



**MASTER BUILDERS
AUSTRALIA**

Response by

MASTER BUILDERS AUSTRALIA

to the

Productivity Commission

Discussion Draft

on

First Home Ownership

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INTRODUCTION

Master Builders Australia is pleased to provide the Productivity Commission (PC) with comments on the Discussion Draft on First Home Ownership.

Master Builders provided an initial submission to this Inquiry (Submission No. 135) in October 2003. In this follow-up submission we will be providing comments on specific issues raised by the PC in its Discussion Draft.

Master Builders is in broad agreement with many of the findings in the Discussion Draft but do have concerns in some areas. We would also like to draw the PC's attention again, to the Housing Acquisition Contribution Scheme which was raised in our initial submission and suggest that it would be an ideal mechanism for all levels of government to assist first home buyers, particularly those on lower incomes who may be currently receiving housing assistance.

The report correctly identifies that there are many factors that influence housing affordability. These factors may be structural, short-term or cyclical. It is recognised that short-term and cyclical factors may be difficult to address through Government policy or intervention except through some short-term targeted programs. However, the pain of housing affordability due to short term or cyclical factors for first home owners is real. The policy question remains whether first home owners should be denied access to affordable home ownership during these periods. An equally important policy question is the ability of first home owners to access housing. It is important that the Productivity Commission (PC) fully examine both the issue of affordability and access as major hurdles for first home owners.

The Interim Report also highlights structural or core issues that impact on the cost of housing which therefore influence the ability of first home buyers to enter into home ownership. As the interim report identifies, most of these factors fall within the jurisdiction of state and local government.

The problems identified and highlighted in the Interim Report are not new, nor surprising. These matters have been fully explored over the last fifteen years. The only surprising feature is that very few state or local governments have acted to address these structural deficiencies in a meaningful way. The challenge is how to put in place measures to pursue the necessary reforms that have been identified both by the PC and in numerous other reviews and reports on housing affordability.

The Interim Report has highlighted that, overall, there have been no significant improvements in addressing the supply side problems. The lack of momentum for reform has been facilitated by the lack of understanding by the home buyer who, in the end, carries the full cost of the inefficiencies (builders carry the intermediate burden, the cost of which is then passed on to the final consumer). This lack of understanding by the home owner is further exacerbated by the infrequent (in many cases no more than twice in a lifetime) home purchase transactions undertaken by households. This has allowed state and local governments to remain apathetic to pursuing necessary reforms because largely they do not have to face any political accountability for their reform inaction except for reviews such as being undertaken by the Productivity Commission.

The Interim Report also highlighted the need for greater accountability and transparency, particularly at the local government level, for the imposition of policies during various phases of the supply chain process which unnecessarily add to the cost of home ownership.

Master Builders Australia believes that it is imperative that the PC seriously looks at how best to ensure the current deficiencies are addressed through a proper reform process. Master Builders Australia believes it is appropriate that a Commonwealth/State Ministerial Forum be established, which includes high level industry representation, as a recommendation to be put forward in the final report.

Master Builders also notes the observation made in the Interim Report of the time constraints faced by the PC in conducting this inquiry. While Master Builders is in broad agreement with the findings of the PC so far, the pressure of time constraints has necessarily limited the veracity of the observations and analysis in a number of key areas. It is important therefore, that, in completing the final report, either more research is undertaken before detailed recommendations are made or that recommendations are qualified subject to the further research. For instance, in the area of taxation it is important that the PC does not allow simple conclusions to be drawn as to the role of capital gains tax in fuelling the current housing boom. As correctly identified in the Interim Report, these matters have broader application and therefore demand a more expansive examination to avoid the risk of false or speculative conclusions being propagated.

COMMENTS ON DISCUSSION DRAFT

The fundamental nature of home ownership

Master Builders has home ownership as one of its cornerstone policies and, therefore, strongly agrees with the PC finding that home ownership is an integral part of Australia's social fabric and that "the house is therefore both a home and an investment". The PC is, therefore, correct in finding that the role of home ownership as a social good should be recognised by all governments. This fundamental importance highlights the urgency and imperative to address the structural deficiencies highlighted in the Interim Report.

