MUNICIPAL ASSOCIATION OF VICTORIA

Parliamentary inquiry into housing affordability and supply

Submission

September 2021

MUNICIPAL ASSOCIATION OF VICTORIA

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1. Executive summary

Australia has a housing affordability crisis. This is largely caused by policy settings that treat housing as an investment asset rather than a place to live. This attitude is reflected in government policy, media coverage, and the activities of developers and property owners. The politics of housing, and the primacy of the investor perspective, have frustrated meaningful progress on addressing housing affordability.

Many Australians have no choice but to rent off the very same investors that outbid them at auction, subsidised by generous tax concessions. These investors are often focused on capital gains, rather than providing housing to tenants. This property speculation is further rewarded by Commonwealth housing affordability policy focusing on grant schemes that frequently benefit existing landowners by further inflating demand far more than they aid prospective first home buyers.

There are four key policy areas that would improve housing affordability in Australia:

- Increasing the supply of social and affordable housing
- Making renting a competitive alternative to home ownership
- Curbing property speculation
- Wage growth and income support

We hope that this inquiry will prompt honest discussion and a genuine desire to address housing affordability.

2. Introduction

The Municipal Association of Victoria (MAV) welcomes the opportunity to provide a submission to the Inquiry into housing affordability and supply in Australia.

The MAV is the peak representative and advocacy body for Victoria's 79 councils. The MAV was formed in 1879 and the *Municipal Association Act 1907* appointed the MAV the official voice of local government in Victoria.

Today, the MAV is a driving and influential force behind a strong and strategically positioned local government sector. Our role is to represent and advocate the interests of local government; raise the sector's profile; ensure its long-term security; facilitate effective networks; support councillors; provide policy and strategic advice, capacity building programs and insurance services to local government.

3. Why housing is so important

The importance of housing should be self-evident. However, there is value in acknowledging the elements of housing and the specific impacts it has. Housing is a key social determinant of physical and mental health. There are three key elements of housing that affect health: suitability, affordability, and security of tenure.

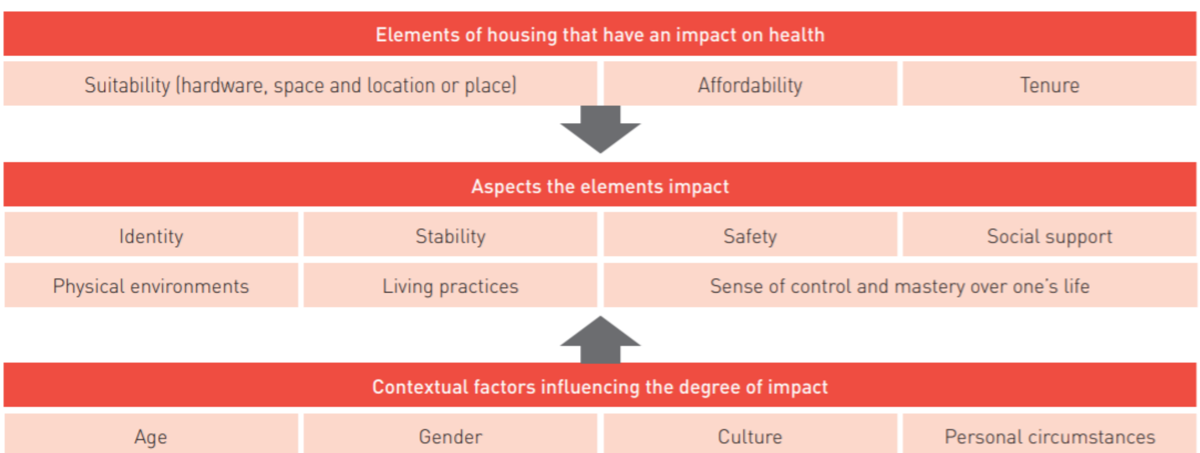

Figure 1 – Elements and impacts of housing. Source – VicHealth, 2011[1]

[1] Housing and health: research summary, VicHealth, 2011 -

Access to suitable, affordable, and secure housing is a critical part of economic equality. Housing costs have contributed to widening wealth inequality[2] . Rental stress is much more prevalent among low-income households and is increasing faster. The need to keep pace with increasingly unaffordable rental costs means that marginal disposable incomes are even further reduced for low-income earners. Home ownership for young people is increasingly unrealistic, contributing to worsening inter-generational inequality. Housing costs are also exacerbating the geographic concentration of poverty in Australia, as people on lower incomes are forced to the fringe to find affordable housing.

The benefits to the whole of society of addressing inequality are well established. Higher levels of inequality negatively impact health, educational, and economic outcomes at a society-wide level, not just for disadvantaged individuals.

