Submission to the Inquiry into Housing Affordability and Supply in Australia

House of Representatives Standing Committee on Tax and Revenue

September 2021

Executive Summary

The Reserve Bank (RBA) recognises the importance of housing to the people of Australia. Shelter is a fundamental human need. Being able to access appropriate housing, whether to own or rent, is a central concern of government policy, and it has been the subject of several inquiries over the years; the Bank has made submissions to these previous inquiries, which form the context for this one. Well-functioning housing markets that are accessible to all people enhance well-being, support labour mobility and promote an efficient allocation of resources across economies.[1]

Government policies, including tax and regulatory settings, affect both the demand for and supply of housing, and in turn housing affordability. These policies can produce incentives that increase demand, transaction costs which can deter housing turnover, or regulations that affect the flexibility of housing supply. Access to credit also plays a role, affecting both households' ability to borrow to buy housing and developers' ability to expand the supply of housing in response to changes in demand. It is necessary to understand the full range of factors affecting both demand and supply in order to design effective policy interventions.

The key messages of this submission are as follows.

- Housing affordability differs across the Australian population and has changed over the past decade in different ways for different groups.
- Housing prices have risen relative to income in many, but not all, areas. At the same time interest rates have been low for a prolonged period, which has lowered the cost of debt service for borrowers. For those looking to purchase a property, the combination of low interest rates, low income growth, and high median housing prices have made it harder to save a deposit.
- For those in the rental market, a large increase in the construction of apartments has lowered the cost of renting apartments in Australia's largest cities, but elsewhere rents have risen for most income groups.
- Affordability is assessed to have declined the most for lower income households who are renting or looking to buy a home.

1 Productivity Commission (2014).

- Some features of Australia's tax and transfer system incentivise owner occupation and investing in property, and discourage mobility. This affects the balance of demand and supply in the housing and rental markets, and may contribute to affordability pressures for some.
- Changes in regulation and other drivers of construction activity affect the flow of newly built housing, which in any one year only shifts the stock of housing incrementally. Even the most flexible construction sector is therefore limited in how quickly it can respond to rapid shifts in demand.
- Some constraints on the responsiveness of new supply relate to Australia's urban structure and geography. Regulatory changes are unlikely to alleviate these constraints entirely. One of the key challenges for supply over coming decades is that if populations in large cities expand further, households will either need to live further away from the centre of major cities (necessitating new infrastructure investment) and/or accept further increases in higher-density housing.
- Other regulations and planning processes may also be able to be streamlined to make supply more responsive to increases in demand. However, many of these regulations are intended to promote other social goals, such as ensuring buildings are constructed safely and that neighbouring residents do not have costs and inconveniences imposed upon them about which they are not consulted.
- The COVID-19 pandemic and the policy response to the pandemic have affected housing markets in a number of ways. For example, changes in housing preferences may have shifted the balance between the supply of and demand for housing in some housing markets. Affordability has improved a little for some and declined for others. Since it is not clear how lasting any shifts in preferences will be, there may be greater than usual uncertainty in evaluating any prospective policy changes.
- In response to declining affordability, some other advanced economies have sought to improve the balance between supply and demand, including by restricting demand.

The remainder of this submission provides more detail on these themes, building on the Bank's submissions to earlier inquiries. The present submission includes a range of material that relates to the Bank's responsibilities that might be useful background to some of the issues raised in the terms of reference. Supplementary information is also provided in Appendix A.

Introduction

'Housing affordability' is commonly used to refer to the relationship between household income and household expenditure on housing, which may refer to price, rents or mortgage repayments. A closely related concept is 'housing accessibility', which refers to the ability of households to purchase their first home or, less commonly, a rental bond for rental housing. Households' access to finance and their ability to accumulate a deposit are important factors in assessing housing accessibility. A decline in housing affordability or accessibility can often mean that some households end up making compromises on the suitability of the housing they occupy, and/or the other goods and services they consume.

In addition to the housing supply issues that are the focus of this inquiry, affordability is also affected by housing demand, changing household preferences and the relationship between housing markets and the broader economy. This submission considers these related issues and their contribution to the cost of housing services for Australian households. [2]

The RBA's submissions to the Inquiry into Affordable Housing in 2014 (RBA (2014)) and the Inquiry into Home Ownership in 2015 (RBA (2015)) outlined changes in affordability and home ownership over the very long term. As such, the discussion that follows mostly focuses on developments over the past decade and should be read in conjunction with those two submissions.