Taxation

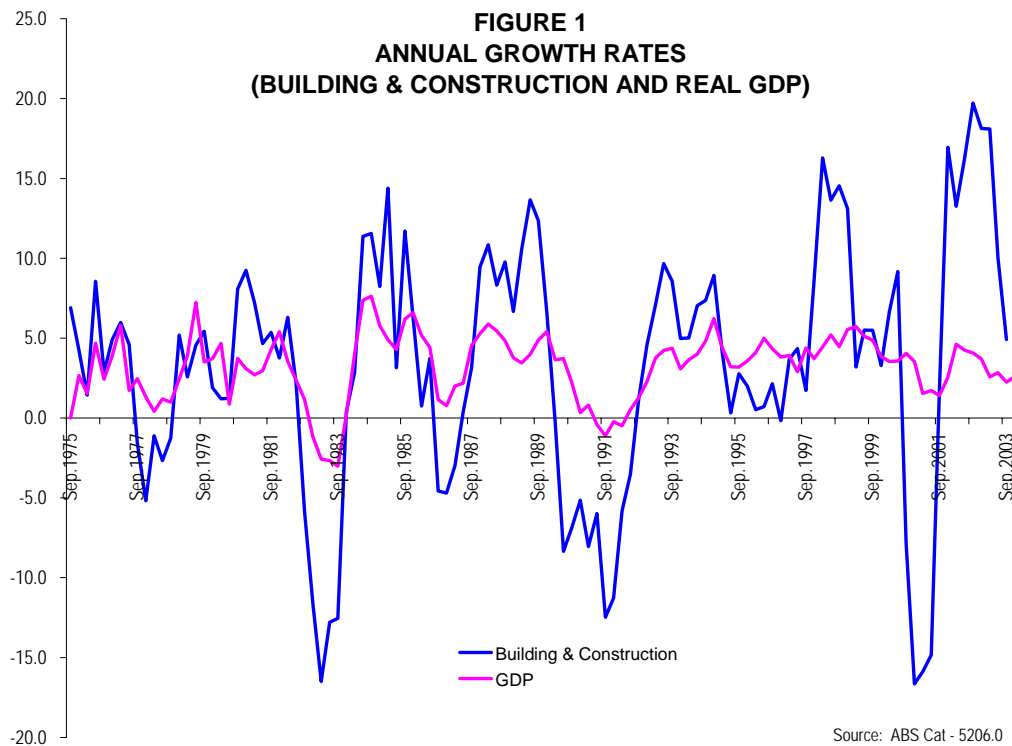
Master Builders notes the observations made in the Interim Report relating to the tax status of the principal residence. The Interim Report also provides a cursory examination of changes to promote tax neutrality in relation to owner occupied housing. Master Builders Australia strongly supports the current taxation arrangements and therefore would strongly oppose attempts by any government to move towards the taxing of the family home.

The Interim Report, in examining various aspects of the taxation regime relating to housing, has observed that these may have magnified the attractiveness of investing in residential property. While it is not in the purview of the terms of reference, it must be recognised that the current taxation regimes do not exclusively relate to housing but also apply to other assets, including shares. It should also be recognised that there are other factors, including other inefficiencies, in Australia's taxation regime, such as high marginal tax rates, that similarly may magnify the attractiveness of residential property as an investment vehicle. Any concession on recommendations relating to taxation matters should not be considered in isolation of other broader taxation policies.

The cyclical nature of housing

As indicated in the chart below, the Australian housing market moves pro-cyclically with the Australian economy but exhibits a far greater amplitude in the cyclicity. While Master Builders would agree with the PC that part of the recent surge in house prices can be put down to the strength of the current housing cycle, we feel that in doing so the PC might be understating the impact of other structural factors behind the current level of house prices and their consequent impact on affordability.

Whilst it is impossible to apportion percentages to the impact of the various demand and supply side factors at work in the housing market, Master Builders disagrees with the PC as to the dominance of demand side factors. Supply side factors, particularly as they relate to the availability of land infrastructure charges and increasing regulatory land tax burdens, must be seen as an equally, if not more significant, part of the current rise in house prices.



The existence of a price bubble

Recent evidence indicates that house prices in certain segments and geographic areas have overshot or have hit a new peak in current cycle.

It is also worth comparing price movements in residential versus commercial. While median house prices are now some 2^{1/2} times their early 1990s peak, commercial property prices remain below the early 1990s levels suggesting that house prices are at a high level.