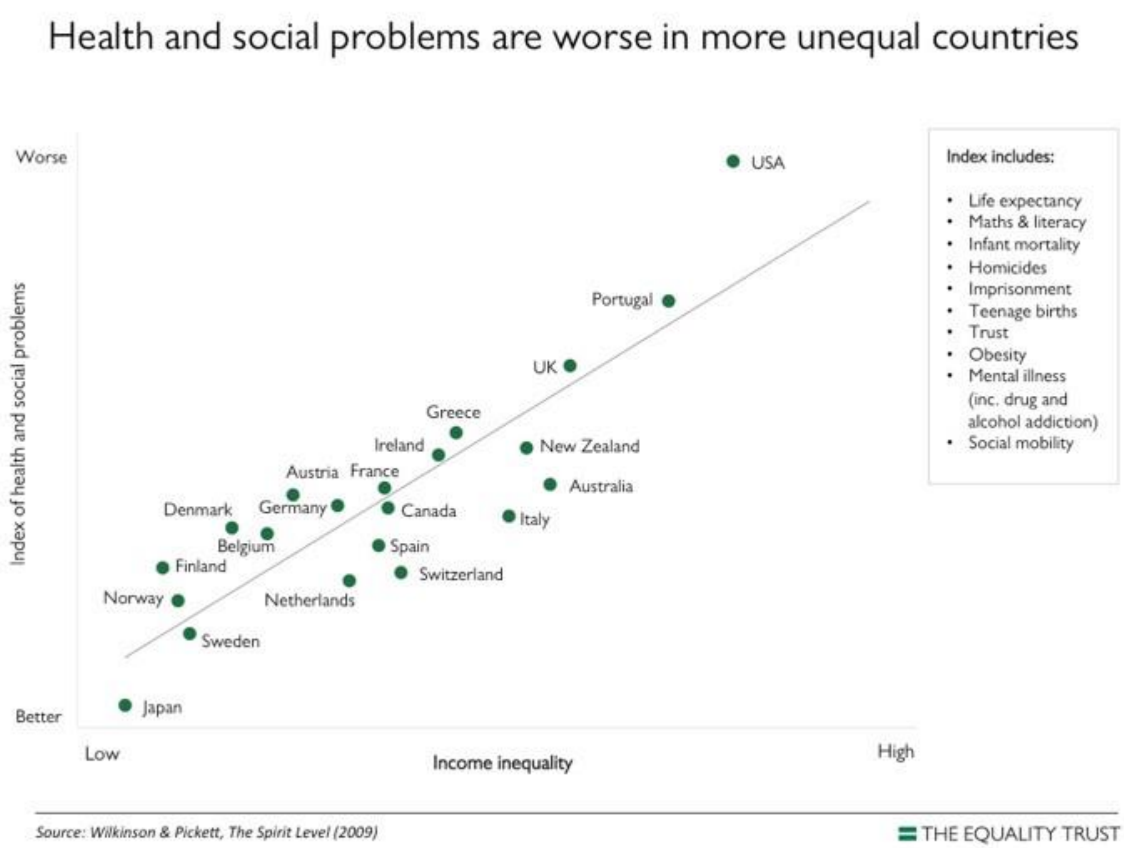

Figure 2 – Health and social outcomes by inequality

[2] Housing Affordability- Re-imagining the Australian Dream, Grattan Institute, 2018

Poor access to housing also has more immediate and local economic impacts. Key workers have been priced out of several regions due to the failure of the market to deliver suitable housing options. In Victoria's Great South West and Barwon regions 4,000 key workers employed within the region live outside of it. This is despite high rates of unoccupied dwellings (75% in Lorne). The combination of holiday homes and short-stay accommodation drives some market demand for high-end housing, but leaves workers in the public sector (health, education, municipal staff), tourism sector, and other local industries with few options.[3]

4. The politics of housing affordability

For home ownership to become more affordable, property prices need to fall (or grow slower than wages). Given for most voters their largest asset by far is their home (or portfolio of investment properties), this prospect is treated with extreme caution by our politicians[4]. It is an unfortunate reality that housing in Australia has become extremely politicised.

Gurran and Phibbs[5] explored this through the lens of policy capture, that is the capacity of special interests to direct policy makers away from decision making in the public good. They note the success of both the development industry and certain think tanks in establishing a land supply problem as the dominant narrative of housing affordability in Australia.

Increasing demand through grant schemes and loosening regulation are fundamentally flawed approaches. Grant programs have popular appeal; however, the beneficiaries have primarily been sellers not buyers. Recipients of first home buyer grants and similar programs must compete against other recipients and investors, further inflating the price.

