Housing Costs and Policies

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Context and Acknowledgements

- Applied Economics P/L was commissioned by NSW Treasury to prepare an overview paper on housing costs and policies, with special reference to Sydney and NSW Government policies.

- In preparing the paper, I received inputs and comments from several sources, including Sandra Ianitto, Alex Tosh and Alex Petrillo (NSW Treasury), Nigel Stapledon and Glenn Otto (UNSW) and Luci Ellis (RBA) as well as feedback from some government agencies on an early draft paper. I thank everyone for their assistance.

- It is also noted that the author is Mayor, Mosman Council.

- All views expressed and all data in the paper are the full responsibility of Applied Economics P/L. They are not necessarily the views of NSW Treasury or of any person or agency who contributed to the paper.

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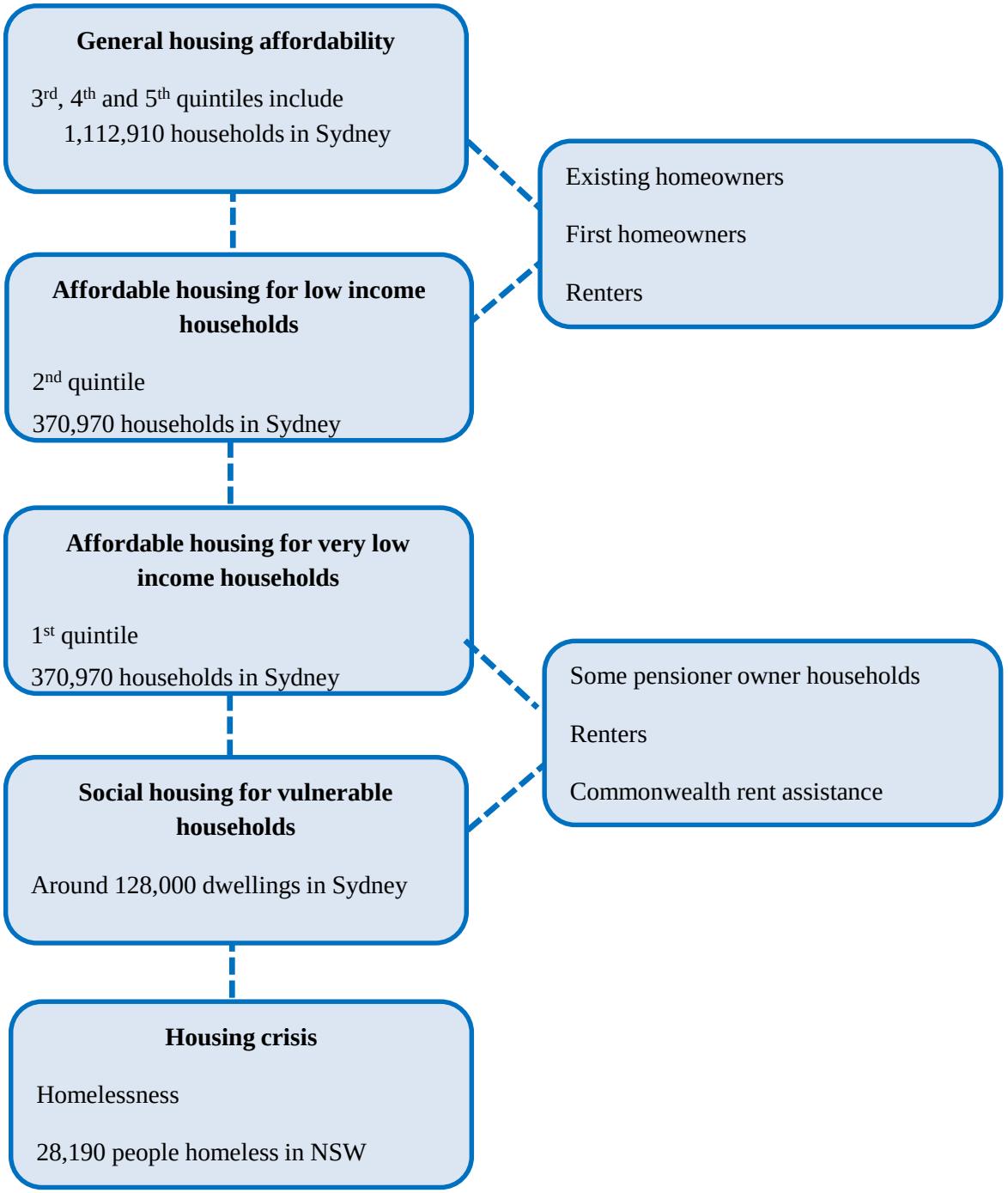
Introduction: Affordability

