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ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia is a research and advocacy body for Industry super funds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members. Please direct questions and comments to:

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CURRENT NATIONAL HOUSING BREAKDOWN

- Dwelling Stock: 9.9 million
- Dwelling Type: Separate Housing 73%, Townhouses 13%, Apartments 13%, Other 1%
- Tenure Type: Owned 34%, Rented 31%, Owned Outright 31%, Other 4%

NATIONAL HOUSING AND PROPERTY INVESTMENT FACTS

- Total Housing Stock Value: $6.7 trillion
- Total Property Investors: 2 million
- 1,240,000 Negatively Geared Investors (62%)
- 440,000 Investors 60 Years and Over (22%)

OWN 1 PROPERTY
- 1.4 Million Investors (70%)

OWN 2 PROPERTY
- 400 Thousand Investors (20%)

OWN 3 PROPERTY
- 200 Thousand Investors (10%)

CORELOGIC® MEDIAN HOUSE PRICE INCREASE 2009 – 2017

- Darwin: 16%
- Brisbane: 26%
- Sydney: 40%
- Melbourne: 75%
- Hobart: 31%
- Perth: 14%
- Adelaide: 26%
- Canbera: 26%
- Perth: 14%
- Adelaide: 26%
- Canbera: 26%
- Melbourne: 75%
- Hobart: 31%

Location Breakdown:
- NSW & VIC: $4.6T (68%)
- Rest of the Country: $2.1T (32%)
Executive Summary

Housing affordability concerns the ability of singles, couples and families to buy or rent dwellings within reasonable distances to employment and study opportunities, and basic amenities. Those dwellings are first and foremost our homes, the foundation of our lives and our families – a basic need. This has become a prominent issue after several years of double digit price growth in some major property markets, with particular pressure in south-east Australian capital cities and certain coastal regional centers.

This discussion paper endeavors to identify the underlying causes of affordability issues, and to consider some useful policy responses in the current and historical context.

The key findings of the paper are as follows:

- Australia’s housing affordability problem has developed over several decades and will require a long-term commitment by all levels of government to resolve.
- Destabilising wealth effects and the continuing expansion of household debt are feeding a cycle of property price inflation which looks unsustainable.
- Policy responses that increase the buying power of households (for example, through grants, or reduced taxes) will only increase demand, and therefore prices.
- Ignoring the emerging crisis in assisted housing (affordable, public and community) now risks major future social and productivity costs.
- Simply increasing overall housing stock will not ensure that more assisted housing becomes available. Instead, increasing the supply of assisted housing specifically is required.
- Waitlists for social housing remain intractable and this system no longer serves as a safety net.
- Achieving the necessary growth in assisted supply is beyond the capacity of Australian governments, and private investment is required.

To resolve the issues in assisted housing, Federal, state and local governments need to coordinate their activity without duplication or political interference. The core elements of any strategy will require:

- A central body to provide rigorous housing supply forecasting, which will assist with planning.
- Developing appropriate incentives (for example, tax policy) to encourage institutional investment in a new assisted housing asset class.
- Expanding the capacity and professionalism of the community housing sector to deal with larger scale developments and tenant administration.

Additionally, some general policy suggestions to address broader housing affordability issues are as follows:

- Explicitly linking state and local government planning and housing approvals to estimates of regional housing supply gaps.
- Encouraging more work and student visa holders to reside outside of property market hot-spots.
- Directing all foreign investment in residential property to new buildings.
- Streamlining town planning procedures by mandating the removal of unreasonable height restrictions within urban infill development zones (including ‘inner’ and ‘middle-ring’ suburbs).
- Discouraging land hoarding by identifying underutilised assets for redevelopment (including assisted housing), and providing recycling bonuses to incentivise the release of public and private sites.
- Reorienting some current tax concessions for existing property towards investment in new housing and institutional investment in new assisted housing.
- Reforming land taxes in Australia via the abolition of stamp duties and replacing them with a mix of land and betterment taxes.
- Promoting stability around property – the largest asset class held by ordinary Australians.
Introduction

Housing affordability concerns the ability of singles, couples and families to buy or rent dwellings within reasonable distances to employment or study opportunities and basic amenities. Those dwellings are first and foremost our homes, the foundation of our lives and our families – a basic need. They help define how well we can engage in the community and how productive we can be in the economy.

Housing affordability has become a prominent issue after several years of double-digit price growth in certain major property markets. House price pressures are most acute in south-east Australian capital cities and certain coastal regional centres. The cities which are our economy’s engines of growth are also the places where housing stress is greatest. The price surge in these localities is forcing more of the population to live further and further from their workplaces. Lower and middle income earners are finding it more and more difficult to balance earning a living with family and other obligations.

The issue of affordability affects household spending decisions, where they’re able to locate and the suitability of dwellings to their circumstances. Other examples include:

- Key workers like police officers, teachers and nurses can’t afford to live near the communities they serve.
- Children are staying at home for longer, marrying later and taking longer to save for a home deposit.
- Many older Australians are locked into big houses that no longer suit their needs while a greater number of near retirees are renting or paying off a mortgage.
- Commuters spend too much time on congested roads and trains which are now the norm in certain Australian cities.
- More Australians are renting.

These trends are, without a doubt, influenced by unaffordable housing. Some argue these inconveniences just motivate people to do better for themselves. But what if your life circumstances don’t permit and you have dependents? It seems that home ownership is slipping away even from many middle class Australians, at least until they reach their middle or late thirties. What was once a bedrock policy objective – prioritising families and the disadvantaged over investors and land owners, has been forgotten.

This discussion paper identifies the underlying causes of Australia’s housing crisis, and proposes policy responses.

State of the housing market

The current stock of residential housing in Australia is 9.9 million, up 17.5 per cent from 8.4 million units 10-years ago. Of the 2017 housing stock, 5.4 million represent owner-occupied dwellings and 2.6 million are rentals, with the balance either unoccupied or unknown tenure. This compares with 4.9 million owner-occupied and 2.1 million rental units in 2006. The current national stock of housing includes 415,000 (4.2 per cent of total national dwelling) social housing dwellings with rents tied to benefit

1 Some proportion of the 2.6 million rental houses are rented for less than 75 per cent of market rates.
ABS 2017, 2016 Census QuickStats, accessed on 16 August 2017, URL:

2 ABS 2017, 2006 Census QuickStats, accessed on 18 October 2017, URL:
payments, of which 320,000 are public housing, and about 80,200 are community housing. In contrast 10-years ago, there were 406,000 assisted dwellings, which includes 337,000 public houses and 50,100 community houses, so the stock has only grown by around 2.5 per cent over the decade.

New arrivals to Australia have added the equivalent of a city the size of Canberra every 2.5-years, or around 200,000 people each year, with the overall population (including natural increase) rising by around 18 per cent over 10-years. To accommodate all these new arrivals Australia needs additional capacity for existing or new centres (including infrastructure and transport links). Right now, new construction is peaking at around 220,000 dwellings, but most of these are one or two bedroom apartments.

Industry Super Australia (ISA) estimates a national shortfall in housing (really a shortfall of assisted housing) of around 230,000 mainly located in New South Wales and Victoria. While other states may experience a surplus of new houses.

Drivers of affordability

The property boom began as a catch-up process rather than a speculative rush. The seeds of the latest property boom began with the resources boom which saw a spike in immigration, especially from Asian nations. The Global Financial Crisis (GFC) then saw ultra-low global interest rates which primed asset classes, whilst failing to elicit a recovery in business capital expenditures. This led to extraordinary developments in Australian housing markets as key groups of longer term investors (often via self-managed super funds) began tilting towards established dwellings with reliable yields in the record low interest rate environment.

From 2013 the problem of housing affordability became more serious. Many property developers (small and large) entered the market, chasing short-term speculative capital gains. This coincided with a ramping up of student arrivals who drew on their parents’ savings (a safe haven strategy) to acquire bricks and mortar, usually near centres of education. Alarm bells did not ring for Australian governments, even though most new arrivals were settling in a limited number of localities. These factors and market dynamics combined to drive record house prices in key centres. The key drivers of low housing affordability are due to imbalances in demand and supply in certain key markets.

- On the demand side, key factors include the extent of unanticipated or uncoordinated immigration flows to growth centres; the relationship between international student intake and the dynamics of foreign investment in established dwellings; the interaction between record low interest rates and investors chasing future capital gains via gearing-oriented tax concessions; and lax lending practices.
- On the supply side, key factors include poorly coordinated land release and infills approvals and the outright restriction of supply by state governments; private land developers stockpiling tracks of land around the urban fringe, and restrictive town planning and zoning rules by local governments that have produced very long lead-times for the construction of new, denser housing stock in areas where affordability is worsening.

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3 As of June 2016, there are 320,041 public houses, 9,949 State owned and managed indigenous houses, 80,225 community houses and 5,046 remote social houses. Additionally, 15,643 units were managed by government funded indigenous community housing organisations. Productivity Commission 2017, Report on Government Services 2017, Vol. G, Chapter 18 - Housing, Table 18A.4.


5 ISA analysis of national housing shortage. Of the total, 202,000 units are located in New South Wales and Victoria. See Figure 15 in page 22.
State of the asset class

Residential housing is the largest component of the Australian household balance sheet, valued at $6.7 trillion dollars. Around 66 per cent of the stock is held by owner-occupiers and 31 per cent held by investors, of whom there are more than 2.5 million. Investors are predominantly mums and dads - a cottage industry, of which 62 per cent rely on the negative gearing concessions. Negative gearing is contributing to the prevalence of low yielding investments in the epicentres of the property boom in Sydney and Melbourne. Around 22 per cent of all investors are over 60 years of age and still have material debts. Also, 10 per cent of investors own three or more properties.

The acquisition of housing assets at ultra-low global interest rates since the GFC has helped produce significant pockets of mortgage stress in certain major capital cities. These are spread far-and-wide across a mix of high and low income postcodes across the suburbs. The ratio of household debt to income has nearly quintupled since the 1980s, reaching an all-time high of 194 per cent in 2017 (a 23 percentage point increase since March 2013). Household debt is currently over 122 per cent of GDP, an amount that is amongst the highest proportions in the world. This is, by far, the greatest level of debt in the G20, with only Canada having debt more significant than the size of their economy.

Servicing these large debts is getting harder too. Households are much more sensitive to tightening financial conditions from high mortgage rates and the lagged impact of tighter macro-prudential policies than many realise. Despite record low interest rates, around 12 per cent of income is now devoted to servicing debt – that is a third more than in 1989-90, when interest rates neared 20 per cent. A return to ‘neutral’ policy interest rates would see lending rates rise by 200 basis points, due to some adverse shock or the restoration of normal wholesale borrowing rates. This would magnify housing stress exponentially. This is especially true now that annual wages growth is only increasing by around 2 per cent, the lowest rate of increase on record. What happens to wages if there is an economic downturn?

The risks associated with ignoring affordability issues

The lack of coordination in housing policy across all levels of Australian government has generated hotspots in property markets that have undermined macroeconomic stability. Destabilising wealth effects and the continuing expansion of household debt are feeding an unsustainable cycle of property price inflation. Net foreign indebtedness has risen to concerning levels for a small open economy that lacks a diversified economic structure and runs persistent current account deficits. Australia is far too dependent on property and pits (extraction of iron ore, coal and now liquefied natural gas) as the launch pad of its economic advance. This is very risky and may end in tears.

Booming house prices are good news for existing owners and bad news for those entering the market for the first time. Prospective buyers paying 2017 prices must have faith, at a time when even investment professionals believe a purchase now is, over the short to medium term, ill-advised. They must also have faith in their capacity to maintain an adequate income to service their debt, or hope that prices will just keep rising. In Sydney, where prices have risen 87 per cent over five years, whilst incomes have risen around 15 per cent on average, that is a tough call. Yet so many people (mostly Australians below age 35) have been prepared to take out home loans valued at over six times their income, facilitated by the relatively lax lending standards of banks.