Discarding the value that planning and building regulation provides risks building substandard homes in communities with poor access to vital infrastructure. Developers will continue to drip-feed supply onto the market to maximise their profits and the value of their land bank on their balance sheets. Even in the total absence of planning constraints, it is likely developers would continue to act as a handbrake on supply because it is not in their interest to flood the market and reduce the value of the significant assets they hold in undeveloped land[6].

5. Negative gearing and capital gains tax

The application of negative gearing and capital gains tax discounts to the housing market must be central to any discussion of housing affordability in Australia. However, due to the reasons outlined in Section 4 this has often been a taboo topic outside of academia.

[3] Key and essential worker housing supply action plan, Victorian Planning Authority and six regional councils, 2020

[4] The budget's affordability measures won't lower Australia's house prices. They weren't designed to, Dennis, R, 2021

[5] Are governments really interested in fixing the housing problem? Policy capture and busy work in Australia, Gurran, N & Phibbs, P, 2015

[6] Time is money: How landbanking constrains housing supply, Murray, C, 2020

In the context of housing, negative gearing refers to the use of net losses associated with rental properties as a deduction against taxable income from other streams (such as employment income). If the costs associated with a rental property (including management costs, interest payments, rates and land taxes, repairs, and insurance) exceed the rental income, this loss reduces the property owner's taxable income.

When an asset is sold for a profit the capital gain is treated as income for tax purposes. If the asset had been held for more than 12 months, a capital gains tax discount of 50% is applied, meaning only half of the capital gain is assessed as taxable income.

Both negative gearing and the capital gains discount apply to other types of assets, however they have a unique distortionary effect on housing. They create an environment that encourages chasing capital gains over rental income. This shifts the role of private landlords from providers of a housing service to speculators. This can be observed in the shift towards net rental income remaining at a loss since the introduction of the capital gains tax discount in 1999.

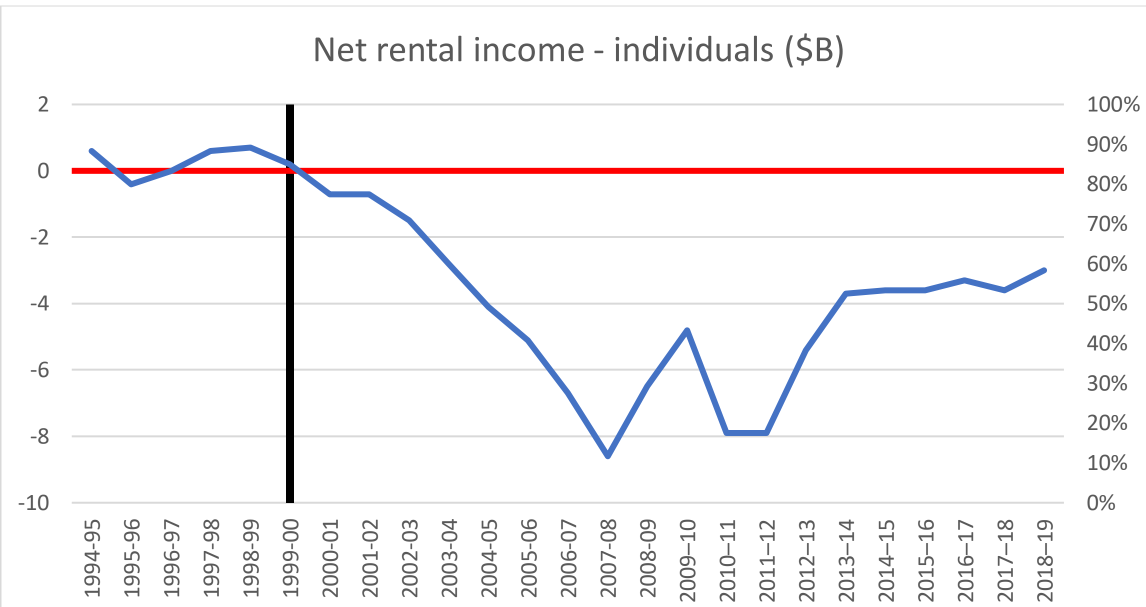

Figure 3 – Net rental income. Data Source: ATO[7]

Through negative gearing and the capital gains tax discount, taxpayers are subsidising property investors to outcompete prospective owner-occupiers at auction. This is exacerbated by the fact that only a small portion of investor lending goes to new dwellings. ABS data has only reported lending for new vs established dwellings for investors since July 2019, however in that time the proportion of new dwelling lending has dropped from 20% to under 14% in July 2021.