- Three main housing affordability issues.
  - **General affordability**: the cost of housing to the general population, sometimes summarized as cost of housing to the median income household.
  - **Affordable housing**: the provision of appropriate housing at an acceptable cost to households with very low to moderate income, generally focusing on the lowest two income quintiles.
  - **Social housing**: the provision of appropriate housing subsidized at low rents to vulnerable households with very low income.

- General affordability applies to home owners or renting households. In Sydney, home owners make up 67% of housing and renters 33%.

- Affordable and social housing relate predominantly to renting households in the private and public sectors respectively.


General housing affordability
3rd, 4th and 5th quintiles include 1,112,910 households in Sydney
Existing homeowners
First homeowners
Renters
Affordable housing for low income households
2nd quintile
370,970 households in Sydney
Affordable housing for very low income households
1st quintile
370,970 households in Sydney
Some pensioner owner households
Renters
Commonwealth rent assistance
Social housing for vulnerable households
Around 128,000 dwellings in Sydney
Housing crisis
Homelessness
28,190 people homeless in NSW

Housing prices in Sydney

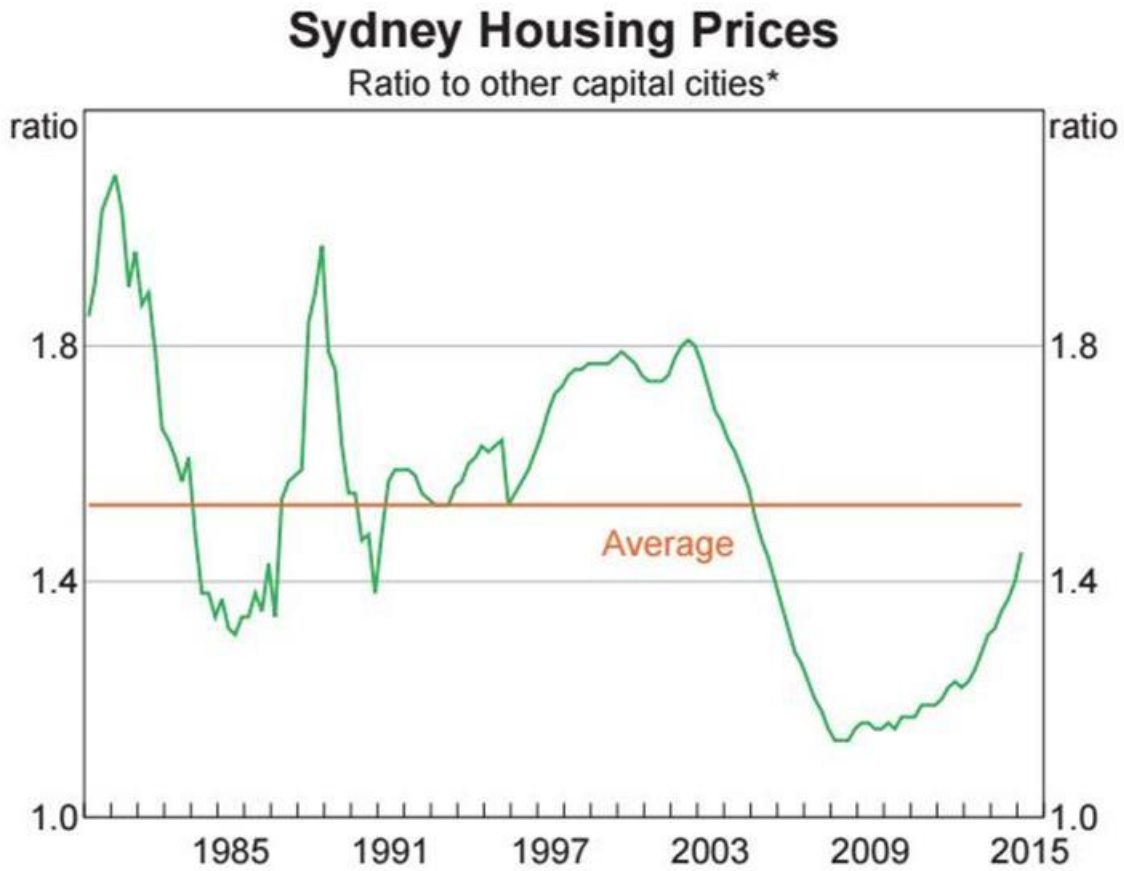
- Between 1991 and 2015:
  - Median dwelling price in Sydney rose from $155,000 to $679,000.
  - Discounting for inflation, increase in real terms of 136%.
  - Allowing for increased quality of housing (1% p.a.), median real constant quality house price approximately doubled
  - Real median disposable household income rose by 51%.