Tough job for regulators and macro policy makers

Another issue is macro-prudential oversight and regulation of the Australian banking system. Does it make sense to allow a ‘cottage industry’ driven by public subsidy to steer so much funding into existing bricks and mortar? The big four banks have an average of 62 per cent of their loan portfolios in mortgages – so they are uniformly vulnerable to a sudden shudder in the housing market. UBS estimates there are around
$500 billion worth of ‘liar’ loans in the system based on ‘not completely factual’ loan applications. Interest-only loans still account for 40 per cent of investor borrowing in 2017. Surveys suggest that most borrowers don’t understand the difference between interest only and principal and interest borrowing.

The haphazard approach to housing policy across all levels of Australian government has resulted in few synergies in regional growth cycles. Currently there are three cycles:

- Sydney with strong Gross State Income (GSI) per capita, stronger private employment prospects and high population growth (the robust growth region).
- Melbourne with weak GSI per capita, higher unemployment but even stronger population growth (the arithmetic growth region).
- The rest of Australia with weaker growth in GSI per capita, higher unemployment but weaker population growth (the declining growth region).

Coordinating macro and prudential policy to account for these regional differences is problematic, especially given differences in household indebtedness and housing affordability. One guiding tenet should be promoting stability around property as Australia’s largest asset class. Destabilising the market would be very adverse for economic stability.

Affordability connects to affordable housing

While housing affordability as an issue is mainly concentrated in certain key regions and hot property markets, some have already cooled or will cool eventually. But when the dust settles, many low to middle income households will struggle to access housing in many parts of the country. What was a serious problem a decade ago is becoming a crisis after a further ten years of policy gridlock.

The maximum affordable rent for a couple on minimum wage with two children is $416 per week, far short of the median Sydney rent of $743 per week for a 3-bedroom house. For households reliant on income support payments the situation is extreme, with less than one per cent of houses for rent in Greater Sydney affordable. In many of our capital cities the rental vacancy rates are below two per cent.

The sharp deterioration in housing affordability in certain suburban and regional centres means that many more Australians are now priced out of the property market and are more than ever reliant on some form of assisted housing (affordable, public or community).

Australia’s housing affordability problem has developed over several decades and will require a long-term commitment to resolve. While housing construction activity in 2016 and 2017 has kept pace with population growth it has not dampened demand generated by years of under-building in certain key localities. The greatest demand is for rental housing which is affordable and available to households on low to moderate incomes. In 2009, the National Housing Supply Council reported that the supply of affordable rental dwellings for low income earners had fallen in absolute and relative terms in the decade to 2006, despite a 20 per cent increase in the overall supply of housing. Since then the situation has only worsened.

Australia’s social housing system is no longer a safety valve for the over-heated private rental market. Public housing supply has fallen by 16,000 in eight years as some has been transferred to not-for-profit community housing operators. It is estimated that 20 per cent of public housing stock has three or more major structural problems or lacks functioning facilities for washing, sewerage, or storing/preparing food. Australia now has one of the lowest proportions (4.2 per cent) of social housing among OECD countries. The only part of the social housing sector which is growing is community housing, both mainstream and indigenous. Despite this, waiting lists for social housing remain intractable.

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The affordable housing supply gap

When property markets are squeezed, affordable housing – or the supply dwellings offered at below 75 to 80 per cent rent of market rent – will likewise be much less affordable. Price pressures filter down to the most vulnerable in our society. They cannot afford to pay market rents and are forced into increasingly marginal housing arrangements to keep shelter over their heads. More than ever people are being sent packing to far-flung suburban and regional localities, significant distances from work, study, hospitals and other key amenities. The most disadvantaged, for example, welfare recipients or survivors of domestic violence, end up in public or community housing if they are lucky. But it is now commonplace to hear of people couch surfing from one night to the next or sleeping in their cars.

The problem of rental housing affordability is clearly too big for governments to solve alone. Estimates of the gap between underlying demand for housing and supply range from 369,000 (National Housing Supply Council, 2012) to 527,500 (Australian Housing and Urban Research Institute, 2017). ISA provides a more conservative estimate of around 230,000, based on a top down approach to measuring demand and supply trends in regional markets.

- A significant investment - in excess of $96 billion in 2017 dollars - is required by governments to remedy the affordable housing supply gap.7
- If the affordable housing supply gap is 230,000, it would take at least 10 years of new supply to address rental stress amongst Australia’s poorest households.8
- Recent government initiatives represent a belated attempt to deal with the problem.9 A comprehensive, long-term commitment to addressing the supply of affordable rentals for low to moderate earners is required.
- This social housing ‘standing still’ strategy we assume will cost $20 billion over the next decade.
  - The Affordable Housing Working Group estimates an additional 6,000 social housing dwellings will be required each year just to keep pace with population growth, without addressing the backlog of need.10

Why the gap is getting wider

The supply of affordable housing is not keeping pace with community needs. Federal and state governments are resourcing fewer and fewer assisted housing places each year.11 As a result, raising the supply of assisted housing falls mainly to not-for-profit community housing providers (CHPs) whether they are adequately resourced to do so or not. CHPs are non-government organisations which provide housing

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7 Based on ISA analysis of the cost of delivering 230,000 units of mixed affordable and social rental units over 10-years nationally.

8 Assuming one in four of the 220,000 dwelling units being built annually is dedicated to assisted housing and it takes one or two years to establish the program.

9 These measures include increasing the capital gains tax discount for sub-market rentals to key workers, enabling managed investment funds to invest in affordable rental housing (without significant incentives), enabling CHPs to borrow at a modest discount to bank lending rates, and some assistance to local government with infrastructure costs. These measures are at best a partial solution and appear unlikely to have a significant impact on the rental affordability threat facing low to moderate income households.


11 Gross numbers of state-owned public housing are reducing as jurisdictions are selling off stock to pay historic debts to the Commonwealth Public housing is still public when the management gets transferred to CHPs. But they are still owned by the state government and get allocated according to state government waiting lists and policy priorities.
for people on very low, low and moderate incomes. These not-for-profit agencies provide mainly long-term rental accommodation for people in need and also manage the assets and tenancy relationships. CHPs sit under a regulatory framework that is shared by the Federal and state governments. Registered CHPs have particular guidelines to follow, which then qualifies them to receive assistance in the form of grants, loans, dwellings, or operational funding. CHPs vary widely in size and sophistication. Some of the larger providers develop their own housing stock, or having fee-for-service arrangements with private entities to manage properties and tenancies. The success rate of CHPs, relies on their ability to deliver low cost housing by extracting as much value from each of four elements:

- Cost-effective construction processes;
- Developer margins;
- Internal efficiencies in their housing projects.
- Concessions from various levels of government (for example, GST credits, land tax concessions, zoning benefits, etc.).

Right now, most CHPs do not operate at the scale required to make a dent in supply gap statistics. To do this, they would need to generate the necessary project returns to satisfy institutional investors. This is virtually impossible to do at scale without some form of government concession. This is especially true in regions where escalating land values have driven down rental yields.

There is also an important role for private developers (big and small) to address the shortfall of assisted housing. Increasingly they are being required to include a certain proportion of sub-market units in new developments to obtain planning approvals. Presumably this a trend that will become more prevalent through time.

Policy suggestions – affordability

A more pragmatic mix of housing policies across all levels of government would certainly contribute towards smoothing imbalances in major property markets that have led to soaring prices and that contribute to rising community uncertainty.

Federal, state and local governments need to find ways to coordinate activity without duplication or political interference.

We consider below in more detail the following general policy suggestions intended to address housing affordability for all Australians. For instance:

1. Explicitly linking Federal government planning and state and local government housing approval processes to estimates of regional housing supply gaps.
2. Encouraging more work and student visa holders to reside outside of property market hot-spots.
3. Redirecting all foreign investment to new residential property.
4. Streamlining town planning procedures by mandating the removal of unreasonable height restrictions within urban infill development zones, including ‘inner’ and ‘middle-ring’ suburbs.
5. Discouraging land hoarding by having all levels of Australian government identifying underutilised sites for residential redevelopment (including assisted housing) and providing incentives to private land developers to expedite the release of new blocks.
6. Reorienting the $12 billion spent annually in Federal tax concessions and currently applied mainly to subsidise the purchase of existing housing towards investment allowances for greenfield developments and institutional investment in new assisted housing.
7. Reforming land taxation in Australia via the abolition of stamp duties and replacing them with a mix of land and betterment taxes.
Policy suggestions – assisted housing

Simply increasing overall housing stock does not ensure that rental housing is both available and affordable for low to moderate income households. What is required is a mechanism to, first, increase the supply of rental housing and, second, ensure that the additional supply is accessible for low to moderate income households.

Achieving the necessary growth in assisted rental supply is beyond the capacity of Australian governments acting alone to fund, so private investment will be required. The core element of any strategy to deal with the current crisis in assisted housing are as follows:

8. Establishing a coordinating body to identify the extent of regional shortfalls in assisted housing, and identifying solutions for dealing with them. This would require the reinstatement of a rigorous housing supply forecasting capacity to underpin effective city and municipal level planning.

9. Developing appropriate incentives to encourage institutional investment in a new asset class - affordable rental housing. This would entail focusing tax policy more on private investment in affordable housing rather than incentivising households to buy existing property for speculative gain.

10. Expanding the capacity and professionalism of the community housing sector to deal with larger scale development and tenant administration; and strengthening social and affordable housing sector regulation to provide assurance to investors and tenants.

11. Attempting to measure the full social and economic cost of ignoring the current affordable housing crisis to worsen over the next decade or two as part of the next Intergenerational Report.

Figure 1 – Policy effects on the housing continuum

Source: ISA Analysis
Avoiding band-aid solutions, waste and mismanagement

Band-aids are short-term or one-off solutions. Institutional investors need long-term policy certainty, so when governments establish concession programs, they should stick with them. Governments should eliminate ‘policy risk’ for investors who fear getting stuck with orphaned assets each time there is an election. Band-aids also refer to haphazard policy, like stimulating building to take a little pressure off a given region, but not systemically creating an overarching policy framework for the national housing system.

In Australia, current and proposed policies that deal with housing affordability are a mix bag of policy effectiveness (see Error! Reference source not found.).

**Figure 2 – Various policy impacts on housing affordability**

A better, more coordinated approach to housing policy by Australian governments over the past two decades, as well as direct engagement with longer term investors, could have forestalled most of today’s affordability issues.

In the fight for assisted housing, over two decades has been wasted. Focusing too much on demand has tended to drive up prices or rents, rather than expand capacity via greenfield investment. This is certainly true of negative gearing, the capital gains discount, first homeowner grants and the recently-announced superannuation saver scheme. These piecemeal policies which cost Australian governments as much as $14 billion per year would be better redirected to investment allowances for assisted housing and build-to-rent schemes.

The best social housing policy is full employment in labour markets with fair wages and access to affordable dwellings that are owner-occupied or, at least, suited to personal circumstances.
A more balanced approach to housing policy by Australian governments would support productivity and raise living standards through a virtuous cycle of construction-driven economic expansion, whilst providing a reliable stream of assisted housing places. This would benefit everyone.

In Australia we need a stakeholder economy where the gains from economic advance are spread broadly, generating gradual wealth effects and stabilising debt levels, which in turn encourage consumer demand and business investment as firms anticipate stability and expanding markets.

Overview of this discussion paper

The first section of this paper sets out key definitions such as housing affordability, assisted housing, affordable housing, and social housing (including public housing and community housing). It considers industry super funds’ current participation in the assisted sector in Australia. It then examines the residential property market and its composition in Australia today.

The second section examines aggregate international, national and regional price trends and then considers the key determinants of housing affordability and how the nation is tracking against these. The paper develops a measure of the national balance between housing supply and demand, and develops a regional ‘gap’ measure.

It also considers the risks for broader economic management embedded in the latest property boom. This includes household leverage risks, banks’ exposure to property loans, the possibility of a synchronous tightening in policy interest rates in major economies impacting wholesale funding costs, and the likelihood of a severe oversupply of high density apartments, certainly in Brisbane, but potentially in Melbourne and perhaps Sydney from late 2018. These risks could have a profound impact on the wider economy if the property boom is followed by a ‘bust’.

The third section examines policy measures - applied and proposed, over the past two decades in Australia, with references to international influences.

We conclude any policy response that increases the buying power of households – whether through grants, reduced taxes or innovative financing – will increase demand, but the main outcome will be increased house prices or rents, not a significant improvement in affordable housing supply.