[7] Taxation Statistics, Australian Taxation Office

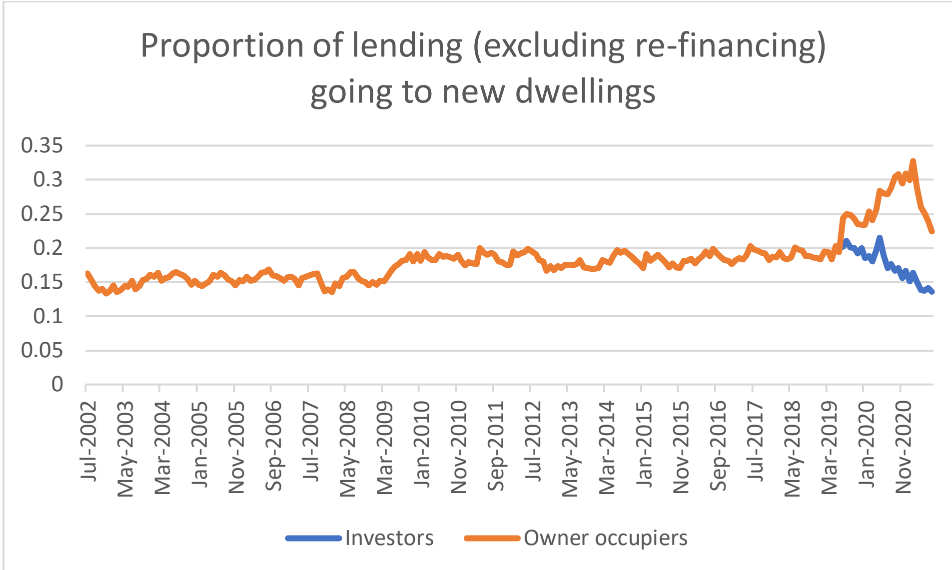

Figure 4 – Proportion of lending to new dwellings. Data source: ABS[8]

The appeal of high property price growth, combined with the propensity to invest in established dwellings creates additional problems for housing affordability. As noted earlier, affordability is a product of both housing costs and income. The nexus of capital gains tax discount and negative gearing incentivises investment into unproductive assets such as established housing[9]. The effect of this investment being effectively parked rather than generating productive economic activity through investing in businesses is a further drag on wage growth.

6. Right to invest vs right to a home

One of the most frequent arguments against meaningful reform to address housing affordability is that the departure of property investors from the market would jeopardise the rental market. Renting is and should be an important part of the housing market. Renting should exist as a true alternative to home ownership. However currently prospective owner-occupiers are being outbid by investors. In addition to buying largely established dwellings, rental stock reflects owner occupier stock in Australia to a far greater degree than other countries[10], indicating that investors and prospective owner-occupiers are competing for the same types of properties.

Across all age groups, most people that rent would prefer to be owner occupiers but aren't able to enter the market. For each of these households, if they replaced an investor in owning a property both the supply and demand for rental properties would reduce, meaning no shortfall is created.

[8] Lending Indicators, Australian Bureau of Statistics
[9] Governance of the nation: A blueprint for growth 2017, Australian Institute of Company Directors
[10] The changing institutions of private rental housing: an international review, Australian Housing and Urban Research Institute, 2018

Reason to rent	18-24	25-34	35-44	45-54	55-64	65+
I can’t afford to buy anything appropriate	20%	19%	22%	23%	26%	29%
I have no other option	16%	14%	19%	26%	34%	43%
I want to own but I don’t have enough for a deposit	19%	25%	24%	20%	17%	8%
	55%	**58%**	**65%**	**69%**	**77%**	**80%**
I prefer renting at the moment	24%	21%	19%	18%	15%	14%
I want to retain the flexibility to move quickly	9%	11%	8%	7%	4%	3%
	45%	**42%**	**36%**	**32%**	**23%**	**20%**

Table 1 – Reasons to rent. Source: Bankwest Curtin Economics Centre[11]

One likely reason that most renters would prefer to own, is that Australia has comparatively weak protections for renters. Our laws in many respects value the right of a landlord over their investment higher than the right of a tenant to their home. Australia is significantly out of step with other similarly wealthy countries, particularly when it comes to no-grounds eviction.

[11] The private rental sector in Australia – Public perceptions of quality and affordability, Bankwest Curtin Economics Centre, 2018

	Minimum fixed lease	Cost controls	Eviction
Australia *(Noting that recent legislation in Victoria have strengthened the rights of renters, including some limits on no-grounds eviction)*	Generally six months or a year, but leases can be shorter	None for private housing. Landlords can charge as much as they like	No reason required. Regulations allow 'no-grounds' evictions for tenants on periodical leases (except in Tasmania)
Netherlands	Renters can stay indefinitely, even if the property is sold	Rents and rent increases are limited by government regulation	Only permitted in certain circumstances listed in the Dutch civil code
Germany	Renters can stay indefinitely, even if the property is sold	Rents and rent increases are limited by government regulation	Not permitted unless the tenant violates the terms of the lease
Denmark	In most cases renters can stay indefinitely	Rent controls apply to most of the rental housing stock	Only permitted under a limited range of circumstances
Ireland	Four years	None for private housing. Landlords can charge as much as they like	Only permitted during the first six months unless the tenant violates the lease, or use of the dwelling changes
France	Three years	Rent increases cannot exceed the 'reference rent index'	Not permitted unless the tenant violates the lease, the property is sold or the landlord intends to move in

