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Australia**

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# The quarter century record on housing affordability, affordability drivers, and government policy responses in Australia

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## **Abstract**

**Purpose** – Discuss the record on housing affordability in Australia over the period 1985 to 2010, link this with its demand and supply drivers, and comment on government policy responses during the same period.

**Design/methodology/approach** – Descriptive analysis of various measures of affordability using readily available commercial and other information and discussion of the affordability drivers and government responses using recent governmental inquiries into housing affordability.

**Findings** – Housing affordability in Australia has worsened significantly in the past quarter century, including both urban and regional areas, and is now among the world's most unaffordable. The main contributor at the national level has been the escalation of housing prices because of continuing strong demand arising from strong economic and population growth, the availability of cheaper and more accessible finance, and tax and other incentives for home and investor housing ownership. An additional contributor is unresponsive housing supply resulting from an extensive governmental role in land release and zoning, infrastructure charges, and building and environmental regulation.

**Research limitations/implications** – Data used from only one of the three commercial measures of housing affordability currently available. No attempt made to model the relationship between housing affordability and its demand and supply drivers.

**Practical implications** – There is a need to reassess government policy at all levels as it relates to population, economic, urban, and environmental planning and government regulation and taxation and housing affordability.

**Originality/value** – This study provides a complete account of housing affordability and the literature on housing affordability in Australia over the past 25 years.

**Keywords** – Housing affordability, affordability drivers, tax and regulatory policy

**Paper type** – Research paper

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## **Introduction**

Housing affordability remains a perennial concern in Australia. As early as the mid-1970s, the establishment of the National Indicative Planning Council for Housing resulted in a series of reports and working papers on housing and housing affordability in Australia, closely followed by two reports into housing costs by the Priority Review Staff (1975) and the Committee of Inquiry into Housing Costs (1978). The decades since have witnessed an increasing succession of inquiries and reports concerned with the various dimensions of housing affordability (including housing costs, mortgage stress, and rental markets), often accompanying the periodic and rapid escalation of Australian house prices (including booms in 1971–74, 1979–81, 1987–89 and 1996–2003), especially since the mid-1990s.

Starting with a Special Premiers Conference on Housing in 1989 and the formulation of a National Housing Strategy (1991a, 1991b), these include, most recently, the ministerial report of the Affordable Housing National Research Consortium (2001) and a series of reports to the Prime Minister’s Home Ownership Task Force (Bor and Moloney 2003; Caplan et al. 2003; Gans and King 2003). They also include a Productivity Commission (2004) report on first-home ownership, the creation of a framework for national action on affordable housing by a joint meeting of the Housing, Local Government, and Planning Ministers (2005), and a Senate Select Committee on Housing Affordability in Australia (SCHAA) (2008).

These national government initiatives, of course, exclude the many separate efforts taken by the states, local government, industry, consumer, and welfare groups in Australia to focus policy attention on housing affordability. These include an ongoing National Affordable Housing Summit (led from 2007 by the Australian Council of Social Services, the Housing Industry Association, National Shelter, the Australian Council of Trade Unions, and the Community Housing Federation of Australia), several state inquiries [see, for example, Tasmanian Legislative Council Select Committee on Housing Affordability in Tasmania (2008)] and various industry reports (see, for instance, Urban Development Institute of Australia (2007)]. They also include a succession of reports from the Australian Housing and Urban Research Institute (AHURI) [Yates et al. (2004), Yates et al. (2005), Chapman (2006), Berry (2006a, 2006b), Gabriel (2006), Yates and Gabriel (2006), Gurran et al. (2007), Lawson and Milligan (2007), Yates (2007a, 2007b, 2007c), and Yates et al. (2007)] and regular comment by the Reserve Bank of Australia (RBA) as the regulator directly concerned with financial system stability and the economic welfare and prosperity of Australians [see

RBA (2003), Richards (2008; 2009a; 2009b) and Ellis (2010)]. Unsurprisingly, some academic work is also in evidence [see, for example, Berry (2003), Berry and Dalton (2004), Beer et al. (2007), Yates, (2008), Gurran (2008), Marks and Sedgwick (2008) and Abelson (2009)].

Reasons for this interest in housing affordability are not hard to find. By all accounts, not only are Australian houses now among the largest in the world [an average 186m<sup>2</sup> for new homes, compared with 76m<sup>2</sup> in the UK, 102m<sup>2</sup> in Germany and 200m<sup>2</sup> in the US (SCHAA 2008)], but also among the most expensive. In evidence, between 1997 and 2010, Australian house prices increased nationally by 220%, compared with 181% in Britain, 129% in Ireland, 70% in the US, 141% in France, 70% in Canada, 157% in Spain, -37% in Japan, 18% in Singapore, and 108% in New Zealand (Anonymous 2010). More ominously, using calculations of the long-run price-to-rent ratio by *The Economist* magazine, Australia also has the world's most overvalued (63.2%) housing market, well ahead of the US (10.6%), Canada (23.9%), Britain (32.0%), and New Zealand (20.2%). Equally disturbingly, there is no sign the price of Australian housing is showing any of the slowdown experienced in most other developed markets, with recent year-on price increases of 6.6% compared with -4.0% in the US, -3.0% in Britain, -3.8% in Canada and -4.4% in Germany (Anonymous 2010).