The final section examines alternative policy responses for various levels of government that could be targeted towards addressing housing affordability gaps in key market segments and more broadly. We argue that more budget dollars should be allocated towards the most effective policy responses and less dollars be dedicated to ‘band-aid’ policies that don’t address underlying issues.
1. Background

This section aims to define key terms such as housing affordability and assisted housing (including affordable housing and social housing). It considers industry super fund involvement in the residential property sector and initiatives to invest in assisted housing. We then examine the residential property market and its composition in Australia today.

1.1 Defining assisted housing

Housing affordability is the relative ease through which people can buy housing outright (and service debt through time) or find suitable rental accommodation within a reasonable distance from work or study and other basic amenities. Therefore, housing affordability relates to personal budgets and the capacity to purchase basic living items such as food, clothing, transport, medicine and education, whilst retaining enough spare funds in reserve to cover the cost of housing. Technically, housing affordability is said to be sustainable where dwelling costs (payments for mortgage or rent) constitute less than 30 per cent of gross household income.

Historically it was a realisable goal for most low to middle income Australians to buy a nice home in a good town that accommodated their family within a reasonable distance of work. Now, for many, home ownership seems like distant dream, especially for single and younger Australians.

Rapidly rising house prices often impact the most vulnerable in our society who often cannot afford to pay anywhere near market rents and have no spare capacity to manage adverse events. In response, many individuals and families will consider all kinds of alternate arrangements in far flung suburban and regional outposts, significant distances from work or study options and basic amenities (such as hospitals).

The least lucky in the community, who may already be in a vulnerable position for one reason or another (for example, victims of domestic violence, mental illness or drug addiction) may be forced to rely on the goodwill of others including family, neighbours, community organisations and government agencies to avoid homelessness. Unfortunately, it is now commonplace to hear of people (including older women) couch surfing from one night to the next or sleeping in cars. Many others sleep outdoors each night or do so for extended periods of time.

Various options for market and non-market housing are depicted in Figure 3 below. Where housing affordability is especially tight, home ownership may not be an option, so individuals will rely on the private rentals market for accommodation. If housing costs outpace growth in household incomes for sustained periods of time, this may reduce the capacity of many people to pay market rentals. Where individuals, couples or families are no longer able to afford to pay market rents, they will generally seek out some form of assisted housing with rents set at below market rates. The continuum of options begins with home ownership and private rentals and ends with off-market arrangements. Each form of assisted housing is more concessional than the last. There are three main types of assisted housing:

1. **Affordable housing** is the supply dwellings offered by tenants at or below 75 per cent of market rent.
2. **Social housing** is the supply of public (directly government owned) or community (built by not-for-profit organisations) housing offered to welfare benefit recipients (the unemployed, disabled and age pension recipients) who are charged at 25 per cent of their welfare payment (unemployment benefits, disability support benefits and the age pension).
3. **Crisis housing** is the supply of temporary accommodation provided by government and community groups to individuals at risk of harm (survivors of domestic violence, homeless children, for example).

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For the purposes of this paper we define **assisted housing** as affordable housing and social housing.

### 1.2 Industry super fund investments in the housing market

Improving housing affordability is overwhelmingly beneficial to the livelihoods of superannuation fund members, especially when it comes to reducing the likelihood of ending up with a large mortgage in retirement. Given that the vast majority of industry super fund members are working Australians of modest means, the issue of housing affordability is vital to Industry Super Australia and our member funds. Hence, this paper seeks to identify causes and examines a range of policy solutions that can be undertaken by government and institutions such as industry funds to make housing affordable again.

In recent years industry super funds have started to introduce residential property (including new housing) into their property portfolios as part of a well-diversified asset allocation.

For example, Industry Super Property Trust (ISPT) co-founded in 1994 by AustralianSuper, Cbus and HESTA, which now has 31 institutional investors representing a diverse base, including industry superannuation funds and public sector super and investment funds, undertakes a wide range of activities such as property development and commercial investments.

ISPT does not invest in residential projects as a build and hold strategy. It undertakes residential land subdivisions and apartment projects through equity investments. These projects (from site acquisition, development phases, through to the sale of each developed lot or apartment) have earned rates on return (after fees and before tax) in excess of 11 per cent over the past decade.\(^1\)

Many industry super funds are now looking for opportunities to increase their direct investment in residential properties such as mixed developments which include assisted housing. For example, currently ISPT, Cbus Property, AustralianSuper and other industry super funds are investigating the feasibility of build-to-rent (BtR) options which are examined in more detail below.

HESTA has made inroads in affordable housing with a $6.7 million investment in the community housing provider - Horizon Housing in Queensland. The initial investment is made through HESTA’s $30 million Social Impact Investment Trust, which aims to deliver both financial returns and benefits to the wider community.

NGS Super does not have direct investments in social housing but it does have a $500,000 exposure to social benefit bonds (the Aspire SIB) which invests in reducing homelessness in South Australia. The bonds fund the Aspire Program, which is delivered by the Hutt St Centre, an Adelaide based homelessness

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services specialist, in partnership with community housing providers including Common Ground Adelaide and Unity Housing.

Other significant announcements will be made on this front in the not too distant future.

1.3 A snapshot of housing in Australia

The 2016 Census revealed that there are approximately 9.9 million dwellings in Australia. Of those occupied, 66 per cent are owner-occupied and 31 per cent rented (i.e. investment property) as illustrated in Figure 4.14 Most Australians live in a stand-alone dwelling that is either owned outright or via a mortgage. The fastest growth in dwelling type has been the townhouse category which has grown by 60 per cent over a decade. Detached houses make up about 73 per cent of all dwellings, with semi-detached town houses at 13 per cent, flats and apartments at 13 per cent.15

The national stock of dwellings revealed by the 2016 Census represents an increase of 1.47 million units or 17.5 per cent from the 2006 level. Over the same period, the national population increased by 17.9 per cent from 19.9 million to 23.4 million. Of the 2016 housing stock, around 2.6 million are rentals compared with 2.1 million recorded at the 2006 Census. In 2016, the national stock of social housing (rentals) stood at approximately 415,200. This is approximately 2.3 per cent higher than the 406,000 units recorded in 2006. The stock of social housing in 2016 consisted of 320,000 public dwellings, 80,200 community dwellings and 15,000 social dwellings in remote regions.16 In 2006, the breakdown consisted of around 337,000 public dwellings, 50,100 community dwellings and 18,300 remote social dwellings.17

Our social housing system no longer provides a safety valve for the over-heated private rental market. Public housing supply has fallen by 16,000 dwelling in eight years as some has been transferred to not-for-profit community housing operators. It is estimated that 20 per cent of public housing stock has three or more major structural problems or lacks functioning facilities for washing, sewerage, or storing/preparing food. Australia now has one of the lowest proportions (4.9 per cent) of social housing among OECD countries. The only part of the social housing sector which is growing is community housing, both mainstream and indigenous. Despite this, waiting lists for social housing remain intractable.

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14 Percentages of occupied private dwellings nationally (8.29 million) according to 2016 Census QuickStats.


Figure 4 – National dwelling statistics

<table>
<thead>
<tr>
<th></th>
<th>Owner Occupied</th>
<th>Investment Property</th>
<th>Social Housing</th>
<th>Types of Dwellings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2006</strong></td>
<td>4.9 MILLION</td>
<td>2.1 MILLION</td>
<td>406 THOUSAND</td>
<td></td>
</tr>
<tr>
<td></td>
<td>65%</td>
<td>27%</td>
<td>5%</td>
<td>APARTMENTS 14%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>TOWNHOUSES 9%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>OTHER 2%</td>
</tr>
<tr>
<td><strong>2016</strong></td>
<td>5.4 MILLION</td>
<td>2.6 MILLION</td>
<td>415 THOUSAND</td>
<td></td>
</tr>
<tr>
<td></td>
<td>66%</td>
<td>31%</td>
<td>5%</td>
<td>APARTMENTS 13%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>TOWNHOUSES 13%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>OTHER 1%</td>
</tr>
</tbody>
</table>

Source: ABS Census Quick Stats 2016 & 2006
Note: Rented dwellings we assume to be investment properties.
2. Explaining changes in housing affordability

This section first examines where affordability issues are greatest in Australia. We then consider what’s driving the lack of affordability and introduce ISA’s analysis of the extent of the supply gap across the states and territories, both in terms of general housing and assisted housing. Finally, we consider the consequences of housing market imbalances for the broader economy and macro-prudential management.

2.1 Aggregate price trends

House price growth in advanced economies has flat-lined for most OECD countries during the period since the GFC. But this is not true for Sweden, the United Kingdom, Norway, Canada, New Zealand and Australia. Each of these is a small open economy, with the latter three in particular, heavily reliant on resource and rural commodity exports to China.

Figure 5 – Real house prices in selected countries (1995– 2016)

Source: OECD Statistics
Note: Assume 1995 price level = 100 (Index)

2.2 National versus regional variation in house prices

In terms of housing price trends and how they impact housing affordability within Australia’s capital cities and regions, the story is very mixed over the past decade or so. Significant price increases in certain localities since mid-2012 have frustrated the policy goal of improving housing affordability for all Australians. Various factors are behind this trend, but the main driver has been a collective failure to anticipate demand and then build or renovate enough dwellings so that supply keeps pace with burgeoning demand.

House prices in Sydney and Melbourne have experienced significant growth since 2013 and consecutive years of double-digit growth from 2014 to 2016, with Canberra close behind. Perth and Darwin recorded

---

continuous annual declines since 2014 as the mining boom unwinds, while growth in Brisbane, Adelaide and Hobart was relatively subdued.

Figure 6 – RBA residential property price index (2003 – 2016)

![Graph showing RBA residential property price index](image)

Source: ISA analysis on ABS Cat.6416.0 (Mar 2017)

Growth in national average house prices has far outpaced growth in wages over time. This is especially true in suburban Sydney and Melbourne where house prices have experienced double-digit growth since 2013. On the other hand, wage growth has averaged about 2.6 per cent. The greater lack of affordability in Sydney and Melbourne are seen in Figure 7 where price growth in south-east coast capital cities has outstripped the rest of the country since 2013.

Figure 7 – Wage vs house price index by region since 1998

![Graph showing wage vs house price index by region](image)

Source: ISA analysis on ABS Cat.6345.0 and CoreLogic
Note: Index 1998 = 1

Therefore it is not surprising that house prices have risen as a share of income for Sydney and Melbourne since the GFC, but risen less so for the rest of the country. As seen in Figure 8, the house price to income ratio for Sydney and Melbourne on average, now exceeds 6.5 times gross annual personal income. The high ratio is also making home ownership significantly more difficult for low-income earners and young buyers as they need to save a greater share of their income to save for a deposit.
2.3 The determinants of housing affordability

To explain the relative patterns of affordability between Australian cities and regions it makes sense to identify any shortfall in supply of residential housing over time. This is true because residential housing construction is a lagged process. When supply is sufficient, prices tend to moderate over time. But when supply is insufficient, prices may rise rapidly. Nor does supply respond quickly to higher prices – it is said to be inelastic – partly because of the dynamics restraining rental yields for investors. The scale of new constructions depends on the availability of land and the relaxation of zoning laws permitting high density housing. Local planning and regulations may constrain development in so-called ‘middle-ring’ suburbs, where access to services and public transport are most available.

The price of residential property is a function of supply and demand.

Housing demand is driven by borrowing costs, population and social trends (such as new household formation, divorce rates and immigration levels) market structure, investment dynamics and government policy.

The borrowing costs for owner-occupiers and investors have been declining for more than three decades in nominal and real terms (Figure 9). This is especially true after the GFC when ultra-low interest rates employed by major central banks helped to lower wholesale funding costs of Australian banks to record lows, fuelling investor sentiment.
Over recent years Australia’s natural population growth rate and the level of immigration into Australia has far exceeded that of other advanced OECD countries. While a significant immigration program is a big positive for raising living standards over time (via deepening economies of size, access to a skilled workforce, capturing the desire of arrivals for success, adding cultural depth, and offsetting ageing populations) the path to higher population needs to be managed with skill.