How are Australians housed?

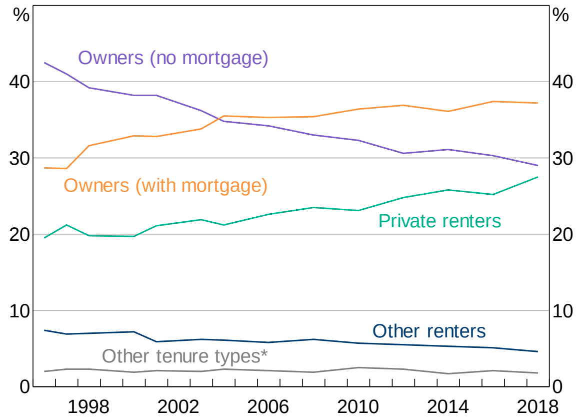
Information on housing tenure and home ownership can help identify which population groups might be facing affordability pressures. This in turn can inform assessments of how policy measures might affect affordability.

- Most Australians have access to shelter, although more than 115,000 people were homeless on Census night in 2016, including 8,200 people in improvised dwellings, tents or sleeping out.
- Rental affordability is an increasingly important issue. The share of households that rent has increased from around one-quarter in the late 1990s to around one-third in 2018 (Graph 1).
- A little over two-thirds of Australians own a home, many with a mortgage. Home ownership rates have drifted down over several decades for most age groups, but this trend is most evident among households with heads aged between 25 and 49 (Graph 2).

Graph 1

Housing Tenure Type

Share of households

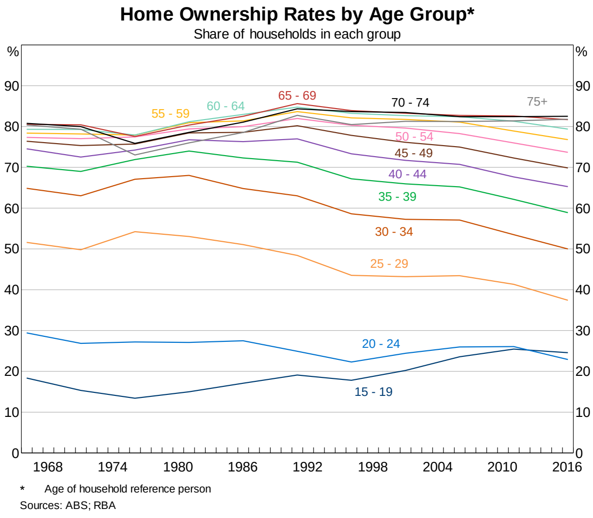


* Includes shared equity schemes, life tenure schemes and other

Sources: ABS; RBA

2 Other recommendations for addressing housing affordability also suggest that both demand and supply factors need to be considered. See Daley, Coates and Wiltshire (2018) for example.

Graph 2



Multiple factors have contributed to the decline in home ownership and they are difficult to disentangle. Changing demographics and shifts in household preferences (including marrying later and higher divorce rates) are likely to have contributed.[3] Using standard statistical decomposition techniques, these factors are estimated to have subtracted around 2–3 percentage points from the rate of home ownership for those households with heads who were born between 1972 and 1991. Other factors, which would include, among other things the effects of public policies, are estimated to have subtracted around 2–4 percentage points from the home ownership rate over the past decade.

How has housing accessibility and affordability changed in Australia?

Housing accessibility and housing affordability have changed significantly in Australia over the past decade, with the extent of those changes varying across different groups and regions within the country.