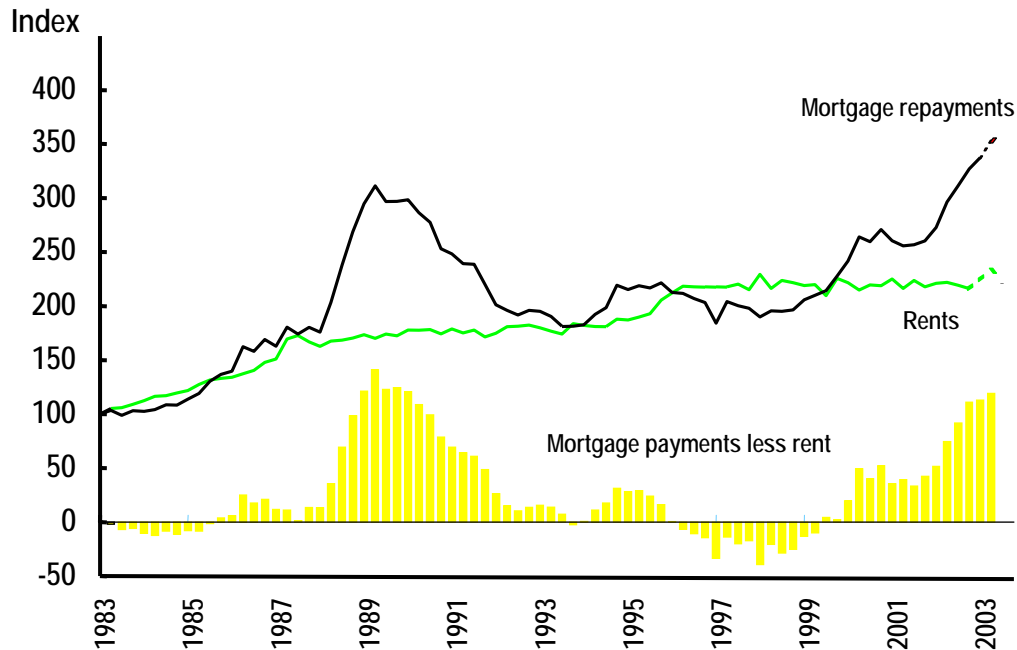
The enhanced role played by investors and speculators in the current housing cycle, together with the "irrational exuberance" created by various property spruikers, would also lend weight to the view that prices have overshot their true values in certain segments of the market.

Net yields on residential property are now as low as 2-3 per cent, way below comparative international rates and less than half traditional rates available in the professional property market.

However forward indicators would indicate, that the housing market, particularly the new housing market has peaked and is slowing. The recent two increases in the cash rate will further temper any remaining exuberance.

Further research needs to be undertaken before any firm conclusions can be drawn of a price bubble of the kind experienced in the 80s, early 90s.

MORTGAGE PAYMENTS AND RENT



The impact of immigration

Master Builders has a policy that favours a high immigration program for Australia. Immigration brings many social and economic benefits to Australia. It adds to the supply of skilled labour, increases accumulated savings and contributes to domestic investment and expanded domestic consumption.

Higher immigration will be especially important in coming years in slowing the demographic transition and ageing of the population and will help lift Australia's economic growth potential.

Master Builders, however, believes that the PC may be overstating the impact of the current immigration program on recent movements in house prices. Some doubt has arisen about the current levels of immigration as reported by the ABS and it is likely that the actual program is lower than currently reported by the ABS.

The PC has also pointed out that Sydney and Melbourne do receive a significant proportion of net immigration although it must also be noted that these cities also receive a similar high proportion of intra and interstate migration. This suggests that population induced pressures on house prices would remain in these cities even if immigration were to stop altogether. Indeed, it is these internal population flows that make it imperative that long term plans for the provision of new residential developments and the concomitant provision of infrastructure are put in place by all governments in a timely fashion to reduce the cost pressures currently being experienced.

Negative Gearing

Much publicity has been given to the reports suggesting that the Reserve Bank has argued for the removal of negative gearing. This is a misrepresentation of the Reserve Bank submission. As stated by the Bank *"In fact, there are no specific aspects of the current tax arrangements designed to encourage investment in property relative to other investments in the Australian tax system."*¹ and*"The ability to offset losses from one activity against income or profits from another is part of the normal operation of the Australian tax system."*²

Master Builders therefore agrees with the PC's conclusion that.....*"In this regard, tax arrangements for investors do not explicitly discriminate in favour of investment in housing."*³

Master Builders strongly recommends that the current negative gearing provisions remain. In the main, most investors are 'mums and dads' who provide the bulk of investor/rental housing and are therefore the major source of affordable housing in Australia. Any changes can only create a housing affordability crisis as was the case when negative gearing was disallowed.