A sharp uptick in population growth can send “false” signals of economic success, while driving up asset prices and straining existing capacity. For example, driving up the cost of housing and infrastructure services. All this can focus entrepreneurs on pursuit of “rents” via property development rather than more truly entrepreneurial pursuits such as technology start-ups. The battle for resources also causes competition between the existing and new labour force driving down living standards for low and middle income earners on average. Latest population projections by the Australian Bureau of Statistics (ABS) indicate the Australian population will increase by between 70 per cent and 120 per cent by 2050.

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19 Analysis of data from ABS Cat.3101.0 has shown from 2000 to 2016, population change due to net overseas migration has risen from about 30,000 per quarter in the early 2000s to over 50,000 per quarter on average since 2008.

Another potential risk associated with a high population growth strategy is when most arrivals settle in a limited number of regions. This has been true in Australia. New student and work visa card holders have settled in affordability hotspots of suburban Melbourne and Sydney. Around 62 per cent of migrants are now residing in New South Wales or Victoria.

A significant portion of loan activity and sales of existing houses in Sydney and Melbourne have been made to foreigners and tied to education. Nationally, 343,000 student visas were issued in 2016-17. Latest estimates for the June quarter 2017 from National Australia Bank indicate 17 per cent of new apartment buyers and 11 per cent of new house buyers are foreigners. Figure 11 shows that foreign student enrolments have increased since 2013, with enrolments in New South Wales and Victoria accounting for the vast majority.

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The significant uptick in growth in student numbers has coincided with significant inbound investment by Chinese in Australian real estate dedicated both to new and existing property and the purchase of residential development sites. Figure 12 shows investment inflows from China rising from around $1 billion in 2008-09 to almost $32 billion in 2015-16 (the latest data point).

It does seem likely that there was significant rorting by non-residents purchasing existing real estate prior to 2016, with the tacit assistance of real estate agents, mortgage brokers and banks. Until very recently, non-residents have had a very easy time obtaining funds from Australian or offshore lenders to purchase of both new and existing dwellings in Australia.
The significant uptick in Chinese ‘family’ purchases of established property, funded from offshore, driven by safe haven motives, perhaps explains a significant portion of housing demand near centres of secondary and tertiary education from 2015 perhaps to the first quarter of 2017. From this point on there has been a crackdown on foreign currency outflows by Chinese monetary authorities.

Figure 13 – Foreign investment in residential real estate

Housing supply, conversely, is subject to a variety of constraints, each which adds to the cost of new developments and the speed of delivery. The Reserve Bank of Australia, along with the Productivity Commission and other industry observers have noted that there are a number of supply side constraints that increase the cost or time for the delivery of new properties.\(^\text{23}\) These include the complexity of the planning and approval process, the provision of infrastructure for greenfield developments, the availability of land and infill opportunities and the public’s attitude to infill development.

The magnitude of supply inelasticity

Ideally, market forces should respond to price signals, and housing supply should increase in relation to price increases and return to some equilibrium in terms of household disposable income. However, housing supply often shows low degrees of elasticity.\(^\text{24}\)

Table 1 presents estimated price elasticities for different dwelling types for the Sydney housing market for the 15 years up to 2006. An elasticity below one reflects market conditions where an increase in demand is primarily transferred to increased prices, rather than an increase in quantity supplied. The analysis indicates that Sydney’s market has a history of significant price inelasticity.

Table 1 – Elasticity of housing supply (Sydney)

<table>
<thead>
<tr>
<th>Region</th>
<th>Strata</th>
<th>Non-Strata</th>
<th>All Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inner ring</td>
<td>0.35</td>
<td>0.08</td>
<td>0.26</td>
</tr>
<tr>
<td>Middle ring</td>
<td>0.84</td>
<td>0.10</td>
<td>0.31</td>
</tr>
<tr>
<td>Outer ring</td>
<td>0.66</td>
<td>0.38</td>
<td>0.43</td>
</tr>
</tbody>
</table>


\(^\text{24}\) Price elasticity is a measure of the effect of a price change or a change in the quantity supplied on the demand for a product or service.
Measures of the ‘supply gap’ in Australia

One way to measure whether there’s enough new housing to meet the demand of a growing population is to measure the ratio of dwelling supply to population change. This supply could be represented by new dwelling approvals, construction commencements or completions.

Comparing new dwelling approvals and completion numbers with changes in population is one way in determining the current state of housing supply relative to historical trends. Typically, approval numbers are slightly higher than completion numbers and in some instances, the former acts as a leading indicator. During the 1990s we observed a higher overall ratio, suggesting high levels of supply relative to demand in the form of population growth. This level decreased in the years prior to the GFC and remained at a lower level until 2014. Note that comparing the national level of dwelling supply to population growth may not capture the wide disparity of levels of housing affordability observed across the country.

The decrease in housing affordability seen in Sydney and Melbourne, can be partially explained by the low ratio of new dwellings coming into the market compared with population growth, shown in Figure 14. This is in contrast to the rest of the country, where since 2015, the amount of new dwelling completions notably increased in relation to population growth. Therefore it is not surprising that property prices in these regions are subdued relative to the booming markets of Sydney and Melbourne.

Figure 14 – Ratio of new dwelling completion to population change (by region)

The national supply and demand for residential housing can be modelled by analysing a time-series of dwelling completions against household formation numbers over time. As shown in Figure 15, the model suggests that the nationwide gap between dwellings completed and dwellings formed has narrowed since 2015. However, the cumulative housing shortage since mid-2010 has risen to approximately 228,000.
The housing construction cycle is typically a slow process which spans over two-and-a-half to five-year period through planning, approvals, commencement and completion. In Australia (and perhaps everywhere else as well) the supply of standalone houses and apartments does not respond very quickly to price signals in property markets. That said, the prolonged period of soaring prices observed in certain capital and coastal cities suggests that there are fundamental barriers to greater supply in play, preventing a more speedy downward adjustment in price. Therefore, identifying factors that act as barriers to greater supply would assist with devising more effective policy solutions on affordable housing.

Disaggregating national supply and demand for residential housing into different state regions shows a somewhat different story. The left chart of Figure 16 describes New South Wales and Victoria – regions that have experienced significant capital city property price increases, which as expected account for most of the supply imbalance in terms of new construction with a housing shortfall of 202,000. Whereas the right chart shows capital city prices for the rest of the states and territories, where the post-mining investment boom decline has seen lower population growth and a consequent decrease in construction now easing the overall cumulative housing shortage, which is only estimated to be approximately 26,000.
Housing affordability and the supply-gap

The rapid pace of property price appreciation, most acute in Sydney and Melbourne, has been influenced by several factors. However, first amongst these is the so called “supply gap” – driven by insufficient supply of housing stock and surging demand.

Many factors contribute to the demand and supply imbalance:

1. Unanticipated population growth in our major capital cities driven by high levels of new arrivals on work and study visas, especially since the onset of the China mining investment boom.
2. Antiquated government planning and zoning rules that are hampering supply of new dwellings.
3. Untargeted tax incentives such as negative gearing and the capital-gains tax discount which serve as a vehicle for tax minimisation and speculation by individual investors in existing property rather than a targeted allowance for new building aimed at institutions.
4. Foreign investment, particularly those from Asia, concentrated around Sydney and Melbourne have added additional sources of demand for dwellings.

2.4 Risk of boom and bust

The extraordinary developments in Australian housing markets are inescapably linked to ultra-low global interest rates since the GFC which have pumped up the price of shares (especially in the United States and Europe), residential property (namely in Australia, New Zealand, Canada and Norway), commercial real estate and junk bonds, while failing to elicit recovery in business capital expenditures.

The asset price boom in Australia, experienced primarily via real estate, began with the resources boom even before the GFC. After the GFC, key groups of longer term investors entered property markets, chasing established dwellings with reliable yields in an environment of record low interest rates. This was often
facilitated via the use of self-managed super funds and non-recourse borrowing arrangements. Then followed property developers (small and large) chasing speculative gains. Around 2014, Asian investors began to target residential real estate, due to favourable exchange rate movements and perhaps a desire to pursue an effective safe haven investment strategy. Often purchases of existing property were made via younger family members who were studying in Australia.

**Unsustainable house prices**

Whilst a boom in house prices was very good news for existing owners, it is very bad news for those entering the market, especially in recent years. For example, potential market entrants in 2017 must have a leap of faith, paying prices that even investment professionals believe are overpriced in the short to medium term. For example, analysis by Capital Economics on capital city property markets suggests that prices in Sydney and Melbourne may need to fall by between 25 per cent and 30 per cent and Hobart and Brisbane fall by a more modest 5-10 per cent, to return to sustainable ratios of house price to earnings levels (where adjustment is via prices rather than incomes) see Figure 17. 25

Moreover prospective buyers must have faith to believe that their capacity to generate income will not erode or be significantly interrupted so they can service their debt. In Sydney, where prices have risen 87 per cent over five years, while incomes have risen by only around 15 per cent on average, that is a tough call.

**Figure 17 – House price adjustment (%) needed for normalisation of house price-to-income ratio**

At the same time, the growth in household incomes (or their debt service capacity) has also slowed to below 2 per cent. Children are staying at home for longer, marrying later and take longer to save for a deposit. Australians are also now more likely to rent than buy, with a greater number of near retirees renting or still paying off their mortgage. Policy failures are ‘blunting’ incentives for investment in new housing supply, and as a result property prices are continuing to rise in key property markets. This has led to increased affordability pressure which has affected the composition of housing finance in favour of investors over owner-occupiers, particularly first home buyers. At least until very recently, financing for investment properties has been growing while financing for owner-occupied properties has trended downwards. This general trend looks set to continue because high rental costs and higher prices continue to limit the ability of first home buyers to save a home loan deposit.

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Record household debt

Australia has very high household debt and significant national indebtedness. But unlike most of the other nations with significant national indebtedness, Australia has run persistent current account deficits, so most of our debt is owed to foreign countries, or net foreign debt (Figure 18). For this reason Australian policy makers have always been extremely sensitive to the vagaries of global financial markets and especially attuned to pronouncements of credit rating firms and international stabilisation agencies regarding the conduct of domestic macroeconomic and budget policy.

Australia’s net foreign indebtedness has risen to concerning levels, especially for a small open economy, lacking a diversified economic structure that runs persistent current account deficits. As a nation we are far too dependent on property and pits (extraction of iron ore, coal and now liquefied natural gas) as the launch pad of our economic advance. This is very risky and may end in tears.

Figure 18 – Composition of nation’s national debt in 2016 – selected nations

The fact that Australia has so much debt, accumulated so quickly, is cause for concern. The ratio of household debt to income has nearly quintupled since the 1980s, reaching an all-time high of 194 per cent (a 23 percentage point increase since March 2013). Household debt is currently over 122 per cent of GDP, amongst the highest proportions in the world. By far the highest level of debt in the G20, with only Canada having debt higher than size of their economy.

Australia’s debts have been accumulated mainly to procure residential housing assets currently valued at around $7.5 trillion dollars. Around 69 per cent of that stock is held by owner-occupiers and 31 per cent held by investors, of whom there are more that 2.5 million. Investors are mainly mums and dads - a cottage industry, of which 62 per cent access the negative gearing concession (which has helped to drive down yields and shut professional investors out of the sector). Around 22 per cent of all investors are over 60 years of age and still have material debts. Also, 10 per cent of investors own 3 or more properties.

Servicing big debts is getting harder for households. Households are much more sensitive to tighter financial conditions from high mortgage rates and the lagged impact of macro-prudential policies than many realise. Annual wages growth is currently increasing by below two per cent, the lowest on record, and would presumably fall further in the event of a downturn. Despite record low interest rates, around 12 per cent of national income is now devoted to servicing debt – that is a third more than in 1989-90, when interest rates neared 20 per cent. A return to ‘neutral’ policy interest rates, due to some adverse shock or just a normalisation of wholesale lending rates would be very tough for existing, highly indebted,
households and significantly impacts broader economic prospects going forward. The International Monetary Fund has warned Australia is now far more susceptible to these type of risk premia shocks going forward which presumably will be the basis of GFC Mark II.

**Lax lending practices and prudential oversight**

So how did household debt rise so quickly in Australia, especially after the GFC? The answer is that the debt was originated mainly by the big-four banks as a by-product of normal lending operations into inflated property markets. Many people (including Australians below 35 years of age) have been prepared to take out home loans valued at more than six times their income, facilitated by the relatively lax lending standards of banks. So there are now significant pockets of mortgage stress (as shown in Table 2) spread far and wide across a mix of high and low income postcodes across major Australian capital cities.