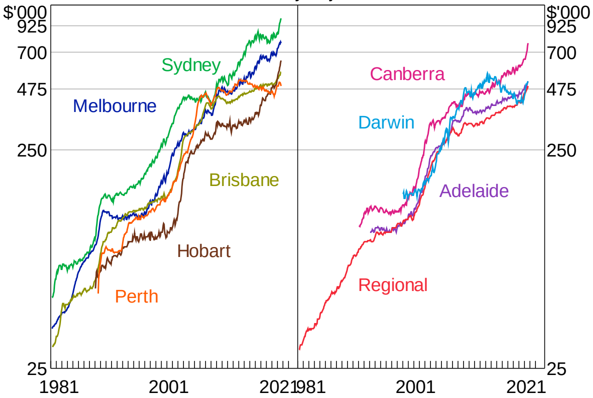
The affordability and accessibility of home ownership

Housing prices have risen considerably around Australia over recent decades, increasing the initial outlay required for those who want to enter the property market, upgrade or purchase an additional property. This increase had a number of drivers, including rising incomes, declining nominal interest rates, financial liberalisation and higher rates of population growth.[4] Median prices for houses have increased particularly rapidly over the past year, with this increase geographically broad based, including in smaller capital cities and many regional areas (Graph 3).

3 See RBA (2015) for a more detailed discussion of longer-run demographic and other factors affecting rates of home ownership. See also Ellis (2017b) where it is noted that the increase in marriage and childbearing age after the baby boom is a restoration of the norms from pre-war and past centuries, and that the post-WWII period was the anomaly.

4= See Kohler and van der Merwe (2015).

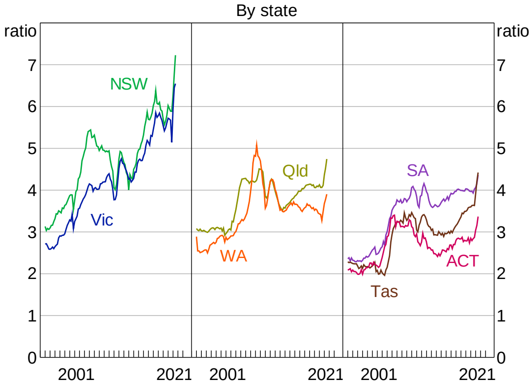
Graph 3
Median Housing Prices
Seasonally adjusted



Sources: CoreLogic; RBA

One high-level way of assessing how these trends are likely to have affected affordability is by looking at the change in housing prices relative to incomes. If housing prices are rising relative to household income, then housing is becoming more expensive, all else being equal. The housing price-to-income ratio increased in all states, particularly in New South Wales and Victoria over recent decades and more recently in less populous states (Graph 4).

Graph 4
Housing Price-to-income Ratios*
By state



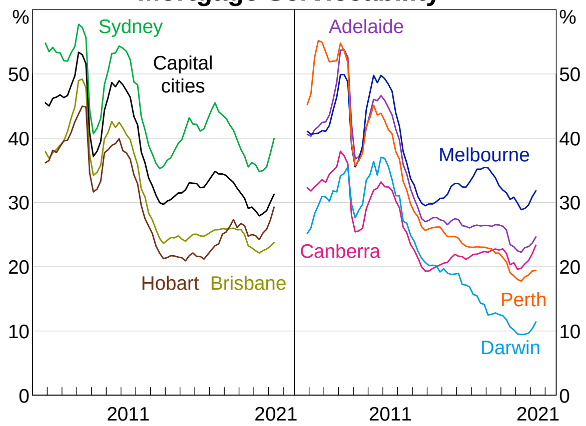
* Average dwelling prices to average annual household disposable income
Sources: ABS; CoreLogic; RBA

While these ratios comparing average dwelling prices to average incomes are informative, they have several limitations in assessing the situation faced by home-buyers. For example, first-home buyers typically do not purchase the average or median-priced home, but rather one that is somewhat cheaper. And the typical first-home buyer earns somewhat more than the median household – though that could either be because the household sector includes retired homeowners who may have lower incomes, or because home purchase is out of reach for lower-income households. In any case it cannot be concluded from the ratio of average prices to average income alone that home ownership has become 'unaffordable' for a typical first-home buyer household.

Since most homeowners borrow to finance their purchase, a complementary metric of how affordability is changing is the cost of servicing mortgage debt, relative to income. Mortgage serviceability depends on prevailing mortgage interest rates, as well as housing prices and income. The decline in interest rates over the past few years has lowered the cost of servicing a typical new mortgage as a share of median income (Graph 5). On this metric, housing affordability has improved considerably.