Replacing stamp duties with GST revenue

Master Builders strongly supports the rationale for replacing existing stamp duties with revenue accruing to states from the GST. As the PC correctly points out, stamp duties are an inefficient tax which add directly to the price of houses but also make it more difficult for first home buyers to raise enough funds to pay both stamp duty and provide initial equity in the house. Stamp duties are also inefficient in that they are a transaction tax and, thereby other things being equal, would tend to reduce the turnover of housing resulting in inefficient use of the current housing stock.

Stamp duties applied to first home buyers raise the "deposit hurdle". While stamp duty may only be a small fraction of the total price of a house, it can be a significant proportion of the initial funds needed to enter into home ownership.

In June 1999, the state and territory governments signed an Intergovernmental Agreement to remove a range of inefficient taxes as part of the ANTS agreement. The rationale for removal of these taxes was that they generally failed badly on the usual tests of efficiency, simplicity, equity and low compliance and that, as transactional taxes, they impeded economic activity. This applies particularly so to stamp duties. Most states and territories are now GST positive in the sense that the Commonwealth will no longer be paying budget balancing assistance to them. And, since GST grows in line with nominal growth in spending, this revenue source will remain robust over time without any change in the actual rate.

The PC should recommend that states use GST revenue to eventually abolish stamp duties and in the interim index stamp duty rates to take account of the recent surge in house prices. The current boom in house prices has generated a windfall gain to state governments. This windfall has been further boosted by the progressive nature of stamp duties which has meant that state revenues increase more than proportionately than the rate of increase of house prices.

Concomitantly, the proportion of stamp duty in the overall cost of housing to a first home buyer has also increased and as a consequence the burden of stamp duty in bridging the deposit gap is also higher.

¹ Reserve Bank of Australia Submission to Productivity Commission – Page 5

² Op cit – Page 55

³ Productivity Commission Discussion Draft, Page 88

Thresholds for stamp duty concessions and rebate rates to first home buyers should also be adjusted immediately to take account of recent movements in house prices.

Stamp duty and GST

When new residential property (as defined by the ATO) is sold, GST is payable. The stamp duty payable by the purchaser is then based on the GST inclusive price, creating a situation of a tax on a tax. Master Builders suggests that the PC include in its final report a recommendation that states only charge stamp duty on the GST exclusive price of new residential property.

Investment Saving Accounts (ISA)

Master Builders notes and supports the concept of ISA raised by the ANZ⁴ in their submission to the PC.

Special purpose savings vehicles for first home buyers only, attracting low or zero tax on interest earned, would be of great benefit in helping first home buyers bridge the deposit gap. Moreover, such measures would be consistent with the need to increase national saving.

First home owners grant

Master Builders submits there is a strong case to index the compensation payment under the current FHOG Scheme to maintain the intended policy objectives stated in ANTS and to bring the grant into line with other areas of spending which are indexed annually to maintain their real value.

Failure to index the grant would invalidate the initial policy objectives of compensating for the impact of the GST on new home buyers so that intergenerational equity is maintained.

The First Home Owners Grant plays an important role in bridging the deposit gap for first home buyers.

According to latest figures on median house prices, the actual rise for established houses has been closer to 40% and that for new houses closer to 60%, further eroding the original policy purposes of the Grant and exacerbating intergenerational equity.

Master Builders has argued in the past that a higher grant be applied to those purchasing new homes rather than to those purchasing established homes which are GST free. It is the purchase of new homes which directly adds to activity in the housing area and which also brings advantages in terms of the significant flow-on effects to upstream and downstream industries.

Master Builders recommends an increase in the grant for new houses to at least \$15,000 and that both this and the existing grant for established houses are indexed to the CPI. Consideration should also be given to means testing the grant.

⁴ ANZ Submission to the Productivity Commission Inquiry on First Home Ownership

The planning approval process

The planning approval process is clearly not delivering a cost effective outcome and is in need of a complete review. The delays experienced are getting longer with inconsistent outcomes.

Master Builders fully supports the recommendations contained within Chapter Six of the Discussion Draft That include:

- separating policy making and implementation
- streamlining permit processes (especially for minor jobs)
- reducing delays in appeals
- introduction of "as of right" provisions

Master Builders further supports the increased funding of the Development Assessment Forum in progressing these reforms.

These are all sensible recommendations which would ensure progress towards eliminating the red tape in the current development approval process.

Firstly, criteria for planning applications should be assessed by qualified planning professionals as this would deliver more consistent outcomes in a more timely manner and add transparency to the process. The Council should be separated from the approval process.