However, it is in relative terms that the deterioration of housing affordability in Australia is most alarming. For instance, in 1980, the average salary in Sydney, Australia's largest city, was \$13,780, and the average house price \$64,800, a multiple of 4.7 times earnings. By 1990, house prices in Sydney were a multiple of 5.89 times earnings, and 6.58 times earnings in 2000, until by 2010 the average salary was \$65,565 but the average house price was some 10.1 times higher at \$663,000 (Callaghan 2010). In other evidence, among Australia, Canada, Ireland, New Zealand, the UK and the US, housing in Australia is the most unaffordable, with all but one of its 23 urban and regional submarkets (96%) ranked severely unaffordable compared with 18% in Canada, 63% in New Zealand, 58% in the UK, and just 6% in the US (Cox and Pavletich 2010).

The lack of affordable housing in Australia has many worrying implications. Apart from meeting the basic need for shelter, affordable housing also provides a foundation for family and social stability, and contributes to improved health, educational, social and economic outcomes (Gabriel et al. 2005, Productivity Commission 2004). Further, though affordable,

high-quality rental housing also provides many of these benefits, the suggestion is they are even larger for home ownership. For instance, owner-occupiers may have a relatively stronger incentive for civic involvement, their typically longer residential tenure suggests minimal disruption to social networks and children's education, and the enhancement of self-esteem through homeownership can potentially reduce the incidence of socially disruptive behaviour and promote physical wellbeing (SCHAA 2008). Yet other work points out the benefits of homeownership for access to disability and aged services and the reduction in welfare dependency. Combined together, the societal benefits of affordable housing help justify the interest and contribution of governments to this important policy area, in both Australia and elsewhere, and provide the central motivation for this study.

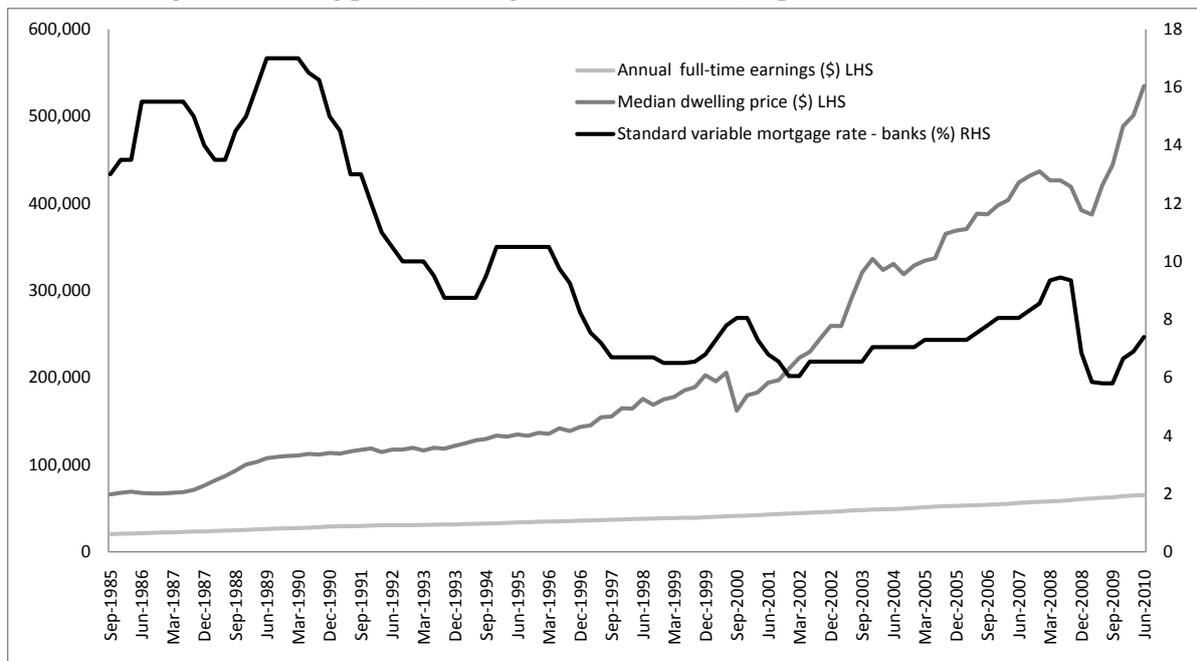
The purpose of this paper is then threefold. First, examine the trend in housing affordability in Australia across recent decades. This will provide a better understanding of the nature of housing affordability, the severity of the lack of affordability and the outlook for the immediate and longer future. Second, assay the drivers of housing affordability in Australia, both in terms of their historical and social context and the contemporary supply and demand factors. This will allow an informed assessment to be made of the targeting of both policy and policy comment by regulators, policymakers, media and industry, consumer and welfare groups aimed at improving housing affordability. Third, provide a critique of recent government policy in the area of housing affordability, with a special focus on how it links with the purported drivers of affordability. This will permit both the opportunity to appraise government efforts in Australia over time and provide a convenient summary for researchers and others in other national contexts to compare efforts to improve housing affordability in their own countries.

The remainder of the paper comprises three main areas. The first section provides the record on housing affordability in Australia in the past twenty-five years and discusses the attributes of the main measures of affordability. The second section briefly discusses the main drivers of housing affordability during this period and provides a critique of the accompanying government policy efforts aimed at improving affordability. The paper ends with some concluding remarks and policy recommendations.