- Rents have risen much less than house prices. Between 1990 and 2015, median rent rose from $165 to $460 per week, a nominal increase of 185% compared with rise of 438% in housing prices over similar period. Median housing rent has risen only slightly more than median household income.

- Average house prices in Sydney are typically 40% higher than average in other Australian capital cities.

Sydney house and unit prices

	All dwellings			Sydney		Houses: Sydney			Units: Sydney[a]		
Year	Sydney	GMR	Rest NSW	Houses	Units	Inner	Middle	Outer	Inner	Middle	Outer
1991	155	110	98	155	140	210	165	136	173	130	130
2001	316	175	137	327	305	565	413	264	370	285	245
2011	534	385	309	650	490	1120	775	470	590	476	370
2015	679	452	335	752	620	1585	1150	625	760	620	480
Index[b]											
1991	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2001	165.8	129.4	113.7	171.6	177.2	218.8	203.6	157.9	174.0	178.3	153.3
2011	205.3	208.6	187.9	249.9	208.6	317.9	280.0	206.0	203.3	218.2	169.6
2015	236.2	221.6	184.3	261.6	238.8	407.0	375.8	247.8	236.9	257.2	199.1



* Darwin excluded prior to June 1999; Hobart excluded prior to June 1984; dwelling stock weights prior to 1991 held constant

Sources: ABS; CoreLogic RP Data; RBA; REIA

Housing stock, completions and turnover

- In 2015, there were 1.86m dwelling units in Sydney, with 1.73m private and 127,000 social housing units.
- Between 1990-91 and 2013-14, completions averaged 22,000 p.a.
- They averaged just under 17,000 p.a. between 2006-07 and 2013-14 before rising to 28,314 in 2014-15.
- Turnover rate around 100,000 dwelling units per annum

Population

- In 2014, population of Greater Sydney was 4.84 million.
- From 1991 to 2006, population grew on average by about 1.0% p.a.
- Since then, average growth = about 1.6% p.a.
- There are currently about 1.8m households.

Key Determinants of Housing Prices

- Housing supply (stock) changes slowly. Averages about 1.4% p.a. i.e. stock is price inelastic. Thus changes in supply have little short-term effect on house prices.
- Demand = f (population, income, interest rates, loan to valuation ratios, foreign demand)
- A fall in interest rates from 5% to 4% reduces real housing costs by some 15% and can therefore greatly increase demand.

Key finding on supply and prices

- Australian and international research: price elasticity of housing with respect to the housing stock is in the order of -3.0.

- i.e. after allowing for changes in demand, a 1% increase in the housing stock will result in a fall of 3% in real house prices.

- An increase in annual completions from 1.4% to 2.0% of the housing stock would reduce real house prices in Sydney by about 2% (= -3.0 × 0.6).

Other key findings

- Production of housing is efficient. Planning regulations may create inefficient restrictions on housing supply.
- Prices of new houses are determined principally by prices of existing houses
- Housing taxes and subsidies are often shifted.
- Reducing transport costs increases house prices.
- There is an inter-city welfare equilibrium. Household welfare = f(income, house prices, commuting costs and amenity). Amenity = f (climate, access to water, views and vegetation).
- House prices in Sydney can = level in other capital cities by reducing income or amenity premiums or by increasing commuting costs.

Housing affordability: renting households

- About half of 300,000 rental households in lowest two quintiles in Sydney (i.e. 150,000 households) pay over 30% of income in rents, standard benchmark for housing stress. (ABS data)

- This includes about 45,000 high need households on waiting list for social housing in Sydney.