Table 2 – Comparison of rental laws. Source: Choice[12]

Our current system not only frequently prices prospective owner-occupiers out of the market, it also frequently prices many tenants out of the type of rental properties they need. Despite the increased flexibility and responsiveness to changing circumstances that renting should offer, households in the private rental system consistently have higher rates of housing that doesn't meet their needs than owner occupiers.

[12] Rental Rights, Choice, 2014

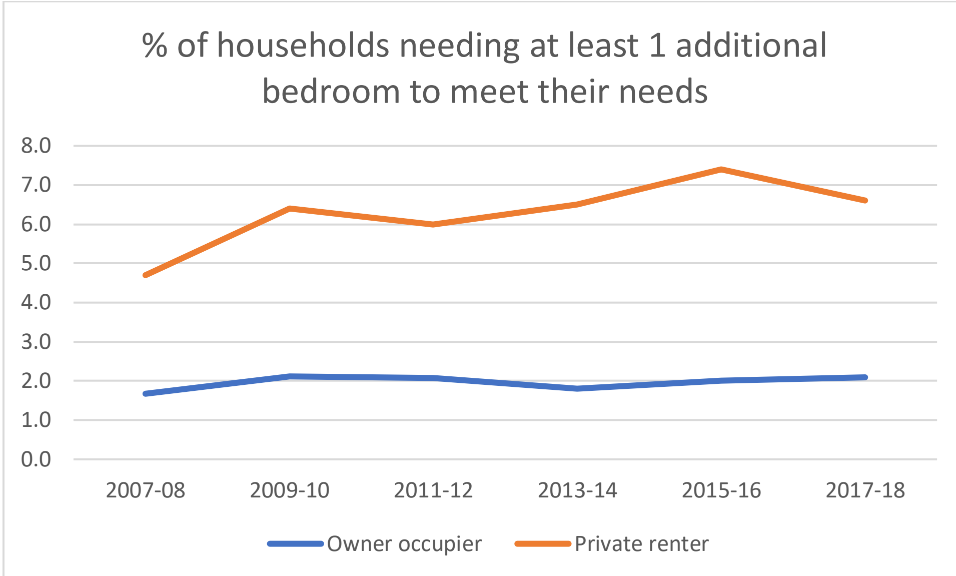

Figure 5 – Housing utilisation. Data source: ABS[13]

7. Does regulation hinder housing affordability?

The development industry frequently claims that every planning permit required, every infrastructure contribution levied, and every building inspection conducted results in direct costs passed on to homebuyers. While a convenient narrative, this is inconsistent with the economics of development.

Developers are ultimately price takers, not price makers. As an example, consider infrastructure contributions. If the cost of contributions were passed directly on to homebuyers, the inverse should also hold. If infrastructure contributions were to disappear tomorrow developers would not discount home prices at tens of thousands of dollars below market value. Yet it is exactly this logic that these claims rely on.

Where is the money from infrastructure contributions coming from? They impact the residual land value of potential development sites. Residual land value is the maximum price a developer is willing to pay to obtain a development site. Residual land value can be found by taking the eventual price the property will sell for and subtracting all the costs of getting the land to that point.

[13] Housing Occupancy and Costs, Australian Bureau of Statistics

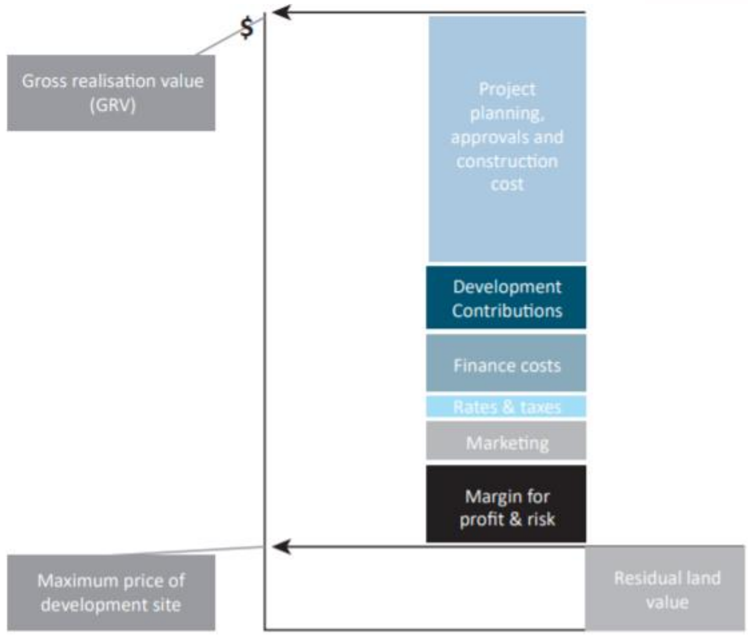

Figure 6 – Residual land value. Source: SGS Economics & Planning[14]