## Measures of affordability

Despite the longstanding interest in housing affordability in Australia, its definition and measurement remains contentious. Perhaps the simplest definition is the ratio of house prices to full-time ordinary earnings, where an increase in the number of years of earnings required to purchase a house suggests a worsening in housing affordability. For example, Merrett (2000) concludes that from the 1880s to the 1930s, the price–earnings multiple in Australia was about 5, while Yates (2007) suggests a multiple of 3–4 in the late 1950s, increasing fourfold between 1960 and 2006. Similar sorts of figures are given by the Committee of Inquiry into Housing Costs (1978) in the 1970s, while the Productivity Commission (2004) estimated that the multiple had increased from 6 in the mid-1990s to about 9 at the time of its report.

**Figure 1 Housing prices, earnings and interest rates, September 1985–June 2010**



Source: Australian Bureau of Statistics, Housing Industry Association, Reserve Bank of Australia

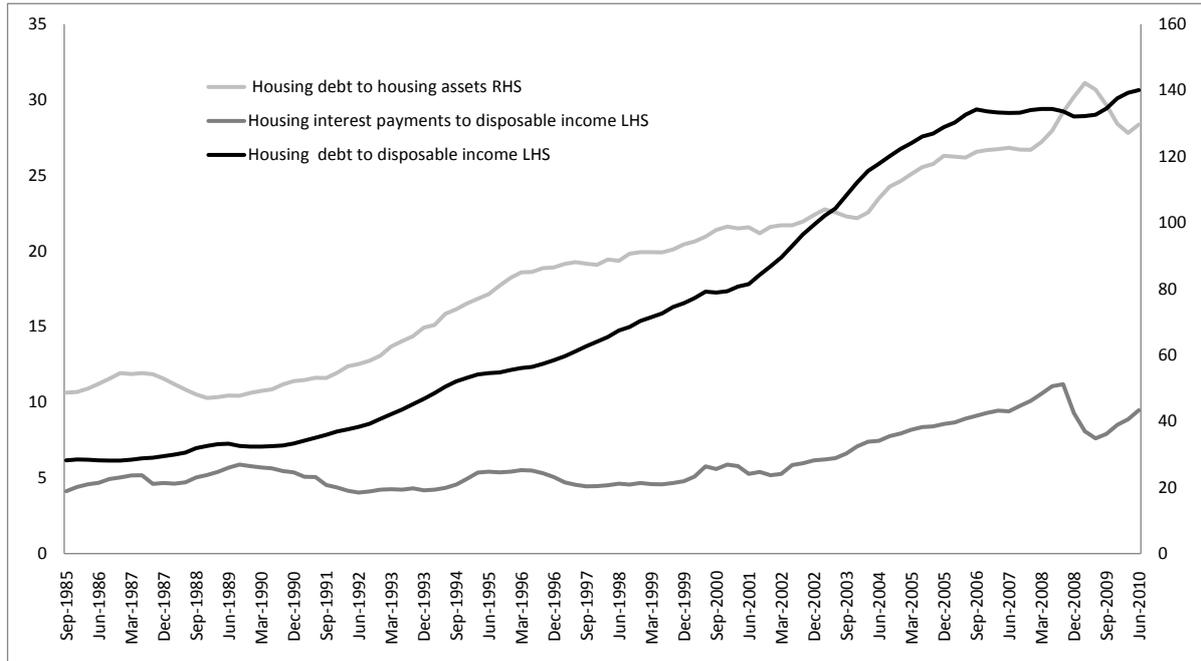
Figure 1 depicts the two components of the housing price–earnings multiple over the period September 1985 to June 2010 by quarter. As shown, median house prices have increased substantially in Australia over the period 1985–2010, from \$65,900 in the September quarter of 1986 to \$534,800 in the June quarter of 2010, an eightfold increase representing an annual growth rate of some 8.9%. However, during the same period, average annual full-time earnings increased from only \$20,191 to \$65,114, a slightly better than threefold increase at an annual average growth rate of 4.8%. As a result, the housing price–earnings multiple

increased from just 3.3 in September 1985 to 8.2 in June 2010, suggesting a substantial and persistent worsening in housing affordability.

Notwithstanding the ready availability of the data needed for calculating the housing price-earnings multiple, its major fundamental weakness, as recognised by the Productivity Commission (2004) and Abelson (2009), is that it ignores the cost of housing finance. This is particularly pertinent in Australia where the notional cost of housing debt, represented here by the standard variable bank mortgage rate, has generally declined since 1985. Consider Figure 1. As shown, the standard variable mortgage rate fell from 13.0% in September 1985, with a high of 17.0% over the four quarters starting June 1989, to 7.4% in June 2010, an average of 9.7% over the period. While not the subject of this paper, the downward trend in home lending rates is arguably not only a condition of the Australian macroeconomy, but also the substantial role of financial deregulation and the progressive narrowing of the spread between mortgage rates and the official cash rate from increased competition in the banking and non-banking sector during this time. As discussed later, it also partly accounts for the worsening of housing affordability during the sample period.