Graph 5

Mortgage Serviceability*



* Percentage of median gross household income needed to service a variable rate mortgage with an 80 per cent loan-to-value ratio for a median priced dwelling

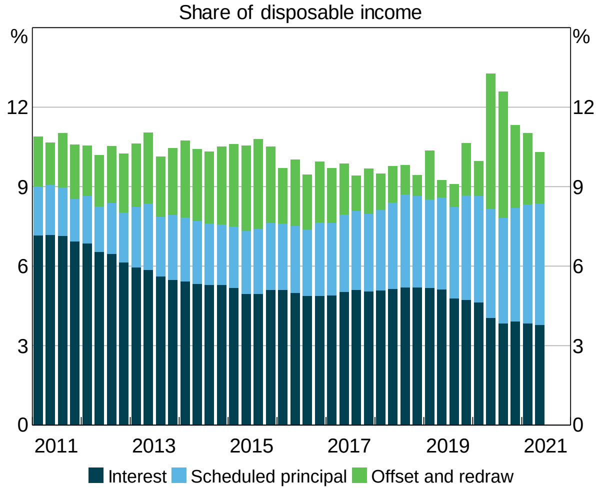
Sources: ABS; APM; RBA

Total interest payments have fallen as a share of income, while scheduled principal payments have increased (Graph 6). This is a feature of standard mortgage contracts, where repayments are held constant over the life of a loan if interest rates also remain constant. Under this payment structure, repayments of principal are higher in the early part of the life of the mortgage when interest rates are lower. In addition, by maintaining mortgage payments steady as interest rates fall, existing homeowners can pay off their principal faster than the mortgage contract requires. For the households that make these voluntary additional repayments, this implies that current repayment rates are affordable given their incomes and other financial obligations.

Graph 6

Housing Loan Repayments*

Share of disposable income



* Seasonally adjusted and break-adjusted; net of missed payments

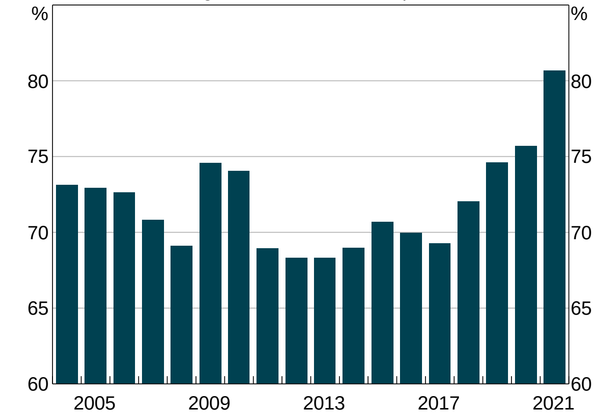
Sources: ABS; APRA; RBA

While lower interest rates increase affordability for existing home owners, this effect is at least partly offset for those trying to purchase a property for the first time. This is because lower interest rates increase capacity to borrow and pay for housing for both current owners and potential first-time buyers. Housing prices therefore tend to be bid up, which increases the size of the deposit first-time buyers must accumulate and/or reduces the size/quality of the property they can purchase. Relatively low income growth over the past decade has also made it harder to accumulate the deposit. The estimated average deposit required for first-home buyers has risen as a share of income over the past decade (Graph 7), as has the time to save for a deposit for buyers in most cities (Graph 8). [5,6]

Graph 7

Average First Home Buyer Deposit

Owner-occupier; estimated as a share of average annual household disposable income*

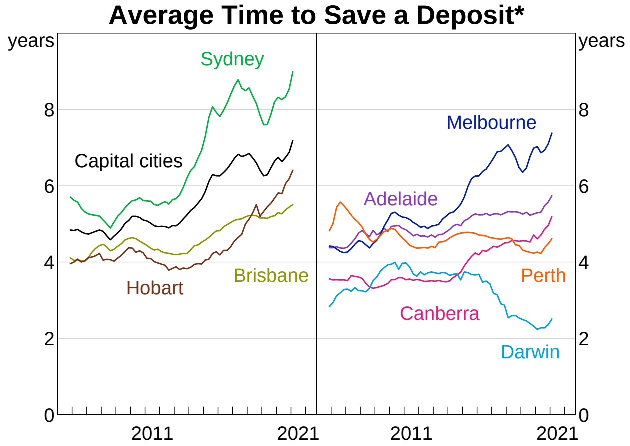


* Estimated using average first home buyer commitment size and assuming 20 per cent deposit. Seasonally adjusted and break-adjusted.