Where the developer's calculation of residual land value is at least equal to what the current landowner is willing to sell for, the development will proceed. If the development costs increase to a point where the landowner no longer believes the residual land value is a fair price, the development may not proceed. This, as well as the potential for the developer to seek to increase the final value of the land by holding back lots to manufacture scarcity, will have some effect on supply. However, this is quite different from the direct passing through of costs that is frequently argued.

The role of developer choices in interacting with regulatory systems is underplayed. Developers often push the envelope in terms of building form that complies with the requirements of planning schemes. This means a greater level of scrutiny must be applied, as the potential environmental, social, and economic impacts for the local area are greater. While planning is frequently told to "get out of the road" of development, development could also stand to "stay in its lane" that strategic planning processes have laid out for it. Developers often call for both flexibility in design and certainty of approval, when the reality of a well-functioning planning system is that these goals are largely opposed to one another.

8. Value of social housing

Direct investment into social housing increases the supply of housing available for those in greatest need. Governments at all levels have a responsibility to address the needs of vulnerable and disadvantaged people.

[14] Development contributions for affordable housing: theory and implementation, SGS Economics & Planning,

Investment into social housing also makes economic sense. Housing people who are homeless or at risk of homelessness can reduce their need to access health services exceeding the cost of housing them[15].

From 1997-98 to 2017-18, the share of Australian households renting from a state or territory housing association has almost halved. Other social housing (such as that held by community housing associations) has grown faster than public housing has declined, but overall the social housing stock has not kept pace with need. While investment such as the Victorian Government's Big Housing Build is welcome, it remains a drop in the ocean compared to both the one-off and ongoing investment that is needed. It is estimated that Victoria alone requires 6,000 additional social housing dwellings per year for 10 years to bring it up to even the national average rate[16].

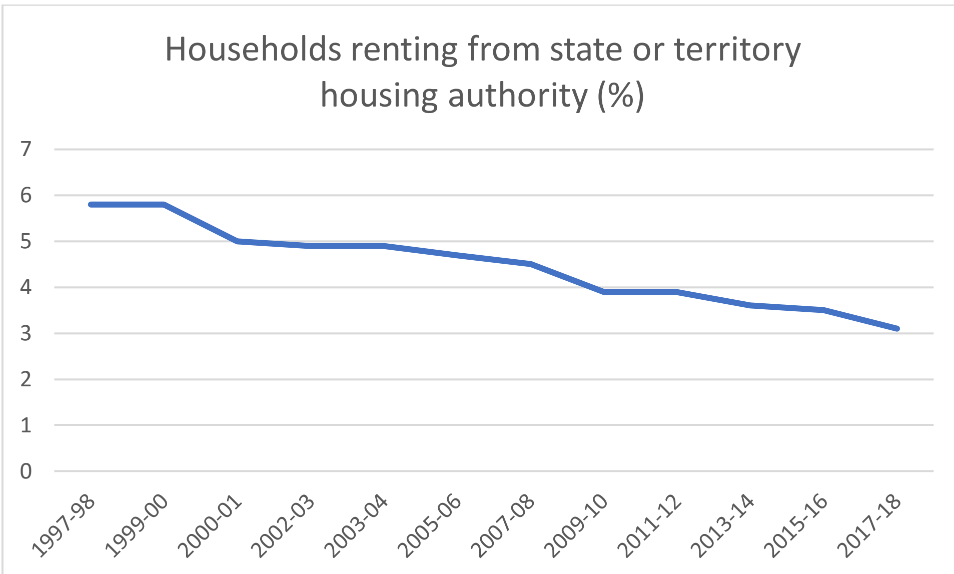

Figure 7 - Households renting from state or territory housing authority. Data source: ABS[17]

[15] What are the health, social and economic benefits of providing public housing and support to formerly homeless people?, Australian Housing and Urban Research Institute, 2016

[16] Submission to Parliamentary Inquiry into Homelessness, Community Housing Industry Association Victoria