With this in mind, Figure 2 highlights the critical interface between housing affordability, as simply defined, and the cost of housing finance in Australia by plotting the ratios of housing debt to housing assets, housing interest payments to disposable income and housing debt to disposable income over the period September 1985 to June 2010. As shown, in the 25 years to June 2010, the ratio of household debt to disposable income rose from a level that was arguably low by international standards (28%) to one of the highest for most comparable economies (140%). Other measures show similar results. For instance, household debt servicing (interest plus required payment of principal as a percentage of disposable income) has more than doubled over the past 25 years, from 4.1% to 9.5% but has recently been as high as 10.2%.

**Figure 2 Housing debt, assets, interest payments and disposable income, September 1985–June 2010**



Source: Reserve Bank of Australia

Likewise, gearing (the ratio of the value of housing debt to housing assets) has nearly tripled over this same period, increasing from 10.6% in September 1985 to 28.4% in June 2010. Importantly, while these aggregate figures clearly justify the interest of the RBA as the Australian regulatory body most concerned with systemic stability and prosperity in the Australian economy, they also downplay some of the serious distributional concerns. For example, borrowing for owner-occupied housing accounts for most housing debt and the bulk of this is concentrated in a small number of households, as many households actually hold no housing debt, either owner-occupied or investor related, at any point of time. Accordingly, gearing and debt servicing are substantially higher in owner-occupied debt-holding (especially low-income) households than what the aggregate figures suggest.

It is for this reason that some more developed measures of housing affordability in Australia have attempted to incorporate the link between the strict cost of housing and the ‘mortgage stress’ implied by the need to service the debt necessary to purchase this housing. The three most widely used indices of housing affordability in Australia are as follows:

- The *Deposit Power–Real Estate Institute of Australia Housing Affordability Index*—the ratio of median household income to average loan repayments, with

the average determined by the average size of new loans for each quarter. Available at <http://www.reia.com.au/>.

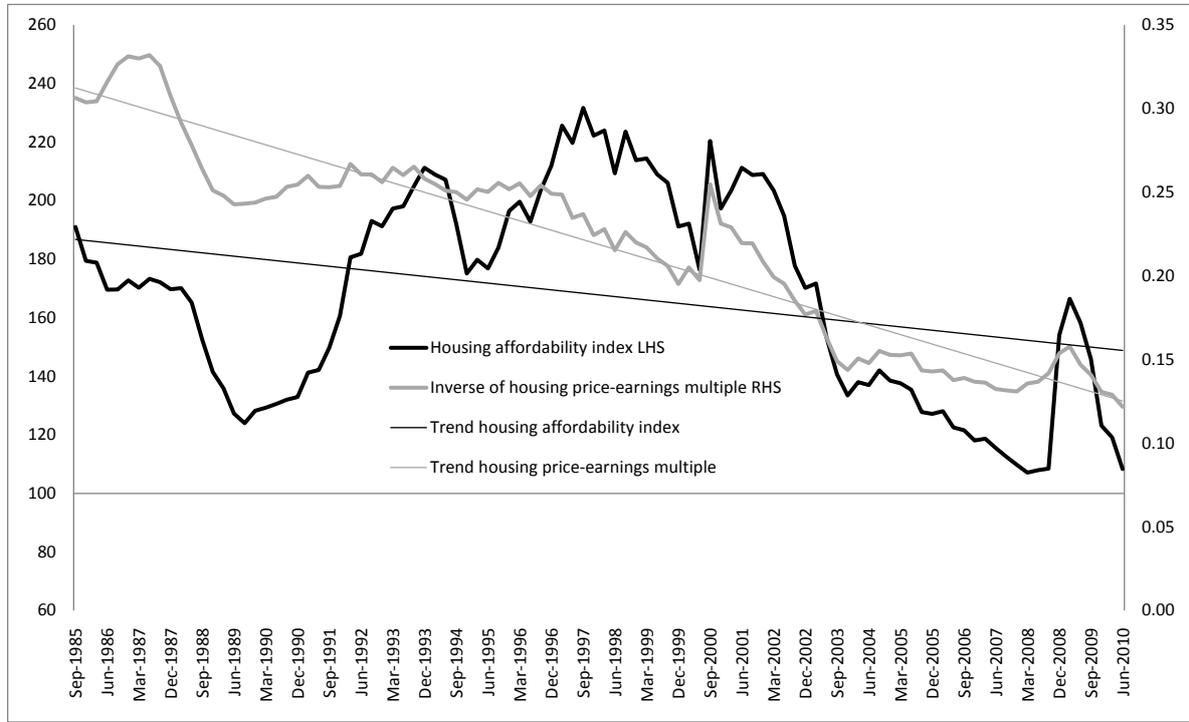
- The *BIS Shrapnel Home Loan Affordability Index*—the ratio of mortgage repayments on a ‘typical’ housing loan to average full-time male earnings. The mortgage repayments assume a 25-year loan for 75 percent of the median house price. Available at <http://www.bis.com.au/>.
- The *Commonwealth Bank of Australia–Housing Industry Association (CBA–HIA) Housing Affordability Index* — the ratio of average household disposable income to the ‘qualifying’ income required for a ‘typical’ first home loan. Qualifying income employs the assumption that the repayments on a 25-year loan, for 80 per cent of the price of a ‘typical’ property purchased by a first homebuyer, are equal to 30 percent of household income. Available at <http://hia.com.au/>.