**Table 2 – Worst performing post codes in mortgage stress**

<table>
<thead>
<tr>
<th>Postcode</th>
<th>Locality</th>
<th>Region</th>
<th>Mortgage stress (%)</th>
<th>Postcode</th>
<th>Locality</th>
<th>Region</th>
<th>Mortgage stress (%)</th>
<th>Postcode</th>
<th>Locality</th>
<th>Region</th>
<th>Mortgage stress (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2168</td>
<td>Ashcroft</td>
<td>Sydney - Southwest</td>
<td>3.69</td>
<td>3976</td>
<td>Hampton Park</td>
<td>Melb - Southeast</td>
<td>4.64</td>
<td>4825</td>
<td>Alpurrurulam</td>
<td>Queensland - NT border</td>
<td>5.34</td>
</tr>
<tr>
<td>2800</td>
<td>Belgravia</td>
<td>Central West</td>
<td>2.56</td>
<td>3023</td>
<td>Burnside</td>
<td>Melb - West</td>
<td>3.52</td>
<td>4680</td>
<td>Barney Point</td>
<td>Gladstone</td>
<td>4.83</td>
</tr>
<tr>
<td>2171</td>
<td>Carnes Hill</td>
<td>Sydney - Southwest</td>
<td>2.37</td>
<td>3021</td>
<td>Albanvale</td>
<td>Melb - West</td>
<td>3.17</td>
<td>4506</td>
<td>Moorina</td>
<td>Moreton Bay</td>
<td>4.07</td>
</tr>
<tr>
<td>2480</td>
<td>Bentley</td>
<td>Richmond - Tweed</td>
<td>2.71</td>
<td>3064</td>
<td>Cragieburn</td>
<td>Melb - Northeast</td>
<td>3.04</td>
<td>4114</td>
<td>Kingston</td>
<td>Logan - Beaudeser</td>
<td>3.88</td>
</tr>
<tr>
<td>2340</td>
<td>Appleby</td>
<td>New England</td>
<td>2.21</td>
<td>3095</td>
<td>Eltham</td>
<td>Melb - Northeast</td>
<td>3.03</td>
<td>4128</td>
<td>Shailer Park</td>
<td>Logan - Beaudeser</td>
<td>3.84</td>
</tr>
</tbody>
</table>

Source: Moody’s and The Australian

Note: Mortgage stress is defined as suburbs where homeowners are more than 30 days behind in their mortgage payments

This significant mortgage debt has been originated mainly by the big-four banks, and overseen by APRA and the RBA. UBS has estimated that home loans with a face value of $500 billion have been approved based on applications containing questionable information. This is close to one-third of the value of all mortgages held by Australian banks. In response to commentary on financial risks, APRA has recommenced its bottom-up review of banking lending practices, whilst the RBA has announced a top-down review of the Australian financial system.

This comes as record number of new apartments are expected to hit the market in 2018. Citibank has estimated that existing high density housing ‘blackspots’ in Brisbane, Sydney and Melbourne are most likely to experience an oversupply of apartments.

The lack of coordination in housing policy across all levels of Australian governments has generated a lack of coordination in regional economic growth prospects which makes the conduct of macro-prudential policy more difficult. It seems there is now a three-part business cycle economy in Australia:

- Sydney (strong Gross State Income (GSI) per capita, strong job prospects, high population growth).
- Melbourne (weak GSI per capita, higher unemployment rates, but still strong population growth).
- Others (falling GSI per capital, high unemployment rates, but weaker population growth).

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### Table 3 – Population and economic growth by regions

<table>
<thead>
<tr>
<th></th>
<th>Date</th>
<th>NSW</th>
<th>VIC</th>
<th>Rest of Australia</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Population growth</strong></td>
<td>5-yrs to Mar 17</td>
<td>1.5%</td>
<td>2.3%</td>
<td>1.3%</td>
</tr>
<tr>
<td><strong>Unemployment rate</strong></td>
<td>Sep 17</td>
<td>4.6%</td>
<td>6.0%</td>
<td>5.7%</td>
</tr>
<tr>
<td><strong>GSP growth</strong></td>
<td>2015-16</td>
<td>3.5%</td>
<td>3.3%</td>
<td>2.0%</td>
</tr>
<tr>
<td><strong>GSP/Per capita</strong></td>
<td>2015-16</td>
<td>2.0%</td>
<td>1.4%</td>
<td>0.9%</td>
</tr>
<tr>
<td><strong>Real GSI growth</strong></td>
<td>2015-16</td>
<td>2.8%</td>
<td>2.0%</td>
<td>-1.1%</td>
</tr>
<tr>
<td><strong>Real GSI/Per capita</strong></td>
<td>2015-16</td>
<td>1.4%</td>
<td>0.1%</td>
<td>-2.1%</td>
</tr>
</tbody>
</table>

Source: ABS Cat.3101.0, Cat.5220.0 & Cat.6202.0
Note: GSP – Gross State Product; GSI – Gross State Income

Coordinating monetary and fiscal policy to account for these regional differences is problematic, especially differences in household indebtedness and house prices. One tenet of good policy making is that given residential property is Australian households’ largest asset class, worth $7.5 trillion dollars, it must be treated with care or a recession could be the consequence.

### Risk of market reversal

Predictably a bust can follow a boom. Higher prices eventually encourage overbuilding with significant time lags. Property markets can be satiated well before building completions reach their peak. Excess supply then drives down prices and rents.\(^\text{28}\) This is very good news for those entering markets for the first time or who have struggled to find affordable accommodation. But it is very bad news for anyone who has borrowed in recent years based on inflated valuations. If property markets do go into decline, the balance sheets of household and business will have to be repaired. This will lead to a period of downturn where austerity and saving depress consumption and investment spending and drive down employment prospects and living standards. Certain segments of the Australian property market are in bubble territory, along with our major trading partner China and the Canadians according to Bank of International Settlements statistics (Figure 19).

Now property markets in eastern states have reached their zenith, worrying statistics on market fundamentals abound. For example, according to Citibank, some 1.9 million investment properties could come under the hammer if speculators with multiple properties, or people nearing retirement rush to sell as prices slide.\(^\text{29}\) That sounds very high but if even a fraction of these are brought to market there could be a significant correction.

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\(^{28}\) It can reasonably be argued that prices for land and detached dwellings will not fall by greater than 5-7 per cent, on average, due to the inelastic nature of supply. Some would argue that the Australian market is fundamentally different to the European or the United States real estate markets.

Good planning and farsighted policy can smooth the property cycle. Unfortunately alarm bells did not ring for certain State governments, nor for the Federal government, until around 2013 when it became clear that property markets were heating up as investors were tilting into bricks and mortar, and new arrivals, especially foreign students were congregating in just a few east coast locations. At the same time responsible authorities were systematically estimating their population forecasts each year. These factors and market dynamics combined to drive record house prices in key centres.

We have seen that the key factors driving the housing affordability challenge are inelastic supply and unanticipated demand. Recognising this dynamic allows a more constructive consideration of previous and current policy responses, and should help to design more effective policy solutions or financing models.
3. Previous approaches and recent developments

Below we consider past and current policies that have been put in place by Australian governments to assist housing affordability including subsidies such as the First Home Owners Grant, equity schemes such as the Defence Housing Australia model and the 2017-18 Budget housing affordability measures (First Home Super Saver Scheme and the Senior Downsizing Scheme). We also consider past, current and proposed policies designed to expand the supply of affordable housing including the former National Rental Affordability Scheme, the proposed Australian Housing and Urban Research Institute (debt) model and the 2017-18 Budget proposals (the National Housing Finance and Investment Corporation, an entity dedicated to improving housing affordability to be achieved via overseeing an affordable housing bond aggregator).

3.1 Housing affordability

The decline in housing affordability has historically been met with a vast range of incentive programs, both by Federal and state governments, mostly designed to stimulate the residential property market. Until recently, the main form of incentive programs – namely grants and stamp duty concessions – have promoted demand-led increases in supply; i.e. they have focused on increasing the ability of individuals to acquire residential property.

3.1.1 The First Home Owners Grant

There are two iterations of the First Home Owners Grant (FHOG). The original FHOG scheme was introduced on 1 July 2000 by the Federal government, initially to offset the effect of the GST on home ownership. A second iteration of the grant was initiated during the GFC, pursuant to which additional amounts (up to $14,000 in some states) were made available to stimulate the housing market which was feared to be under stress. The FHOG is complimented by stamp duty exemptions or reductions with the most generous schemes offered in Victoria and New South Wales.30

By offering incentives to first home buyers, the first generation of FHOG (rolled out by the Commonwealth Government) marginally improved the purchasing capacity of first home buyers relative to existing home owners and investors. However, it did not orient first home buyer activity towards new construction, and therefore did not help to address the issues with supply as discussed above.

The introduction of the original FHOG and the GFC FHOG resulted in short-lived increases in the participation of first home buyers in the market, as shown in Figure 20. Unfortunately, the increases were not sustained, presumably because this type of scheme brought forward home purchases from future periods but did not change demand overall. The scheme also contributed to raising prices. As prices rise and the scheme ends, first home buyers are returned to the disadvantaged position they had before the policy change. This is reinforced by a recent study that showed FHOG had minimal impact on housing affordability.31

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30 As of July 2017, Victorian first-home buyers purchasing a property equal to or lower than $600,000 will be exempt from paying stamp duty. For properties between $600,001 and $750,000, a concessional rate will apply. New South Wales provides exemptions on transfer duty on new homes valued up to $650,000 and concessions on transfer duty for new homes valued between $650,001 and $800,000. Other states also offer various levels of concessions for first-home buyers. Stamp duty exemption and concessions are not available in Tasmania. Delahunty, E., ‘State-by-state guide to first home buyers grants’, realestate.com.au, access on 12 October 2017, URL: https://www.realestate.com.au/advice/state-by-state-guide-to-first-home-buyers-grants/.

The FHOG was not targeted in any way on new construction. The second generation of the FHOG (rolled out across states and territory governments from mid-2012) has seen the grant restricted to purchases of new construction. This is designed to re-orient the purchases of first home buyers towards new construction, and provide a boost to supply. Limiting the eligibility of the grant does, however, significantly reduce the choices available to buyers. New housing stock is generally more expensive, all else equal, which presents further issues for first home buyers. This is consistent with the declining presence of first home buyers in the market until very recently.

3.1.2 The DHA model

Defence Housing Australia (DHA) presents a successful model of large scale private investment in the provision of housing. A number of key features of the model might be adapted to expand housing supply in Australia.

The DHA Model

DHA’s role is to provide housing and related services to Defence personnel and their families. To achieve this, DHA is an active participant in Australian residential housing markets, engaging in the following activities:

- Acquiring and developing land.
- Constructing and purchasing housing.
- Raising funding in financial markets through a unique sale and leaseback program.
- Property management, including tenant and leasing arrangements and property maintenance.

Sale and leaseback program

One innovative feature of the DHA model is the sale and leaseback program, where DHA sells properties to private investors on the condition that they lease the property back to DHA. The lease duration can vary from medium term (three years) to longer term (six to twelve years). The leases include the following provisions:
• A guarantee that rent is paid (even if the property is vacant). \(^{32}\)
• The rent is at market value, reviewed annually by independent valuation experts.
• Minimum rental guarantee: the weekly rent cannot drop below the starting rent.
• At the end of the lease, DHA refurbishes the property.

DHA also assumes the role of a rental property manager, including managing routine maintenance. It manages tenants who are Defence force personnel and their families. DHA charges a high management fee of 16.5 per cent of rental income. This fee is higher than those charged in the private rental property management market, which are typically around 7 or 8 per cent. \(^{33}\)

The sale and leaseback program has proven to be successful. In June 2014, DHA managed 18,577 properties across Australia worth around $10 billion. Around two-thirds of those are owned by private investors, and leased back to DHA.