To improve the constraints on the supply of land, councils need to focus more on strategic planning and develop policy concentrating on the big picture issues rather than lesser day-to-day items.

A possible solution to resolving differences of opinion between applicants and the approving officer would be to appoint a panel of industry experts from different disciplines to hear appeals or seek clarification of planning schemes on technical related matters only. More complex and legalistic issues would still go to the appropriate appeal body in each state.

A further problem is the number of triggers that instigate a planning permit. If the number of triggers were reduced and clear descriptions of what is required to comply with the planning scheme developed and made public, this would reduce the workload on councils and allow the resources to be utilised in a more effective manner.

An example would be a planning permit for painting a dwelling in a heritage area. Councils could list in documents held at their offices or on the internet all colours that they would approve. If the owner proposes a colour on the list, then no planning permit is required. However, if an alternative was proposed, a planning permit would be required.

The "as of right" concept, if designed correctly with broad rules to deliver conservative outcomes would greatly take the pressure off local government planning departments. The concept could start with issues as simple as above and could move through to multi unit development. An example of this would be put in criteria that would deliver a design that would not breach key issues.

A national model or framework can only assist the industry to deliver better outcomes in a minimum timeframe at reduced costs. A model along the lines of the Building Code of Australia (BCA) can aid uniformity within the system.

Another problem concerns the number of greenfield lots released which are too few. This results in escalating prices and putting pressure on first home buyers to move in closer to the CBD and purchase smaller units on smaller parcels of land. Large blocks on the outer ring are becoming less and less affordable.

Master Builders Australia also agrees with the PC comments on excessive use of the appeal process. The community should have the opportunity to express all their views prior to council making a decision, however once the council have assessed the application against predetermined criteria, the public or community should not have the opportunity to instigate an appeal. The council is the representative of the community. There are too many examples of individuals, sometimes not in the immediate area, appealing Council's decisions and further prolonging and frustrating the system because of individuals' personal views rather than the overall community view.

However, should the third party appeal process remain, it should only remain under exceptional and tightly prescribed conditions and should be structured so as to minimise further unnecessary delays with the planning system.

Master Builders also notes that a number of state governments have, at times, considered the preparation of "model local laws" for use by local councils. This proposal has merit as it could simplify processes and add to uniformity of building regulations.

Are infrastructure charges excessive?

The current low level of public infrastructure investment and the resultant decline in the quality and quantity of the infrastructure stock is a major concern.

The provision of, and equitable and affordable access to, infrastructure is integral to the performance of both the Australian economy in general and the building and construction sector in particular. Meeting infrastructure needs in Australian cities and regions is of paramount importance and short term political imperatives, which usually involve social welfare spending, must not be allowed to drive a run-down in the infrastructure stock.

Levies and charges on new housing developments clearly add to the cost of new houses and disproportionately impact first home buyers.

Master Builders disagrees with the conclusions of the PC report when it comes to infrastructure charges. While the practice of charging or seeking contributions from developers for "basic" infrastructure may be long standing, the evidence suggests that the level of these charges increases over time as councils impose greater and more diverse requirements on developers in order to reduce subsequent on-going maintenance costs to them.

It is our view that the controlling authorities in the business of charging for services or goods through infrastructure should play some role in providing part of the initial set-up costs because they are actual beneficiaries, in an economic sense.

In the case of “major” (shared) infrastructure and social infrastructure there is no case at all for up-front charging. Charging for such infrastructure means that the new buyer pays twice – once through developer charges and then through the general rateable base.

Are building regulations appropriate?

Master Builders Australia supports in general the current building regulation process. The BCA is delivering regulations that generally work with industry, however the states/territories are introducing many variations. Master Builders supports a national framework for building regulations and the ABCB’s proposal for the BCA’s amendment process going to a yearly cycle to allow industry to keep up with change.

In contrast the Regulation Impact Statement (RIS) process could be more transparent. At present, local governments have no need or requirements to go through any RIS or similar process prior to creating a considerable amount of local laws pertaining to buildings and building sites that vary all over the country. The industry has real concerns at the frequency and variations of these ad hoc local government laws.

The current work on creating a new national framework under the BCA will increase efficiency by allowing national building companies to design and build in multiple states using the same or similar criteria.

Deemed to Satisfy provisions within the code also add certainty, while performance provisions allow more diverse and creative cost effective buildings.

The code is supported by the industry which is actively involved in amendments to the code thereby ensuring that buildability and cost effective solutions are incorporated when amendments are proposed.

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