[17] Housing occupancy and costs, Australian Bureau of Statistics

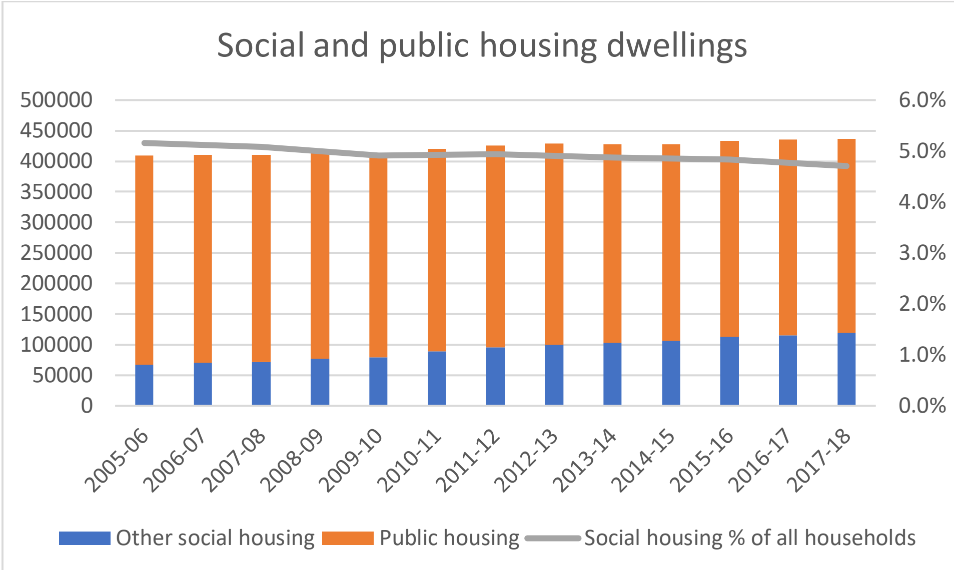

Figure 8 - Number of social housing dwellings and % of all households. Data sources: ABS[18], AIHW[19]

In addition to addressing immediate needs, social housing can act as a bridge to stable housing in the private sector. Reduced housing costs can allow people to improve their personal circumstances and save. Rent to own style schemes can provide a more direct pathway to ownership.

9. Policy proposals

9.1. Increasing the supply of social and affordable housing

To meet Australia's social and affordable housing needs there needs to be a combination of direct investment by government, and ongoing contributions from development through the planning system.

The MAV has argued strongly for Victoria's planning system to adopt mandatory social and affordable housing contributions. As discussed in Section 7, this would not result in these costs being passed on to other homebuyers.

9.2. Making renting a competitive alternative to home ownership

Making renting a more attractive prospect would take heat out of the property market.

Stronger laws protecting tenants' rights would give tenants increased security of tenure and make them more likely to consider renting as a true alternative, rather than a last resort. Victoria's recent reforms offer a starting point, although time will tell whether they are sufficient.

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[18] Housing occupancy and costs, Australian Bureau of Statistics

[19] Housing assistance in Australia, Australian Institute of Health and Welfare

Currently many landlords see themselves in the business of making capital gains, not providing housing. If tax settings were adjusted to encourage investment based on rental return this may move the rental market more to institutional landlords or more active smaller landlords. This shift, if well regulated, would see a greater proportion of landlords committed to providing a high-quality rental product.

Initiatives encouraging Build to Rent models, such as those being pursued by the Victorian Government, could be a valuable part of this shift in the rental market.

9.3. Curbing property speculation

Addressing tax concessions that advantage investors over owner-occupiers at auction would make a significant contribution to housing affordability. Revisiting prudential lending standards with regards to both investors and interest-only loans is another option that would help even the scales for prospective owner-occupiers.

Land taxes are another potential lever to discourage speculation, although for household investors the presence of negative gearing moderates their impact as any additional tax burden can be claimed as a deduction against other income.

Of Melbourne's 9 interface councils[20] that span the greenfield growth areas, five levy a higher differential rate on vacant land ranging from 1.4 to 2.4 times the general residential rate in the dollar.

In each case where vacant land is levied at a higher rate, council rating strategies describe encouraging timely development as a key reason behind the policy. Even the highest of these rates for vacant land represents $0.0064 for every dollar in capital improved value. The quantum of council rating makes it difficult for differential rating alone to counteract the gains developers accrue in restricting supply. It is likely that a state-levied tax on developable land would be required to provide enough disincentive to affect landbanking behaviour.

9.4. Wage growth and income support

Wage growth is the other side of the housing affordability equation. Despite an overwhelming focus on productivity gains as the gateway to wage growth this has not borne out. Wage growth has consistently lagged productivity gains.