The innovative sale and leaseback program is a primary source of funding for DHA. It helps to reduce capital requirements of the organisation, while maintaining an adequate level of housing stock for defence force members. \(^{34}\)

In a sense, the DHA program undertakes property selection and management, and fundraising, to overcome collective action problems, with a government minimum rental guarantee to private investors. These features have successfully helped to shift private capital into the kind of housing stock that is desirable for public policy or Defence policy purposes.

3.1.3 Budget measures

The Federal government’s 2017-18 Budget contained two major initiatives intended to ease housing affordability issues for key groups including first-home-owners and retirees. Both of these measures are currently before the Senate and it remains to be seen whether either of the policies will pass into law.

First-Home Super Saver Scheme

The First-Home Super Saver Scheme (FHSSS) proposes to use the superannuation system to pool voluntary contributions for the purpose of funding parts of a deposit on a member’s first home. Under the policy, an individual would be allowed to make voluntary contributions of up to $15,000 per year and up to $30,000 in total, which can be withdrawn from their superannuation fund along with earnings after 1 July 2018 and directed towards a deposit for a first home. \(^{35}\)

The selling point of this scheme is that it allows first home savers to enjoy the same tax advantages as superannuation members.

The problems with the scheme are fundamental.

• It makes housing less affordable by contributing more to demand rather than supply.
• It undermines the efficient operation of retirement income policy.

\(^{32}\) Defence Housing Australia (DHA) is a wholly owned government enterprise, so the guarantee is essentially a government guarantee. The shareholder Ministers of DHA include the Minister for Defence and the Minister for Finance.


\(^{35}\) Voluntary contributions are personal or salary sacrifice contributions, and the concessional contribution cap of $25,000 still applies, so, anyone earning over $106,000 cannot contribute the full pre-tax amount of $15,000 per year.
− The policy also sets a dangerous precedent of drawing upon superannuation savings for purposes other than retirement income. The scheme is inconsistent with the sole purpose test which is supposed to underpin trustees’ decision making and the Federal government’s own proposed objective for superannuation.36

• It is costly in that it delivers lower savings compared with a post-tax contribution towards a deposit account, partly due to the super contributions tax.37
• It may need to allow members to draw on compulsory superannuation contributions and so interferes with their long-term retirement income goals.
− It seeks to ‘guarantee’ returns through the use of the shortfall interest charge to calculate earnings rather than actual returns. This mechanism will require superannuation trustees to pay withdrawals using superannuation guarantee assets if returns are too low. Probably, more than half of savers would have their SG assets eroded due to scheme design.

Senior Downsizing Scheme

The Senior Downsizing Scheme (SDS) intends to encourage senior Australians to transition from their existing family home by relaxing the non-concessional contribution rules for superannuation introduced in the 2016-17 Budget. This would enable seniors to direct any gains from the downsizing transaction towards their superannuation account in the form of non-concessional contributions.

The specifics of the proposal are that the Federal government will allow a person over 65 years to make a non-concessional contribution of up to $300,000 from the sale proceeds of their home from 1 July 2018. These contributions will be in addition to current arrangements, however the $1.6 million transfer balance cap will still apply (anything over the transfer balance cap will go to an accumulation fund). As there is no exemption of the sales proceeds from the pension income or assets test, it is likely that the measure will only be helpful to self-funded retirees rather than age or veteran pensioners.

3.2 Affordable housing

The gradual diminution of the public housing stock and increasing evidence of homelessness in Australian cities and has been met with some attempts by the Federal government to stimulate the provision of subsidised ‘assisted’ housing, supported by the policy suggestions of expert agencies.

3.2.1 National Rental Affordability Scheme

The National Rental Affordability Scheme (NRAS) sought to address the shortage of affordable rental housing by offering financial incentives to individuals or entities to build and rent dwellings to low and moderate income households at below-market rates for 10 years. The scheme commenced in 2008. It aimed to:

• Increase the supply of new affordable rental housing.
• Reduce rental costs for low to moderate income households.
• Encourage large-scale institutional investment and innovative management of affordable housing.

NRAS provided substantial annual incentive to individuals or entities to build and rent new dwellings to low and moderate income households at a rate that was at least 20 per cent below the market rental value. The

36 Section 62 of the Superannuation Industry (Supervision) Act 1993 and the Superannuation (Objective) Bill 2016.
37 The salary sacrifice contribution would be further reduced by the tax paid on withdrawal (despite the 30 per cent offset).
incentive was available to approved participants who successfully applied through an open call for applications.

Potential participants in NRAS included financial institutions, medium to large-scale investors, private developers, not-for-profit organisations and community housing providers who might build, own, finance or manage NRAS dwellings.

Participants applied for allocations of incentives under an open call for applications. When the scheme was stopped for new property incentives in 2014, a total of 37,142 dwellings had been built.38

It contrasted to the other incentives reviewed in this section because it focused directly on supply. This is a major benefit of the program.

The major weakness of the scheme was that NRAS did not garner the widespread participation from major institutional players such as superannuation funds through build-to-rent and other scale investment projects. This is probably because of the lack of long-term regulatory arrangements around leases in Australian state law and the insecurity regarding concessions from government that are necessary to make this scheme palatable to investors.39

Another problem of NRAS which limited the attractiveness of the scheme to big institutional players was that there was no variable subsidy depending on the locational cost to provide dwellings. The NRAS needed to provide a variable subsidy depending on the cost of unimproved land in different localities. For example, providing $15,000 per year in inner Melbourne and $5,000 per year in Hobart.

3.2.2 The AHURi model

The Australian Housing and Urban Research Institute (AHURI) released a position paper in 2014, detailing a solution to lower the cost of finance for affordable housing investments by establishing a guarantee scheme similar to other jurisdictions.40 The proposal aims to correct market failures by providing affordable housing to lower and moderate income households, which would have flow-on effects across all segments of the housing market.

The policy proposal has the potential to “overcome many of the barriers cited by institutional investors like Australian superannuation funds by offering suitable investment opportunities at an appropriate scale ... It would meet the risk/return strategies of large and rapidly growing superannuation funds...It also meets the policy objectives to increase private investment in affordable rental housing and build a stronger and more efficient rental housing market.”41 AustralianSuper, Australia’s largest super fund, has been a supporter of this model from an early stage.

The proposal by AHURI involves two key changes that correct market failures. Firstly, it seeks to overcome the problem of scale, monitoring of investment and information asymmetry by establishing an expert not-for-profit financial entity, the Affordable Housing Finance Corporation (AHFC). This is effectively the


39 NRAS was traded and cost developers up to $20,000 per licence. The 10-year term was also a complete disincentive to institutional participation. There was also brand risk for institutional investors associated with evicting tenants after the 10-year incentive had expired.


National Housing Finance and Investment Corporation (NHFIC) and bond aggregator model that the Federal government have proposed, which is discussed below.

The AHFC would do the following:

- Assess and aggregate demands of affordable housing stock providers (registered community housing providers (CHPs)).
- Combine the approved borrowings of CHPs and raise funding from long-term, low-yield bonds issued to institutional investors.
- Distribute the funding and monitor CHPs’ proper and effective use of the funding.

Secondly, the AHURI proposal would provide uplift in the risk-return profile of an investment through a government credit guarantee on bonds issued by the AHFC. This is particularly desirable given that the income stream on bonds primarily rests on the repayment for affordable housing by low and moderate income households.

Arrangements similar to the AHURI proposal are common across a number of jurisdictions and have been successful in increasing housing supply.

Positive features of the proposal

AHURI’s proposal is worth considering because it:

- Focuses on a supply-based solution.
- Facilitates the development of a private investment market in affordable housing, including the provision of funding from superannuation.
- Bridges the gap between Australia’s affordable housing investment needs and the risk/return strategies of large super funds.
- It appears from overseas experience government guarantees have minimal impact on public budgets and do not affect their credit ratings. These schemes have nil defaults so no outlay is required from governments.

3.2.3 Budget measures

The Federal government’s 2017-18 Budget contained a set of targeted measures to promote the provision of affordable housing including the establishment of the NHFIC, a new public corporation established by the Commonwealth to act as a bond aggregator to drive efficiencies and cost savings by CHPs. The idea is that the NHFIC be a permanent agency to aggregate affordable housing debt demand and issue paper to the debt capital markets. It will have no role in stimulating the supply of the housing to be aggregated.

The proposed NHFIC’s objectives (building on the AHURI proposal for the AHFC) should help to catalyse institutional investment into the community housing sector and improve the financial strength of the sector by assisting it to grow in scale and sophistication. It should assist to originate transactions and to assess credit and investment risks.

The NHFIC’s primary mission is to activate a bond aggregator model for assessing and aggregating funding proposals from affordable housing providers. It has been estimated that such an approach would enable CHPs to borrow at between 90bps and 140bps below their standalone funding costs. The implicit Federal government credit support for bonds issues by the entity is intended to address the risk/return challenges of affordable housing investment.

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The NHFIC has been put out to consultation by the Federal treasury in advance of being brought to the Federal parliament in some specific form.

**Positive features of the proposal**

ISA welcomes the 2017-18 budget announcements that sees the proposed NHFIC interfacing between institutional investors and CHPs.

The creation of NHFIC to coordinate funding models is very important since not all institutional investors have the capability or willingness to directly manage residential property issues. This model is also more efficient in terms of scale.

**Shortcomings of the proposal**

The missing element of the Government’s plan via NHFIC is an NRAS like concession that could create an equity pipeline for new affordable housing developments using the NHFIC to coordinate projects, help attract institutional capital and capture existing and new state and local government concessions to magnify the stream of feasible projects.

The combination of equity and debt models under the NHFIC would focus activity around the creation of a project pipeline by “densifying” existing developments and then recycling the proceeds. The adoption of both equity models and a bond aggregator (via a mix of equity and debt of perhaps 70:30) would enable the agency to oversee development and assets, aggregate assets, and manage demands for financing.

The establishment of the NHFIC coordinating both equity and debt funding models are complementary activities. Both types of models require some form of government guarantee to attract investors, who require an uplift in the risk-return profile of investments in affordable housing. This may be a result of the difficulty assessing the credit risk of a broad range of renters, particularly in the affordable housing space. Excluding equity models from the funding mix is like trying to bake a cake without using eggs and sugar.

**Conclusion**

Overall, based on the analysis of this section, we conclude that any policy response that increases the buying power of households – whether through grants, reduced taxes or innovative financing – will increase demand for housing, but the main outcome will be increased prices. This will not result in a significant improvement in the affordable housing supply.
4. Targeting policy on affordability and assisted housing

This section first proposes an alternative set of administrative, policy and strategic reforms that could assist to reduce housing affordability hotspots without the negative side effects often associated with policies in this field. Next, we examine policy initiatives which could help improve affordable housing outcomes with an emphasis on practical suggestions linking to the institutional environment. Finally, we consider the relative effectiveness of policies likely to be adopted by Australian governments. We argue that more budget dollars should be allocated towards the most effective policy responses and less dollars be dedicated to ‘band-aid’ policies that don’t address the underlying issues.

4.1 Improving housing affordability

This section examines general policy measures intended to identify and address housing affordability issues in regions where they are of greatest concern.

4.1.1 Linking housing approvals to housing supply gaps

Perhaps the most effective and direct means that state and local governments have at their disposal to address housing affordability is to:

- Estimate the current stock of different housing types (market, affordable, social etc.) in each jurisdiction and match these estimates to current and emerging population and housing formation statistics.
- Match regional variation in population and housing formation to infill housing approvals and land release blocks.\(^\text{43}\)

The idea is to run a pro-cyclical planning strategy matching planning approvals to regions of greatest need as indicated by price pressures at the local government area (LGA). The goal of the strategy would be to facilitate the gradual increase in the national housing stock while helping to smooth property prices and regional business cycles, by adding stability to household consumption and business investment decisions.

The supply gap calculation would be relatively straightforward based on the Household, Income and Labour Dynamics in Australia Survey, Census data and ABS population and housing data catalogues. Pulling together these estimates is a relatively inexpensive exercise, especially given the usefulness of the resultant series for governments and property market participants.

The fact that the Federal government does not yet report these statistics has robbed it of a very useful tool for national economic and social policy making. This framework would also be invaluable to help coordinate Commonwealth-state planning processes (identifying precise infrastructure requirements, especially public transport, specific affordable housing deficits, grant funding arrangements, etc.). Infrastructure Australia or a newly configured independent infrastructure authority, would also benefit from receipt of this analysis.