As always, these indexes have their limitations. However, the most fundamental drawback is that they ignore the choices of households. For example, over time households may collectively choose to spend more on higher quality or better located housing. This process is well evidenced in Australia where the overall quality of housing has increased substantially in recent years and where households have increasingly relocated to larger urban and regional centres through emerging preferences for, among other things, a ‘sea change’ or a ‘tree change’. Ultimately, this manifests itself as a decline in measured affordability. Further, choice of housing will also determine gearing and hence debt servicing as when some households prefer to hold proportionately more of their wealth in housing they simultaneously choose to hold a relatively higher level of housing debt to support their choice, as also reflected by conditions in banking and financial markets. For example, the loan to valuation ratio of the typical Australian mortgage loan has increased significantly in the past few decades.

In this study, we select the *Commonwealth Bank of Australia–Housing Industry Association (CBA–HIA) Housing Affordability Index* to discuss further the record on housing affordability in Australia. As noted above, the definition of affordability in the CBA–HIA index is in accordance with the longstanding, but arguably arbitrary, lending premise that housing costs should not account for more than 30 percent of household income. As common, concern also lies only in the direct costs of housing purchase (the cost of the housing itself and subsequent mortgage repayments), and therefore ignores the ongoing costs of ownership,

including property rates, depreciation and maintenance, and the indirect costs of acquisition (including stamp duty, real estate agency fees and charges, furniture removal, transport, etc.).

**Figure 3 Australian housing affordability index and housing price-earnings multiples, September 1985–June 2010**



Source: Australian Bureau of Statistics, Housing Industry Association

Figure 3 plots the CBA–HIA affordability index for Australia over the period September 1985 to June 2010 (along with a linear trend line). For comparison purposes, we also include the inverse of the housing price–earnings ratio (and trend) calculated using the same data as in Figure 1 above. Accordingly, a decrease in both measures represents a decrease in housing affordability. However, while the housing price–earnings measure is by construction only relative to past and future values and includes no absolute standard of affordability, the CBA–HIA index is both relative and absolute in that when the index value equals 100, housing costs account for the maximum 30 percent of disposable income.

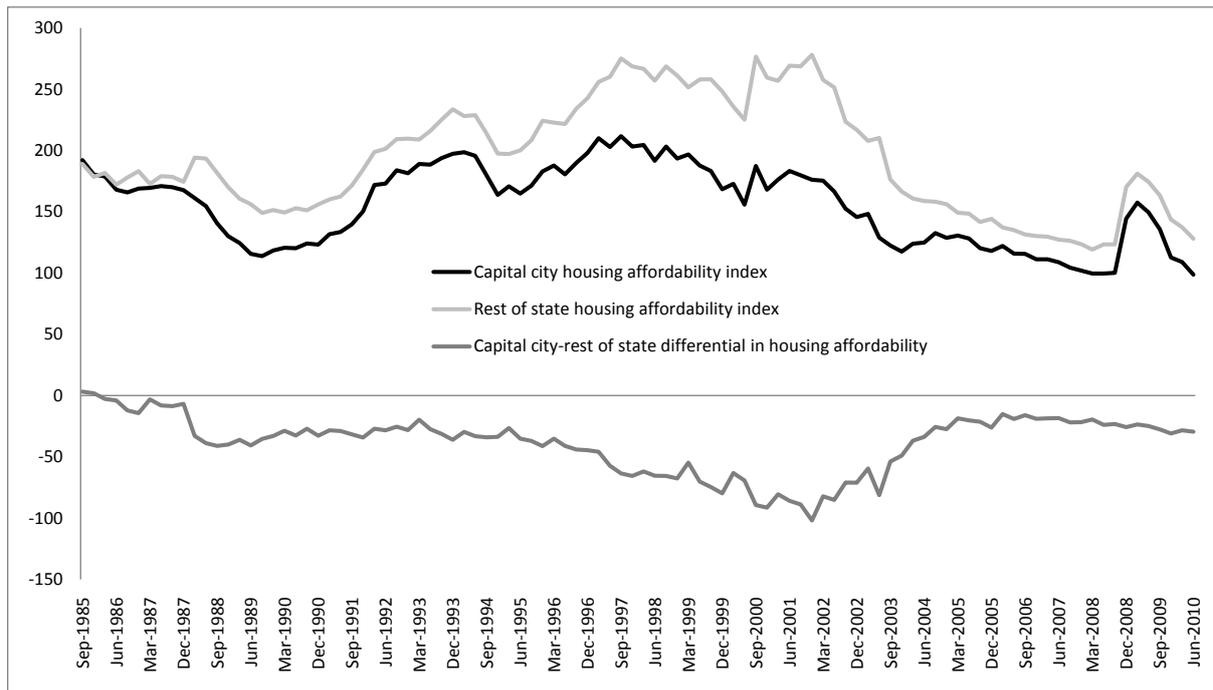
As shown in Figure 3, both measures clearly show that housing affordability has worsened in Australia throughout the sample period. From Figure 1, we know household earnings have trended up at a moderately constant rate so the observed volatility in the measures relative to trend is largely a result of changes in house prices for the housing price–earnings multiple measure and house prices and interest rates for the CBA–HIA index. Starting with the affordability index, we visually identify three sub periods in housing affordability in the past quarter century, corresponding with periods of worse, better and worse affordability,

respectively. The first period corresponds to the period September 1985 to March 1992 when affordability was significantly below trend. During this time, median house prices grew at an average of 8.7% per year, substantially worsened by average mortgage interest rates of 14.8%. As a result, affordability deteriorated dramatically, only improving when affordability rose above trend in the second period, running from June 1992 to June 2003.