Sources: ABS; RBA

Graph 8

Average Time to Save a Deposit*



* Years needed to save a 20 per cent deposit for the median priced dwelling in each capital city for a 24-35 year old household saving 20 per cent of median gross income (income data from ABS Survey of Income and Housing)

Sources: ABS; APM; RBA

Despite these developments, there has been a large rise in the share of new housing loan commitments from first-home buyers over recent years (Graph 9; Graph 10), suggesting that housing accessibility has improved.

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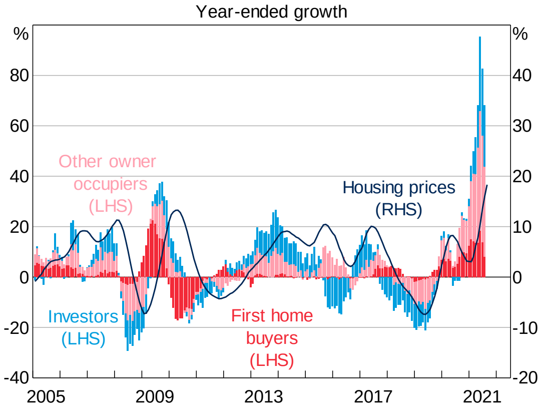
5 Empirical evidence suggests that higher prices and larger deposit hurdles explain most of the variation in first home buyer activity over the past few decades (Simon and Stone 2017). There are government programs that support first home buyers to try and enter the housing market by reducing the deposit hurdle, either by providing grants (such as the First Home Owner Grant) or buy guaranteeing part of a loan to enable purchases with a much lower deposit – such as the First Home Loan Deposit Scheme (FHLDS) and Family Home Guarantee (FHG). In a market where housing prices are high and rising, these deposit guarantee schemes can assist with the deposit hurdle, though the repayment burden over the life of the loan will be higher.

6 The FHLDS and FHG provides support for 10,000 purchasers of new homes, and 10,000 places over 4 years for single parents. FHLDs supported home purchases made up around 8 per cent of the first home buyer cohort in 2020.

Graph 9

Loan Commitments by Borrower Type

Year-ended growth

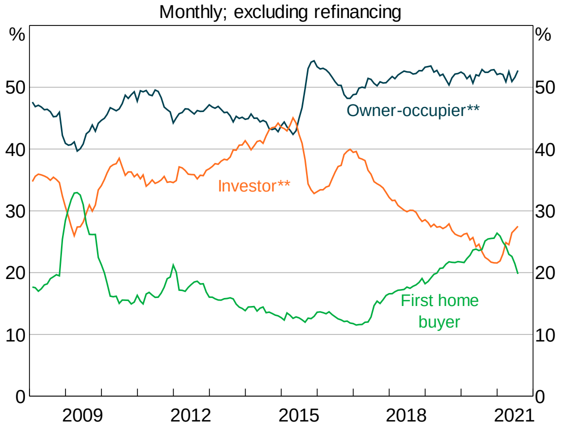


Sources: APRA; CoreLogic; RBA

Graph 10

Share of Housing Loan Commitments*

Monthly; excluding refinancing



* Seasonally adjusted and break-adjusted

** Excluding first home buyers

Sources: ABS; RBA

The indicators discussed above suggest that purchasing housing has remained accessible for many households. Individual experiences will differ, however, because incomes vary across households and housing prices differ both within and across geographic areas. State and national level indicators should therefore be supplemented with survey data showing the variation in incomes, and information on the distribution of housing costs, when assessing how affordability may be changing for different income groups and in different parts of Australia.[7]

Housing in Australia's largest cities is much less accessible for lower-income quintiles than is the case in regional areas. To purchase the median home in most areas of large cities, households in the lowest income quintile would have to devote more than 30 per cent of their incomes to mortgage servicing (Graph 11), which is above standard metrics of affordability. In contrast, they would be able to purchase housing in a larger share of regional areas while meeting this affordability test (Graph 12). However, strong price growth in regional areas around Australia's largest cities over recent years has

