest Rates

- Interest rate rises will soon discourage the race to buy.
- Significant rises (probably as little as 1-2%) may be sufficient to dampen the market.
- Significant interest rate rises and/or economic weaknesses, or sharply lower net immigration, would all slow or stop price growth and possibly trigger price falls.
- However, most home owners would be disadvantaged by price falls, and any benefit to first home buyers would be lost if interest rate rises offset any gains in affordability.

Inner v Outer Urban

- Demand for outer urban land and housing will remain strong unless the affordability gap between inner and outer urban housing narrows noticeably.

Volatility of factors affecting affordability of Housing

- The more volatile contributors to housing costs are the ones that will primarily drive any major housing price changes, eg:-
 - Interest rates,
 - Economic strength/weakness and therefore employment and incomes,
 - Net migration flows to and within Australia, and
 - Land supply and access to infrastructure.
- Changes to one-off charges and related costs, such as the GST, stamp duty, development contributions and other infrastructure charges, have little effect in a rising market, where prices are determined by supply and demand.
- Those charges that directly fund infrastructure, often simply by up-front user payment, as opposed to incremental components later, probably have little or no long-term effect on costs. They are limited to addressing definable needs and failure to address them early normally penalises the first generation of residents, mostly first home buyers.

8. RECOMMENDED RESPONSES

Effective responses to soaring residential prices can include:

- 8.1
 - Actions to slow housing demand and reduce risks of losses if the market falls eg:-
 - Interest rate management, and
 - Discouraging purchase on marginal deposits;
- 8.2
 - Ensuring ample land releases in agreed growth corridors, subject to adequate infrastructure service levels and disciplined commitment to economic, environmental and community sustainability;
- 8.3
 - Continuing to encourage redevelopment in established areas, whilst respecting the genuine concerns of neighbours;
- 8.4
 - Supporting well targeted development contributions towards transport, hydraulic and community infrastructure, providing that:-
 - Needs are well defined;
 - Nexus to contributing developments is proven;
 - Equity between contributors is achieved through transport processes, and
 - Accountable processes are established, including ensuring that the contributions are quickly translated into actions to deliver the facilities funded.
- 8.5
 - Supporting periodical or on-going review of development and building standards and their costs;
- 8.6
 - Examining the impacts of private regulations (eg. covenants) on housing affordability and flexibility, and on the ability to provide well-distributed public housing; and
- 8.7
 - Encouraging acceptance of smaller, presumably less costly dwellings that are well designed to minimise maintenance, heating and cooking costs.