- The 30% benchmark is arbitrary. To some extent, expenditure on housing is a choice of housing and household size. Evidence indicates that some 70% of households move out of the stress in 1 or 2 years as income increases.

- Theme of the paper: more needs to be done to identify low and very low income households with high housing needs who should be a priority target for state housing policies.

Housing affordability: home owners

- Real costs of home ownership include interest payments, repairs and maintenance, taxes and real capital appreciation, but exclude mortgage repayments which are savings
- Estimated real housing user costs are less than 30% of median and first home owner household disposable income respectively.
- Conclusion is sensitive to assumptions about real capital appreciation.
- Recent increase in house prices have been offset by (driven by) low interest rates
- However, some households may be unable to raise minimum equity deposit for first home.
- Also for some households, an affordable dwelling may mean high commuting times and costs not factored into housing user costs.

NSW Government policies

Major public expenditure programs include:

- Development and management of public housing stock
- Provision of most public housing at a significant subsidized rent
- Support for first home owners via purchase grants and stamp duty exemptions
- Provision of Private Rental Assistance (RentStart and Start Safely) – actually quite small amounts
- Provision of infrastructure to support new housing.

In addition, the Government

- Encourages management of public housing by community housing providers
- Seeks to reform urban planning processes to encourage housing development.
- Supports high density development in priority precincts and major transportation corridors.
- Supports various housing affordability initiatives.

Housing supply and cost policies

- As noted, housing supply has significant but small impact on house prices. To repeat, increase in annual completions from 1.4% to 2.0% of housing stock would reduce real house prices in Sydney by estimated 2% (= -3.0 × 0.6).

- **Housing targets?** Ideally target would be based on model for Sydney that incorporates household income and house prices as part of the objective.

- More practically, cost-benefit evaluation of development strategies would seek to maximize net social value (development values less costs).

- The resultant housing target would likely exceed recent completion rates but account for concerns about environment and high density.

- Where net social benefit of rezoning is demonstrably positive, re-doing local environmental plans is key policy instrument.

Housing supply and cost policies (cont.)

- Other planning reforms, such as more complying development **where appropriate** or shorter development approval times may produce small increase in housing supply but have little impact on house prices.

- Stamp duty ($30,000 for a median priced property) doubles most transaction costs, deters transactions and causes under-use of housing stock.

- Removing stamp duty would:
  - Have little direct effect on house prices because supply is inelastic
  - But would have estimated welfare benefit to households that move of about $375m p.a. (25,000 transactions × $15,000), separate from tax savings which are a transfer payment
  - Could increase effective housing supply by 2% due to improved utilisation and reduce house prices by 6% over time with little resource cost.

- Housing costs may be reduced by allowing lower housing standards and more efficient (competitive) provision of housing-related infrastructure. These changes would have small impacts on housing costs.

Reducing demand for housing: impacts

- Housing demand is encouraged by Commonwealth tax concessions to homeowners and investors that raise prices. Should concessions be changed?
- Major concessions to homeowners: non-taxation of net imputed rents and capital gains. Also home asset not counted in pension tests.
- Major concessions to investors: losses deductible at marginal rate against other income and apparent concession of 50% of nominal capital gains.
- Concessions assist recipients to some extent and disadvantage others.
- Given inelastic housing supply, concessions to home owners mainly increase existing housing prices. They provide only small benefits to first-time home owners. They indirectly cause higher rents.
- Given elastic supply of rental housing, subsidies to investors are mainly passed on in lower rents to rental households due to increase in rental properties. But they increase house prices.
- More work needed to quantify these effects.

Reducing demand for housing: policies

- A broad-based land tax would provide a proxy tax on net imputed rents and be a more neutral tax / concession policy .
- Bringing maximum deductions for negative gearing into line with 30% corporate tax deduction rate would be equitable and neutral.
- Possible change in CGT to 60% for investors as per Henry Tax Review. But note: 50% tax on nominal gain is arguably NOT a tax concession when inflation rate exceeds real rate of capital appreciation.
- CGT on homeowners: the home is primarily a consumption good and CGT would penalise and restrict household movements. There are also issues with alterations and additions.
- Effects of tax changes on owners and renters are complex and need to be modelled with other changes in tax concessions.
- Foreign demand has small but increasing impact on house prices. Estimation difficult in lieu of data. May be case for some restrictions / taxes on foreign demand for residential property, but hard to implement.