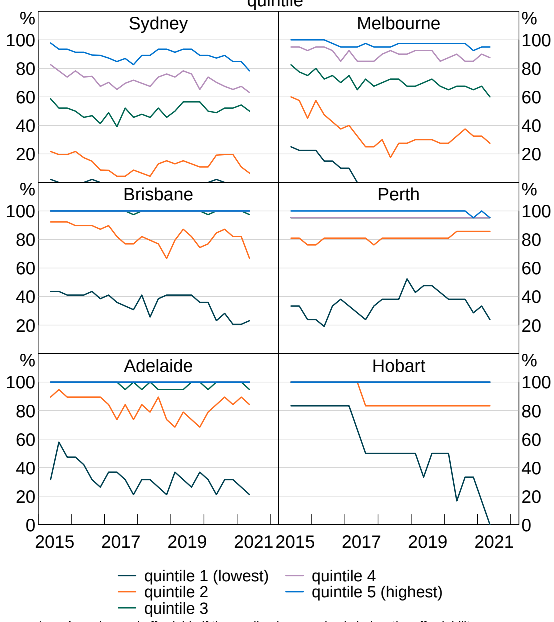
[7] The reported incomes of survey respondents in capital cities and regional areas which are of working age can be compared with the median housing price in each SA3s to determine how many SA3s are deemed affordable. Details on the affordability limit can be found in La Cava, Leal and Zurawski (2017). These calculations do not adjust for first home buyers buying houses that are cheaper than the median. Analysis of potential first home buyer incomes and the associated share of properties deemed affordable can be found in NHFIC (2020).

meant that even these areas have, on this metric, become less affordable to low-income households wishing to purchase a home. To the extent that not all regional areas will be close to suitable employment for all households, some households face difficult trade-offs between home ownership and labour market opportunities, especially in regions where renting is also expensive or otherwise unsuitable for their circumstances.

Graph 11

Housing Affordability

Share of regional areas deemed affordable, by income quintile*



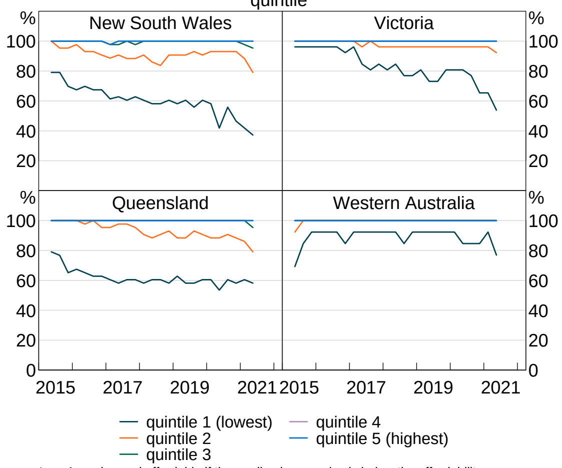
* Area deemed affordable if the median house price is below the affordability limit, as calculated in La Cava, Leal, Zurawski 2017 Bulletin.

Sources: RBA; CoreLogic; Roy Morgan Single Source

Graph 12

Regional Housing Affordability

Share of regional areas deemed affordable, by income quintile*



* Area deemed affordable if the median house price is below the affordability limit, as calculated in La Cava, Leal, Zurawski 2017 Bulletin

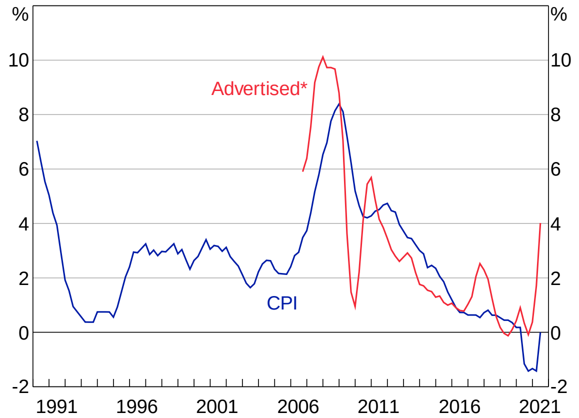
Sources: RBA; CoreLogic; Roy Morgan Single Source

For those who do not buy a home the key metrics for changes in their housing costs will be the cost of renting (including moving more frequently).[8] Changes in the cost of renting are also relevant for assessing changes in the accessibility of home ownership as rising costs in the rental market will incentivise renters to buy a home if they can, while also making it more difficult for them to save for a deposit.