During this sub period, median housing prices continued to grow strongly, in fact, at slightly better than 8.9%, but as mortgage interest rates averaged only 8.1% during this period, affordability improved. Finally, in the last sub period from September 2003 to June 2010, house prices grew even more strongly by 9.1%, only marginally offset by lower average interest rates of 7.4%. Regardless, over the entire sample period, housing affordability has worsened, such that by June 2010, the index was at 108.3, slightly above the record lows of 107.1 in March 2008 and 108.0 in June 2008, and now close to the point where housing costs will exceed 30% of disposable income.

For the most part, the housing price–earnings multiple illustrates a similar deterioration in housing affordability but without the volatility evidenced in the affordability index caused by interest rates and the high level of gearing (80%) assumed in the CBA–HIA index. For most mortgage-holding households, this may then offer a better medium-to-long term perspective on the dynamics of (deteriorating) housing affordability, while the CBA–HIA index places relatively greater emphasis on short-term changes in affordability for first-home (and investor) buyers, both with relatively high levels of gearing and therefore highly vulnerable to changes in mortgage interest rates.

**Figure 4 Australian capital city and rest of state housing affordability indexes, September 1985–June 2010**



Source: Housing Industry Association

Finally, Figure 4 highlights the changing pattern of housing affordability in Australia's capital cities (Sydney, Melbourne, Brisbane, Perth, Adelaide, Hobart, and Darwin) and the rest of the state outside the capital (New South Wales, Victoria, Queensland, Western Australia, South Australia, Tasmania and the Northern Territory, respectively). Fortunately, the calculation of housing prices and household incomes provides adequate information about the levels of income in regional areas so the two indexes reflect both the negative effect of the higher cost of housing and the positive effect of higher incomes in Australia's capital cities on affordability. The main point to note is that housing affordability is still consistently worse in Australia's capital cities over the sample period in absolute terms. The suggestion is that the positive difference in capital city–rest of state incomes is generally insufficient to offset the higher housing prices in the capital cities over the entire sample period.

However, the difference in affordability between the two areas has narrowed appreciably in the past several years, with both capital cities and the rest of the states being now almost equally affordable. This provides similar findings to the Demographia International Housing Affordability (Cox and Pavletich (2010) study of regional housing affordability where lower median household incomes in a region invariably offset the benefit of lower median housing prices. For example, the Sunshine Coast (a regional area north of Brisbane) has a similar price–income multiple (9.0) to Sydney (9.1), even though their housing prices and incomes

differ substantially (\$460,000 and \$50,900 in the former and \$569,000 and \$62,400 in the latter, respectively).

### **Key drivers of affordability and a critique of government policy responses**

As discussed in the preceding section, the relative changes in house prices and incomes are the fundamental determinants of even the most complex measures of housing affordability, with interest rates apparently only providing short-term changes in affordability, and then only most applicable for highly-g geared, first home-buyers. Given the steady growth in Australian incomes over the sample period, house prices serve as the primary driver of housing affordability, ultimately determined by the complex net effect of the determinants of the demand for housing and the costs of housing supply. Of these, some demand and supply factors are cyclical, with their effects felt primarily in the short term, while others are 'structural' and will therefore influence prices over the medium to longer term. Further, over time the price elasticities of demand and supply will determine whether a given change in demand or supply results in a modest or more significant change in the price of housing, while the availability and conditions under which credit is made available will determine the capacity of households to finance their housing purchases.

Fundamentally, we can trace some of the reasons for the decline in housing affordability in the past quarter century to Australia's earliest colonial beginnings. From the start, and almost incongruously given the close association of Australians with 'the bush', Australia has always had one of the world's most urbanised populations. Moreover, the populations in the several Australian colonies (states following Federation in 1901), were concentrated in just a single capital, and so even in comparison with other settler colonies like the US, Canada and New Zealand, Australia has relatively few major urban concentrations. For instance, 57% of the population now call one of Australia's five-largest cities home, compared with 18% in the US, and 27% in the UK (Callaghan 2010).

Other long held inherited factors determining housing demand include the strong cultural preference of Australians for detached dwellings on large suburban blocks and the high rate of owner-occupation [comparable to the US and UK at about 70% but as there significantly higher than elsewhere in the OECD (SCHAA 2008)]. The implications of these factors are that a few increasingly congested capital city markets spread over very large geographic areas

with severe infrastructure and planning requirements dominate the question of housing affordability in Australia.

Outside these factors and in terms of the quarter century that is the focus of this paper, strong housing demand and limited and slow to react housing supply are the most obvious and cited reason for the increase in housing prices and the deterioration in housing affordability. Underlying this market behaviour are several drivers repeatedly cited in the various government and nongovernment inquiries and reports. On the demand side, these include the cost of housing finance, economic growth and population dynamics, and changes in government policy and tax incentives

First, the Productivity Commission (2004), the SCHAA (2008) and the OECD (2010) all conclude that cheaper and more accessible housing finance is a central part of the story. With the move to a low-inflation environment, interest rates fell over much of the 1990s and remained at relatively low levels throughout the 2000s. At the same time, increased competition among housing lenders (including the rise of mortgage originators and brokers) has made it easier for many borrowers to obtain loans, and has contributed to lower interest costs by reducing lending margins. This has also flowed through to investor housing, where expectations of rising housing prices and a favourable tax environment has seen a doubling of the proportions of taxpayers with an investment property and the proportion of new housing loan commitments for investment purposes in just the last decade. Problematically, while changes in interest rate regimes are conventionally only a cyclical influence on housing affordability, the SCHAA (2008, p. 54) argues that as housing prices are 'sticky', vendors are reluctant to accept low bids even with rising interest rates and that affordability will only be restored by the gradual increase in incomes.