Housing policies for low income households

- Social housing is prime state policy for vulnerable households. Accounts for high % of state government funds for housing (a subsidy of about $10,000 p.a. per household).

- Major issue is how to manage the assets and the program efficiently.

- Government policy for CHPs to manage 35% of social housing. May improve management of assets and service quality. And CHPs can collect Commonwealth rent assistance.

- Not clear that transfers to CHPs will lead to a significant increase in the supply of social housing.

- Another major problem is number of households who need substantial housing support but cannot access social housing. Depending on criteria for high and sustained need, could be 80,000 – 100,000 of 150,000 in housing stress. Current policy provides little support to these households.

Housing policies for low income households (cont.)

- Commonwealth Rent Assistance to about 275,000 low income renting households in Sydney. Reasonably targeted. Efficient because households choose preferred housing location, size etc.

- NSW Government provides about $11 million in private rental assistance programs to about 18,000 households. Aim to provide pathways to help households avoid need for social housing.

- State provides $10,000 to first home owners for purchases of new homes up to $750,00 plus some exemptions from stamp duties. May bring forward some home ownership, but small overall effect.

- Paper argues that assisting low income and vulnerable renter households with increased private rental support is higher priority.

- Some increase in first home owner grant and extension to existing low priced homes could be seen as equitable and supportive of a home owning society (+ve externalities).

Special policies for affordable housing

- **Affordable housing policies** are designed primarily to assist very low, low and moderate income rental households who are not in social housing and who do not receive adequate support from Commonwealth rental assistance.

- **Policies include** government subsidies, planning incentives or planning regulations. Whichever, policy needs careful specification and metrics.

- **General issues**

- Targeting affordable housing to most in need households. There are 300,000 very low and low income renting households but only 1000 – 2000 new affordable dwellings available annually. Lowering rents by 20% on new housing unlikely to make housing affordable to the very low income households

- It is not clear where affordable housing policies should be applied.

- Rent controls create administration issues when tenant incomes rise and with sub-letting or on-letting.

Special policies for affordable housing (cont.)

- Planning incentives (density bonuses) presume existing zoning is sub-optimal or allow sub-optimal changes to optimal zoning.
- Inclusionary regulated zoning may deter efficient development and adds complexity to planning for small increase in affordable housing.
- In general, income subsidies to high need households have advantages over rent-controlled dwellings.
- They are more transparent, improve targeting, allow household housing choices, increase labour mobility and improve housing maintenance.
- If affordable housing policies are pursued, more consideration needs to be given to dealing with these issues, especially targeting to most vulnerable households.

Value uplift taxation

- Some value uplift from upzoning should accrue to community, especially when upzoning reflects public investment. This can be achieved by a broad land tax or value uplift tax or combination.
- Land tax would typically be low tax rate of around 1% of land value.
- A value uplift tax would be levied at a significant % rate on the change in land value. This would capture rezoning uplift much more effectively.
- Revenue can be collected centrally and allocated in part to support greatest need households.
- Value uplift does not depend on complex planning regulations or deter development since it is essentially a tax on economic surplus.
- Designing a value uplift tax is complicated and will need considerable assessment.
- A broad land value tax is simpler but captures only a small proportion of improved value and is arguably less equitable.

Conclusions

The presentation discusses major Commonwealth and State housing policies. From a state perspective there are two main sets of issues:

1. How to determine the amount of public resources to support affordable housing and how to allocate this most efficiently and equitably, and

2. How best to engage the private sector notably by regulation or taxation of development.

- A major theme is need to identify most vulnerable low income renting households (probably 80,000 to 100,000 households) who are currently under supported by social housing or CRA.

- More support to these households is seen as major policy priority.

Conclusions (cont.)

- More active rezoning strategy based on cost-benefit evaluations (and community consultation).
- A broad land tax to replace stamp duty, supplemented by value uplift tax on rezonings if can be designed efficiently.
- Various other policies: competition in infrastructure, deregulated unit sizes, small increase in first home owner grant and extended to low priced existing dwellings, lining up negative gearing with corporate rules, have merits.
- But policies cannot change the basic economic theorem of spatial equilibrium. Sydney housing prices can fall in line with those in other capital cities only if the income and/or amenity premium are lost.