The affordability of renting

Rents inflation in the Consumer Price Index, which measures growth in rents across the capital city rental stock, has remained relatively low over recent years (Graph 13), in part reflecting a significant increase in the construction of apartments which lowered the cost of renting apartments in Australia's largest cities. That said, rental conditions have differed significantly around the country and advertised rents have risen for most income groups.

Graph 13
Housing Rent Inflation
Year-ended



* Year-ended change in 3-month average; advertised hedonic dwelling rents in eight capital cities
Sources: ABS; CoreLogic; RBA

Australia's rental markets are typified by short-term leases of around 12 months, which means that households living in areas that have seen large changes in the marginal demand for rental accommodation may have faced much higher advertised rents when their leases ended. That may have happened if, for example, demand increased due to population growth or if supply fell due to some of the rental stock being repurposed for short-term holiday accommodation or owners moving back in. These factors could have been at play recently, given reports of rising rents in some coastal and other regional areas since the outbreak of the pandemic.[9]

One clear trend in advertised rents, which captures price changes for properties recently advertised for lease, has been flat or declining advertised rents in Sydney and Melbourne over recent years (Graph 14). Since late 2017 advertised weekly rents for units in Sydney and Melbourne have declined by around $50 and $30 respectively. Meanwhile, rents outside of these cities have mostly drifted

8 See Ellis (2017a).

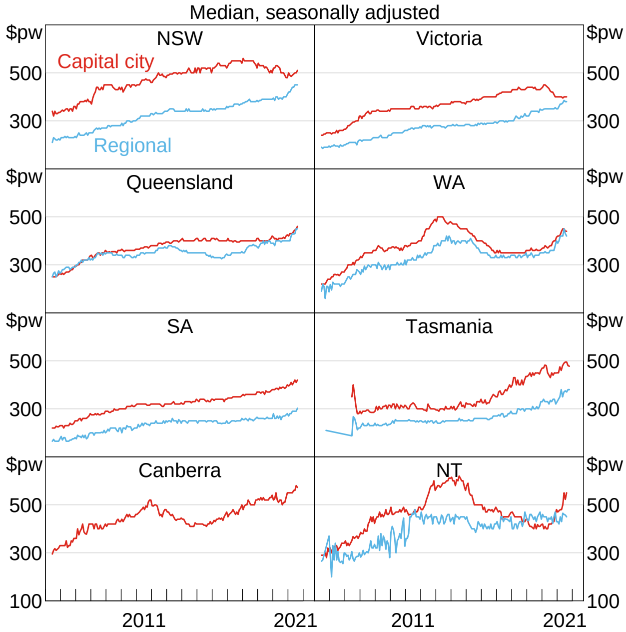
9 Higher demand in regional areas has been reported to have led to acute pressures on rental markets in popular coastal areas, affecting people who may not be well positioned for personal or employment reasons to move to large cities. In regional areas, increased demand has come at a time where the supply to the rental market has declined, either due to formerly leased rental stock being repurposed for very short term holiday accommodation or increased purchases of second homes by city residents, which could also be contributing to affordability issues. See Clayton (2021).

higher over the past five years. Over this period, the gap between the median rent in capital cities and in more regional areas has largely closed in Australia's most populous states. While low-income households would be expected to rent properties that are cheaper than the median rental property, low-income households in regional areas around Australia's largest cities are likely to have been affected by this shift, assuming that rents on lower-priced homes move in tandem with the median rent in the same area.

Graph 14

Advertised Rents

Median, seasonally adjusted



Sources: RBA; CoreLogic

Rents overall have risen as a share of income over the past decade, particularly for low income households (Graph 15).

Outside large-city apartment markets, rents have risen relatively quickly over the past few years. Households with lower incomes have less scope to adjust to rapid price changes as rent is already a relatively large share of their income. The share of regional areas where low income households would be able to rent a median advertised dwelling for less than 30 per cent of their income has declined (Graph 16).

Rents have risen for both for private sector tenants and other tenants (which are largely made up of tenants in social housing). Even after adjusting for the effect of rental assistance, which lowers the level of rent households pay, rents have increased as a share of income for these households (Graph 17).[10] Rent assistance covers around one quarter of the rent recipients pay.[11] There were around 1.7 million recipients of Commonwealth Rental Assistance as at June 2020, up from 1.3 million in June 2019.