A significant economic agency such as the Productivity Commission could be charged with producing and releasing the estimates as part of its annual reporting process. This would expand the Commission’s existing reporting functions relating to housing and homelessness – see the Report on Government Services 2017.\(^\text{44}\)

\(^{43}\) While this analysis is happening, we also need to reintroduce an improved NRAS II, otherwise nothing will happen to increase the supply of affordable housing for at least a few years.

4.1.2 Matching of student and work visas stays to housing conditions

Complementary with our first proposal would be to formalise and streamline the link between LGAs with the greatest housing supply gaps, labour market shortages and the visa points system for our net 200,000+ international arrivals each year. 45

One way to ensure public support for a significant and diverse immigration program is for the Federal government to encourage more new arrivals to settle in regions that have experienced lower property price growth for sustained periods.

A work and study permit system that rewarded new arrivals for settling in regions away from hot property markets could be an attractive option. This approach would build on the recent practice by the Australian Department of Immigration and Border Protection, to give preference to potential arrivals who are prepared to move to regions where labour market skill shortages are greatest.

It is especially hoped that such a system would reward international arrivals who decide to locate and work or study in rural and regional areas on infrastructure and construction projects, in agriculture or resources activities, or in scientific and technological research.

We would envisage that a more targeted permit system could still exist alongside more generous targets for family reunion and refugee categories.

4.1.3 Redirecting foreign investment to new buildings

Another relatively straightforward administrative tool available to the Federal government to curtail excessive price growth in under pressure property markets would be to restrict all foreign investment in residential real estate to new buildings. This change would return policy settings to what existed prior to the GFC. It would direct all foreign investment in residential real estate to expanding supply. Whilst foreign investment inflows to build new apartments are always welcomed, purchases of existing properties often just add to overheated property markets in the most highly desirable localities. The Australian Taxation Office could be used to oversee the transfer of every property to ensure the rules are followed.

4.1.4 Streamlining town planning procedures

Another ‘self-inflicted’ driver of excessive price growth in epicentres of the boom relates to unreasonable planning restrictions and processes that actually relate mainly in the purview of state and local governments. These barriers impose excessive impost on property developers and undermine the certainty and confidence of potential institutional investors. The barriers include unreasonable height restrictions and car parking requirements within urban infill development zones, including ‘inner’ and ‘middle-ring’ suburbs. Another major bug bear of the Property Council includes uncertainty over decision timelines regarding obtaining permits and the possibility of third party appeals, which are a major cause of delays and cost increases facing developers.

Of the several major factors relating to planning, zoning and other regulatory requirements, most could be dealt with through administrative orders and/or changes to planning guidelines by state governments or local governments.

4.1.5 Preventing land hoarding and waste

One little understood piece of the housing affordability challenge in Australia is the extent to which both government and private sector agencies around Australia are holding significant tracts of land that are ripe

45 We understand the current approach of the Australian Department of Immigration and Border Protection gives preference to potential arrivals via the visa points system based on existing labour market shortages.
for higher valued uses, but are not being released. Reasons for this potentially include the lack of robust planning processes by all levels of governments and market dynamics around land supply by private development firms.

Public sector waste

In both Sydney and Melbourne where housing affordability challenges are most acute, it is probable there are tens of significant publicly owned sites that are suitable for major residential developments – including prime inner city sites with scope for affordable housing. Examples include disused manufacturing factories, golf courses, former housing commission developments, vacant space above municipal car parks and railway car parks, space around railway stations and disused sidings and other land set aside for transport activities. Many of these sites could be redeveloped and provide a funding source for a large expansion of affordable and social housing in the inner city.

To fix this oversight we need a systematic review process which identifies underutilised assets in regions where affordability pressures are greatest. The Federal government could instigate a data collection process, drawing on a reconstituted Australian Valuation Office, and the cooperation of state and local governments, especially in those LGAs where the affordability challenge has been identified as being greatest.  

The Federal government could also offer inducements for state and local governments that identify and release underutilised public land. No stone should be left unturned to identify development opportunities. If necessary, the general public could be requested to nominate potential sites, so no big ticket locality is missed.

Private sector warehousing

In terms of private sector development processes, a small number of commercial land development agencies exist to undertake greenfield activity across the country. These land development firms maintain development control over tracts of private land on the outskirts of major Australian cities. The firms operate by aggregating small holdings of land suitable for residential development and by taking options on favourable terms from the huge number of non-urban land owners. When sites are designated by government for release, land banks may attempt to drip feed these sites out to housing developers. Whilst land banks bear the risk of land development, they may also enjoy periods of significant rents from the disjointed and lumpy nature of the development process.

Federal, state and local governments should explore the means to incentivise a smoother, more predictable and less expensive release of these sites for development and rental purposes, including the reduction of associated government fees and charges.

4.1.6 Reorienting tax concessions

Major tax concessions paid by Australian governments need to be directly targeted at expanding supply rather than priming demand and contributing to existing price pressures.

For example, the Federal government provides tax concessions for negative gearing and the capital gains tax (CGT) discount on residential housing which combined are worth around $12 billion annually in

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46 For example, the National Growth Areas Alliance (NGAA) is a collaboration of thirty-one Councils across Australia whose areas are experiencing rapid growth. http://content.id.com.au/economic-indicators-australia


For the most part these concessions do nothing to directly spur new construction and so are counterproductive in terms of assisting housing affordability.

**Negative gearing**

The practice of negative gearing allows losses incurred on an income producing asset to be offset against all of a taxpayer’s taxable income, including income not related to that asset. Negative gearing encourages taxpayers to employ high levels of leverage (which reduces the amount of capital required by investors and maximises tax losses). Over time it incentivises a culture of borrowing and tax minimisation rather than a disciplined culture of saving and income generation. Under existing arrangements, investors tend to rely too heavily on leverage which distorts property markets for owner-occupiers. This also impacts the yield on residential property which has discouraged institutional investors playing a greater role in the sector over time. These factors have exacerbated housing affordability and debt issues associated with the domestic economy. At the same time negative gearing fails to encourage the creation of new housing stock. The impacts of this concession are stark:

- 62 per cent of all investors or 1.2 million Australian own properties that are negatively geared.
- 10 per cent of all investors own three or more investment properties.
- Less than 10 per cent of the total financing for investment properties are applied to build new properties (Figure 21).

**Figure 21 – Financing of new dwelling construction as a proportion of total financing for investment properties (12-month rolling average)**

The cost of the negative gearing concession on residential property to the Federal budget is estimated at approximately $4.3 billion per year. Perhaps, it can be argued that the CGT tax concession is driving this behaviour by investors as the prospect of significant deferred windfall capital gains makes it worthwhile for investors to run negative cash flows in the present day.

**Capital gains tax discount**

CGT on property is applied to only 50 per cent of the appreciation (a discount of 50 per cent) if an asset is held for 12 months or more. The discount aims to ensure that taxpayers are only taxed on the real value of capital gains. But set at 50 per cent, a legacy of the high inflation in the 1980s, it actually reduces tax payable by investors. This tax distortion encourages speculation on land. Acting in tandem with the

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negative gearing concession, it encourages investors to allocate too heavily to property and take on too much debt. This distorts property markets by driving up prices and driving down yield over time.

The CGT discount could be reduced to 20 per cent to better reflect the current low inflationary environment, and so actually taxing the real value of underlying capital gains realised.

The cost of the discount on capital gains for residential property to the Federal budget is estimated at approximately $7.4 billion per year.\(^{50}\)

Overall, it is critical that the existing negative gearing and CGT arrangements which are distorting investment decisions be modified. Better alternatives would include limiting negative gearing to the purchase of new dwellings and reducing the CGT discount to a level commensurate with today's low inflation environment, or eliminating both concessions and targeting a revenue neutral investment allowance at new dwellings construction, and perhaps carving out a special concession for large scale institutional investment in affordable housing.

4.1.7 Reforming land taxes

Australian state governments should abolish stamp duties and replace them with a mix of land and betterment taxes.\(^{51}\) Stamp duties are one of the most inefficient forms of taxation as they distort the ‘housing choice’ decision.\(^{52}\) Ideally, the tax system should have no impact on the type of dwelling chosen by householders. They should be able to choose the type of housing best suited to their current and future needs in terms of family size, stage of life and wealth; irrespective of tax structure. Stamp duties apply a massive one-off barrier to these decisions and so disincentives owners moving away from current dwellings. Rather than moving, often owners try to compromise by renovating their houses instead. This additional investment locks them in even further. Currently many older Australians who would like to downsize are effectively locked into their existing homes. At the same time many younger families cannot access the stock of larger houses, so they have perennial space issues.

A better alternative would be for owner-occupiers to face a small annual land tax each year, equivalent to a second round of council rates. Land taxes applied this way are very efficient as they do not change behaviour and are very difficult to evade. They also provide a more reliable and stable revenue stream for state governments which makes budget planning simple.

As noted in the Henry review:

“When applied uniformly across a broad base, land tax is one of the most efficient means of raising revenue. The efficiency arises from the immobility of the tax base...”\(^{53}\)

By contrast, stamp duty is highly volatile and distorts the property market by discouraging transactions, for example by people changing their residence as their needs change. However, in brief:

“Reforming land tax and conveyance stamp duty arrangements, along with proposed changes to the taxation of rental housing and Rent Assistance, will go some way toward improving housing affordability.”\(^{54}\)

State governments should also consider the introduction of an asset betterment tax where landowners and homeowners lodge a development application that changes the use of a dwelling from one activity to another. Betterment taxes share the windfalls associated with development applications that change the

\(^{50}\) Daley, J., ‘Time to fix Australia’s unaffordable capital gains tax and negative gearing policies’, Grattan Institute, 25 April 2016.


\(^{54}\) Ibid., page 49.
use of a site between private owners and the community. This reflects the fact that planning driven capital gains are more driven by good luck, than effort or skill. Often the rapid appreciation of land values has more to do with population density and public investment then entrepreneur endeavour. So it makes sense to levy betterment taxes and set them aside to extend existing infrastructure facilities.

The abolition of stamp duties and their replacement with land and betterment taxes represents a major microeconomic reform. Indeed, the ACT Government enacted these reforms in 2013, in what represents the most credible microeconomic reform since the introduction of the GST in 2000.

4.2 Policies to support assisted housing

This section examines ways for government to work together with the private sector to expand the supply of assisted housing to those who need it most. Perhaps the primary objective for Australian governments in the area of assisted housing is to promote policies which address the supply of rentals for low to moderate earners. If homeownership can be encouraged at the same time, then all the better.

What follows are suggestions as to how governments can seek to expand the supply of assisted housing to those who need it most.

4.2.1 Establish a council of assisted housing

The Federal government should consider establishing a Council of Assisted Housing (located within the Productivity Commission) to work closely with the development and construction industries and each tier of Australian government to establish a stronger evidence base regarding the operation of Australia’s housing markets. The Council would provide an annual report to the Council of Australian Governments on the state of Australia’s housing which addresses the quantum of land available for development, the efficiency of planning systems, productivity and innovation in the residential construction industry, and an assessment of the gap between housing demand and the level of completed and forecast residential construction activity. A key task of the Council would be to assess the impact of Australia’s changing demography on housing needs and associated transport, energy, communications and social infrastructure.

Members of the Council would be drawn from the planning and construction industries, urban development, academia, the finance sector and state government.

The Council would report to governments on the overall demand for housing among first home buyers and renting households, including those in the bottom two quintiles of household income. The Council would be asked to advise governments on ways to improve housing affordability among renters on low to moderate incomes. It would also advise governments on how to facilitate access to housing for those with special needs such as people with disabilities, older people and indigenous Australians or other people who struggle to find appropriate and affordable housing in the private rental market.

The immediate work of the Council would be to advise the Council of Australian Governments on the investment required to improve the accuracy and currency of Australia’s data on housing supply and demand, demography, and construction and development industry activity.