Second, economic growth and population dynamics have also had a role to play (Productivity Commission 2004; SCHAA 2008). In terms of economic growth, strong productivity gains in the 1990s from deregulation and microeconomic reform and the sustained 'resources boom' of the 2000s has increased household income and wealth and part of this has been diverted into increasing the overall quality of owner-occupied housing and the demand for investor housing. The influence of the mining boom itself on house prices is especially noticeable in regional areas of the major mining states (Western Australia, Queensland but also in New South Wales and South Australia). As for population growth, the Australian population of

22.342 million is now growing at its fastest rate since the 1960s (currently 1.7% per year with 43% from natural increase and 57% from net overseas migration). This is also partly fuelled by the mining boom (with higher rates of population growth in the mining states of Western Australia and Queensland), with immigration an important contributor to the growth in underlying demand, especially in Sydney and Melbourne, and interstate migration a major contributor in Queensland, especially in the rapidly growing southeast. Accompanying this has been the long but still increasing trend to smaller, often single occupancy, households, and the pressures this also places on housing demand.

The final demand driver for housing prices is the changes in government policy and the favourable tax environment for both owner-occupied and investor housing that has prevailed and increased for much of the last twenty-five years. In terms of owner-occupied housing, owners are exempt from capital gains tax (CGT) and land tax while the means-tested public pension excludes the family home. For investor housing, investors benefit from concessional capital gains tax treatment and generous negative gearing (since October 1987) and allowances for depreciation. Overall, SCHAA (2008: 62) suggests that the tax treatment of both owner-occupied and investor housing in Australia is favourable relative to other OECD economies. For its part, the Productivity Commission (2008: 75) considers that "...aspects of the personal taxation regime—including negative gearing rules, 'capital works' deductions, the 1999 change to capital gains tax, and high marginal income tax rates—have combined to magnify the attractiveness of investing in residential property during the recent upswing in house prices, thereby adding to price pressures".

Apart from government policy as it relates to taxation, direct government assistance to households to purchase their own home. Of these, the First Home Owner Scheme, notionally introduced to compensate first-home buyers for the introduction of the goods and services tax (GST) in 2000, is the most noteworthy. For its part, the Productivity Commission (2008) argues that this scheme has not been well targeted, with among other things the cap on price eligibility set too high such that as with other forms of demand-orientated direct assistance, it has placed pressure on house prices. The details of the housing assistance schemes available vary by state. Using NSW as an example, first home benefits of up to \$24,990 are currently available, comprising a \$7,000 First Home Owner Grant and a duty exemption of up to \$17,990 under the First Home Plus Scheme, with a house price cap for eligibility set at \$835,000. This involves a substantial amount of cost subsidisation to first homebuyers, with

the scheme providing the more than thirty thousand purchasers with direct assistance of \$636 million in 2010 alone. Most recently, in 2008 the federal government established First Home Saver Accounts to assist first-home buyers (Australian Government Treasury 2011). Under this arrangement, the government contributes 17% on the first \$5,000 (indexed) of individual contributions made each year. In these accounts, investment earnings (or interest) that accrue in the accounts is taxed at a concessional 15 percent while withdrawals are tax free when used to purchase an owner-occupied home.

While the supply side has not been a principal cause for the increase in housing costs in Australia over the past twenty-five years, a common argument is that the inflexibility of the supply side response has aggravated outcomes. In evidence, the OECD (2011) concludes that while the price elasticity of housing supply in Australia is about average for the OECD, it is relatively low when compared with countries with a similar population density, such as the US and Canada. This means that increases in the demand for housing increases significant increases in housing prices and that the nature of housing development and construction means that it may take some time for short and medium-term supply–demand imbalances to be resolved. Once again, part of the problem in Australia is that inherent geographical and demographic conditions, including physical limitations on land for development and the degree of urbanisation, restrict housing supply in certain areas and open up differences in regional housing affordability.

In this regard, consider Sydney and Melbourne, Australia’s two largest urban areas. While Sydney is constrained by mountains to the west, the ocean to the east and national parks to the north and south, thereby pushing fringe development in a relatively narrow band to the northwest and southwest, Melbourne is located on a broad flat plain with development opportunities technically available around much of the city. This can add considerably to the overall cost of housing where the cost of an ‘infill’ dwelling in an established medium-density area can be thirty percent higher (in Melbourne) than a corresponding ‘greenfield’ development (Stuchbury 2010).

However, government policy also affects the supply of housing as it relates to both land and housing planning, regulation and taxation. One complication in the Australian situation is, of course, the presence of a three-tier system of government where all tiers of government are heavily involved with the housing sector. State and territory governments, for instance, have

extensive responsibilities related to land release and zoning, establishment of charges for (and in some cases provision of) housing-related infrastructure, and implementation and enforcement of building and environmental regulations. Likewise, local government functions typically include the supervision of land development, the administration of planning requirements, and the supply of some infrastructure. Finally, while most of the taxation related to housing is at the state and local level (including stamp duty and land taxes for the former and property rates for the latter), the GST, CGT and allowances for income deductibility at the federal levels also have a role to play.