[20] Victorian Local Government Comparator Groups, Local Government Victoria

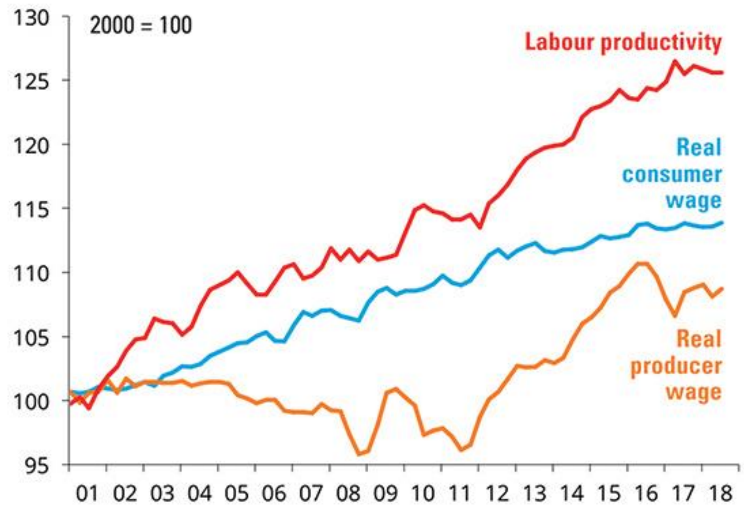

Figure 9 - Productivity and wage[21] growth. Source: Saul Eslake

When compared to growth in housing prices the affordability crisis is clear. While out of scope for this submission, ensuring that workers receive a more equitable share of Australia's economic prosperity must be part of the solution.

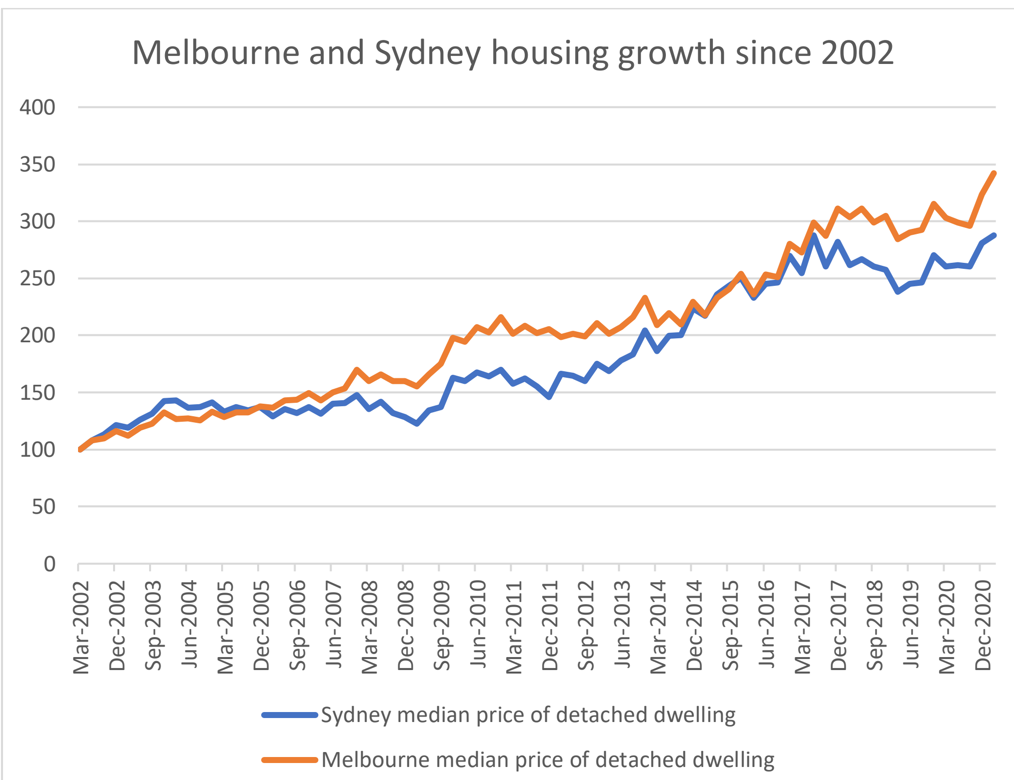

Figure 10 - Melbourne and Sydney house price growth. Data Source: ABS[22]

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[21] Productivity is up, why not wages?, Saul Eslake,

[22] Residential Property Price Indexes: Eight Capital Cities, Australian Bureau of Statistics

For those who rely on government payments the picture is even bleaker. Prior to the COVID supplement, the last time the JobSeeker (or equivalent) payment was raised above inflation was a $2.95 per week raise in 1994[23]. In addition to the clear benefit to the recipients, increasing income support helps grow the economy. Most income support flows directly back into the day-to-day economy because it is necessary to meet the basic needs of the recipient. Additionally, the pre-COVID rate of NewStart/JobSeeker was so low as to undermine the ability of recipients to look for work effectively[24].

[23] Raise the Rate, Australian Council of Social Service

[24] The Recovery Book: What Australian governments should do now, Grattan Institute