4.2.2 Establishing a housing asset class targeting institutional funds

Australian governments should consider pooling all current budgetary and other non-budgetary assistance provided to promote affordable housing and dedicating these concessions to build a new asset class. Attracting institutional investment into this field really requires the origination of a new asset class. That


An investible project would begin with a proposal from a CHP (perhaps acting with a private developer) proposing a mixed (market, affordable and social) housing project. Equity and debt funding for the project would be coordinated through the proposed NHFIC or an equivalent body. The project promoter would be left to manage the construction risk and operation of the asset. CHPs would be left to undertake this role (for the most part) because:

- they are non-profit bodies; and
- the assisted housing asset class (like retirement living) requires an intensive level of client input to achieve desirable social and budgetary outcomes.

Project managers must have a strong customer relationship. They are not just a passive external manager (the norm for institutional property investment). They face numerous risks, especially with social housing tenants that must be managed directly.

Institutional investors will want to stand at arm’s length to the direct management of rental property assets. Governments and CHPs will need to appreciate that institutional investors’ normal mode of operation is to invest in arm’s length core property investments underpinned by long-term leases. Rates of return are usually denominated as CPI+. Government may need to provide some guarantee or insurance scheme to deliver the equivalent certainty around revenue streams.

Governments can ‘make a market’ in assisted housing by focusing all concessions around a streamlined set of incentives (for example, an NRAS like subsidy, a bond aggregator discount, discount land access, etc.) to encourage institutional investors to make long-term commitments and so originate and develop the new asset class of affordable rental housing. All levels of government should offer up additional or complementary concessions (especially around planning and land release), targeting areas of social disadvantage.57

The process of origination, normalisation and then maturation surrounding the establishment of this new asset class would over time generate progressive cost reductions as the market deepens. This would occur as the market progressively deepens, and as a liquid secondary market develops, driving down risk premium and normalising rate of return expectations.58 Over time it would be expected that per unit rates of government subsidy would fall, and perhaps only remain for social housing. This would occur once the other “incentives” are removed from the private market and more of a level playing field develops. This may take a decade or more to develop.

**Built-to-rent**

In North America – the build-to-rent (BtR) or multi-family sector has become significant over the past decade. It is a thriving deep market that caters for idiosyncrasies of certain United States cities with workforces that are extremely mobile and where students travel long distances away from parents to undertake tertiary studies. The United States’ multi-family sector is mainly rented via private markets to young professionals on long-term leases. Returns in the sector are comparable to the long-term commercial property sector. There are also some mixed tenures which are funded via the United States’ federal government low income housing tax credit.

57 Funded by streamlining existing assistance programs (grant payments, direct outlays, tax expenditures etc.).

58 One interesting aspect of this market is that it may help to lengthen Australia’s long bond yield curve beyond the 10-year mark.
Whereas, in Britain, the BtR market mainly cross subsidises affordable housing. Local government dedicates a certain proportion of approvals to affordable housing which is charged out at 75 per cent of market rentals. Government may top up the 25 per cent for property developers.

ISA has investigated the feasibility of a BtR schemes (also mixed with build-to-sell) targeting a 4.5 to 8.5 per cent, risk adjusted return for equity investors. Our analysis suggests that for acceptable levels of public concession, institutional investors could be adequately compensated for investments in assisted housing projects, especially when land is provided on a concessional basis. For example, our costing for inner city Melbourne (as presented in Figure 22) reveals the cost of the explicit subsidy concession required to be paid by governments to drive various rates of return for equity. In all cases, the subsidy is no greater than $16,000 per annum and falls to $6,500 per annum if state governments are prepared to provide concessional land.

For BtR to work in Australia for institutional investors, what is required are predictable returns, someone to manage builder risk, states and local governments to grant land concessions, and for the Federal governments to provide certainty over subsidy flows to potential tenants. All very possible.

**Figure 22 – The funding gap required to achieve a various return targets**
(Melbourne inner-city property)

> Source: ISA modelling
> Note: Pure build-to-rent scheme models 100 affordable rental units. The second chart assumes zero cost for land and no ongoing lease cost. Overall, the modelling assumes affordable rent cost at 75% of market rent, 90% 2-bedroom units and 10% 1-bedroom units, 2-year construction period, $3,000/unit maintenance cost, $3,000/unit rates & insurance, 3% vacancy rate, 70% equity and 30% debt funding for development & 40% debt amortisation.

**Inclusionary zoning**

Inclusionary zoning requires new residential property developments to include a portion of affordable dwellings as a condition of planning approval. It has been implemented in South Australia, New South Wales and the Australian Capital Territory. There are two basic approaches to inclusionary zoning as described below.

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59 It is often stated that institutional investors require long-term leases to get involved in BtR. In fact, they may prefer short-term arrangements that provide more flexibility.
The first approach is a mandatory model which requires new residential property developments to include a certain number of affordable dwellings as a condition of planning approval. The number of affordable homes are determined either through negotiation between developers and the planning authority, or as a fixed portion of the total number of homes to be built. The latter is typical for government land redevelopment. For example, in South Australia, 15 per cent of new dwellings in all significant developments must be affordable, including 5 per cent for high-needs groups. We understand that this system requires developers to provide a certain number of units at specific price points (which are sold at below market). This enriches the lucky people that win the ballot and so the system is flawed. In the Australian Capital Territory, the share is even higher at 20 per cent. In New South Wales, 2 per cent of housing in certain zones must comprise affordable housing or developers pay an affordable housing levy.

The second approach is via the voluntary incentive model, which uses fast-tracking applications and relaxation of planning rules to encourage construction of affordable housing as part of existing market projects. We are not aware of a single example of this type of development in Australia.

Depending on circumstances, the provision of affordable homes by developers within an inclusionary zone doesn’t necessarily mean these homes need to be located onsite. The contentious issue of ‘location’ of affordable dwellings was cleared in early 2015 when the Victorian planning minister, Richard Wynne, allowed developers of high-end apartments to build required social housing elsewhere. The approach is less helpful in terms of ‘breaking cycles of disadvantage by mixing people from diverse backgrounds’. However, it does increase the affordable housing stock, whilst producing the desired investment yield.

We understand that Inclusionary zoning is widely adopted in North America, and has allowed developers to increase the density of their developments beyond regulatory limits if they incorporate affordable housing into the property. These limits are usually guided by the ratio of gross floor area to lot area (floor area ratio). In Vancouver’s Downtown South, the maximum floor ratio is 3:1, increasing to 5:1 for the provision of social housing and up to 8:1 if in-kind or cash contributions are provided towards expanding community facilities.

### 4.2.3 Expanding community involvement

Investing in the further development of the community housing industry would enable the sector to achieve economies of scale and increase real choices for lower income households. These measures must be underpinned by stronger regulation of the social and affordable housing sector to provide assurance to both investors and tenants.

**Community housing providers**

The community housing industry has doubled in size from managing 40,000 dwelling units to over 100,000 units over the past decade. It is well positioned to increase its rate of expansion in the next decade. A group of 50 registered CHPs manage over two-thirds of the community housing dwelling portfolio, with a

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61 Dow, A. ‘Inclusionary zoning policies can exclude poorer residents from high-end apartments’, *The Sydney Morning Herald*, 12 March 2015.

62 It may be however that the playing field in the United States and Canada is just too different to the Australian market for this comparison to be meaningful.

further 900 smaller organisations managing the balance. However, roughly two thirds of CHPs are not 
regulated, including most of the 320 specialist indigenous CHPs. Many smaller organisations rely on 
volunteers or part-time staff. They need assistance to upgrade governance and services to meet the 
regulatory standards and lack the resources to pursue strategies to lift efficiency or service quality such as 
establishing shared service hubs, or pursuing mergers or group structures with other housing organisations.

Regulatory framework

The existing system of state-based regulation under a model law which was introduced in 2012 has failed to 
deliver a national housing market and its fragmented approach means it is poorly-equipped to deal with 
the increasing complexity of financial and corporate structures which typify the community housing sector. 
State-based regulators have not been able to individually resource specialist finance and governance 
expertise. The existing regulatory scheme is backward looking and compliance focussed. It has little 
capacity to identify and address systemic risks and lacks the resources to undertake the educative role of a 
regulator which would both increase compliance and reduce compliance costs for providers and 
government.

A single national regulator would have the operational scale to attract and retain suitably qualified staff. 
The new regulatory agency would be independent of state and territory government policy and funding 
agencies. The regulatory agency would report to a Federal government minister and be supported by an 
advisory board which includes state and territory representation. The regulator would provide an annual 
report to the Council of Australian Governments.

The regulatory requirements enacted under Commonwealth legislation would apply to any entity delivering 
social or affordable housing in association with a government subsidy, grant, or other concession (but not 
including Commonwealth Rent Assistance, Defence housing or other subsidised housing provision for 
Commonwealth employees). The same regulation would apply to organisations which are contracted by 
state or territory governments to manage social housing. The regulator would have oversight of 
management and delivery of public housing, community housing, indigenous community housing and 
disability housing, regardless of whether the regulated organisation is for-profit or not-for-profit.

The regulator’s role would include oversight of financial management, organisational governance and 
maintenance of standards to safeguard tenants. Particular attention would be given to asset management 
and property development standards.

As a complement to the regulatory framework, the National Housing Standards would be redeveloped to 
drive quality and promote continuous improvement in delivery of housing services. State and territory 
governments would retain responsibility for tenancy laws and complaint handling mechanisms.

4.2.4 Measuring the cost of inaction

The issue of meeting the current level of unmet demand for assisted housing needs to be considered in the 
context of the long-term economic costs to the Australian nation from not providing this essential 
infrastructure. The long-term social costs and productivity imposts emerging from the lack of assisted 
housing need to be established as part of the Federal treasury’s next Intergenerational Report through 
formal modelling.

We see the fundamental lack of supply as the root cause of homelessness and increased housing stress, 
with other causal effects including rising mental illness, family stress, domestic violence, increased loads on 
the justice system, and consequent increased dependency on welfare payments. The additional economic 
costs to all levels of government will continue to increase and be a significant burden to future generations.
Not addressing this shortfall will result in either further increasing the budget allocation to welfare payments, or if this cannot be afforded, further social dislocation and community unrest. This is a lose-lose scenario for future generations. It would be an intergenerational impact that we would be accused of not identifying and taking appropriate steps to address. What was once the bedrock social policy objective in Australia has been left behind. We need to return to policies that prioritise families and the disadvantaged over investors and land owners.

4.3 The perils of band-aid policy

Band-aids are short-term or one-off solutions. Institutional investors need long-term policy certainty, so when governments establish concession programs, they should stick with them. Governments should eliminate ‘policy risk’ for investors who fear getting stuck with orphaned assets each time there is an election. Band-aids also refers to haphazard policy, like stimulating building to take a little pressure off a given region, but not systemically creating an overarching policy framework for the national housing system.

Current and proposed policies on housing affordability and assisted housing are a mix bag of policy effectiveness (see Figure 23 and Figure 24).

Figure 23 – Effectiveness of policy proposals on improving affordability

As we have examined previously in this paper, Government concessions targeted at alleviating housing affordability and reducing waiting lists for assisted housing specifically are most useful when they drive new construction and redevelopment, and so generate a significant supply response, where project funding is provided for the best public value for money.

On the demand side of the property market, investors should not be in an advantageous position relative to current or future owner-occupiers when it comes to tax treatment and ease of access to finance. It is
counterproductive to allow speculation to distort property prices, let alone for government to subsidise these distortions, whilst driving low to middle income earners out of the property market. It is also enormously inefficient to subsidise small to medium sized (mum and dad) investors, when scalable concession could be delivered through the institutional sector that could be targeted at affordable housing.

So the ‘fix’ for housing affordability can be wide-ranging, but in terms of the levers the Federal Treasurer has at their disposal, these are largely centred on workforce planning and redesign of the current mix of investment allowances, whilst incentivising the States to reform planning and land release arrangements via Commonwealth – State tied grant arrangements.

Figure 24 – Effectiveness of policy proposals on assisted housing

Surely the best form of housing policy is full employment and access to affordable housing, leading to owner occupation, within a reasonable distance to work. Many of the policies of Australian governments in recent years, whether intended or unintended, have worked against these policy aspirations, whilst driving the demand for housing. What we need now are policies which rebalance the scale in favour of owner-occupiers and patient long-term investors.
REFERENCES


Dow, A., ‘Inclusionary zoning policies can exclude poorer residents from high-end apartments’, *The Sydney Morning Herald*, 12 March 2015.