On this, and further to the discussion of tax policy as a demand driver, the Productivity Commission (2004: 83) concluded that "...although international comparisons of taxation arrangements can be difficult, Australia's reliance on specific property taxation seems high compared with many other countries. Such taxation accounted for about 9 per cent of total taxation revenue for Australia in 2001, compared with a range from below 2 per cent to 12 per cent in a selection of overseas countries". Together, these various taxes and charges can add significantly to both the cost of acquiring and holding housing, and hence reduce the level of affordability. These also influence the overall transaction costs of acquiring and disposing of housing, with the OECD (2011) providing evidence that transaction costs (on both buyers and sellers) in Australia account for about 14% of the property value (fourth highest in the OECD after Belgium, France and Greece).

Putting taxation aside, the capacity of state and local governments to influence housing markets through zoning and development plans and thereby contribute to housing price pressures through new dwelling commencements and redevelopment in existing areas. This is particularly important because of the presence of an argued structural gap between the demand and supply of housing (Stuchbury 2010) and the oft-heard argument by industry that slow and restrictive building and development approvals and onerous infrastructure charges are one of the main reasons for the increase in housing costs (Carter 1990). However, the actual position of Australia in terms of the planning and regulation of housing and development is unclear. This ambiguity is perhaps best reflected in the Productivity Commission's (2004: 123) argument that "...because recent price increases have been due mainly to the surge in demand in established areas, improvements to land release policies or planning approval processes could not have greatly alleviated them". And in the same report, "...urban consolidation policies that introduce constraints on fringe development, including

through ‘urban growth boundaries’, are likely to increase the scarcity value of land” (Productivity Commission 2004: 123).

Overall, the Productivity Commission (2004) concluded that planning processes have not contributed in any significant way to the housing affordability problem (Beer et al. 2007). Nevertheless, there remains general agreement inside both Australia and the OECD (2011) that the housing supply in Australia could be more responsive by designing and enforcing efficient land-use regulations, providing infrastructure and other services along with housing, and using well-designed taxes to encourage the appropriate use of land for residential purposes. There is some recognition of this problem in the recent creation of the Commonwealth government’s \$512 million Housing Affordability Fund (FAHCSIA 2008), expressions of interest (by state and local governments) in which closed in January 2010, the stated aims of which are “...to make housing more affordable by encouraging best practice in local government in respect of residential development assessments, speeding up development assessment processes to reduce the holding costs for developers associated with the time taken to approve a development, and ensure the savings are passed on to the homebuyer, and reducing the burden of infrastructure charges on developers, in order to generate savings for purchasers of new, moderately priced homes”. However, while this scheme is yet to be fully implemented, there are already some concerns over its ability to alter the supply of housing, with the suggestion that subsidies targeted directly at low-income first homebuyer households may be a more efficient and simpler way to improve housing affordability, with less distortion and more allowance for household choice (Abelson 2009).

### **Concluding remarks and policy recommendations**

This study examines the record of housing affordability in Australia over the past twenty-five years. There is also attention to the main drivers of affordability during this period, including strong economic growth and changing population dynamics, ready access to cheap housing finance, and changes in government policy and a generally favourable tax environment. There is also discussion of the various government responses, including direct and indirect assistance in the form of concessions on stamp duty, grants and more recently subsidised home-saving accounts and funds to promote reforms in planning and building approvals. However, despite these well-intentioned efforts, of which at least some are longstanding, the evidence suggests that housing affordability has continuously deteriorated in both absolute

and relative terms to the point where an increasing number of government and nongovernment inquiries have called for urgent action.

However, there is a tendency to regard the decline in housing affordability as principally the outcome of cyclical rather than structural imbalances. This is problematic in that many of these cyclical influences, especially strong economic growth and a relatively low interest rate regime, have prevailed for the most of the long sample period in this analysis with little sign of abatement in the short to medium term. Moreover, the causes of housing affordability are complex and often interwoven with other policy concerns not directly in the terms of reference of many recent government inquiries. For example, there is no doubt that Australia's strong population growth, augmented by substantial overseas migration, has added considerably to housing demand pressure, particularly in major urban areas, especially Sydney and Melbourne. However, reducing immigration may not be economically feasible in, say, the current labour market context when Australia's mining boom and ageing population are considered. Other relevant factors include issues of sustainability, infrastructure requirements and regional development policy.

Nevertheless, policy could usefully proceed in several directions. First, increase the responsiveness of housing supply to housing demand. This is because supply that is more responsive can limit the house price volatility and mitigate the excessive price increases found in much of the recent housing affordability record. Key policy tools here include enhancing the efficiency of the building approvals process, reform of the urban planning process and the provision of long-term projections for urban development and infrastructure requirements. Second, remove existing tax policies that favour both owner-occupied and investor housing over other investments. Once again, favourable tax treatment lowers borrowing costs, encourages excessive investment, promotes speculation, and limits household mobility, thereby perpetuating regional disparities in affordability. Finally, better targeting and design of assistance to disadvantaged households. This would eliminate both the distortions to housing markets associated with broad direct assistance and more adequately assist households where need is greatest.

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