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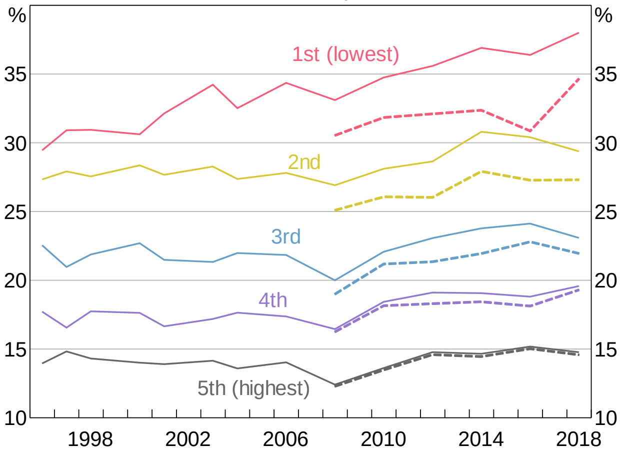
10 Rental assistance has been available for longer than the period of adjustment in these graphs, but could not be adjusted further back due to data availability.

11 Data from Department of Social Security (2021) on median and average fortnightly rent and CRA, June 2021.

Graph 15

Rent by Income Quintile*

Share of household disposable income



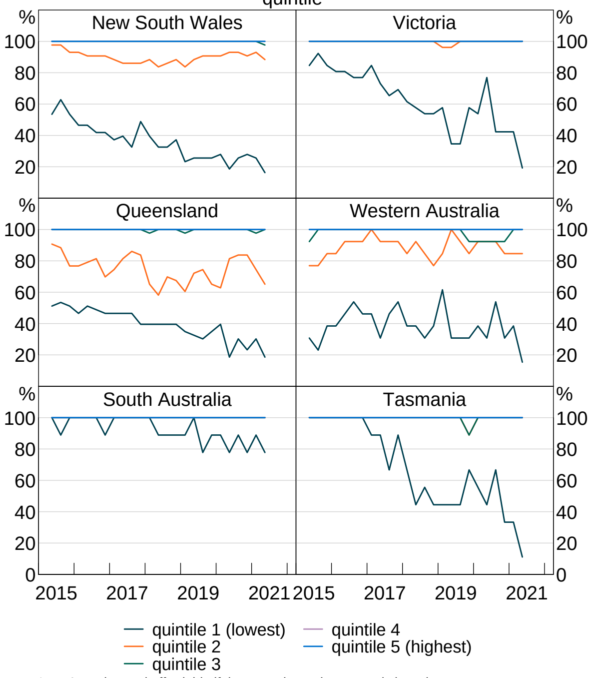
* Dotted lines include an adjustment for rent assistance received

Sources: ABS; RBA

Graph 16

Regional Rental Affordability

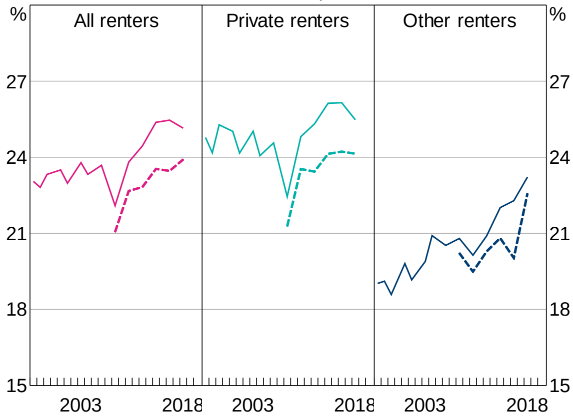
Share of regional areas deemed affordable, by income quintile*



* Area deemed affordable if the annual rental payment is less than 30 per cent of a household's disposable income

Sources: RBA; CoreLogic; Roy Morgan Single Source

Graph 17
Rent by Tenure type*
Share of household disposable income



* Dotted lines include an adjustment for rent assistance received
Sources: ABS; RBA

Determinants of affordability

As documented in previous RBA submissions, trends in housing affordability and accessibility reflect the interaction of a range of demand and supply factors. Demand for housing services depends on demographic factors such as population growth and average household size, economic factors such as income and financial conditions, and aspects of the taxation system, among other things. Government policy, including tax and regulatory settings, affect both supply and demand and can have an important influence on affordability across the income distribution. This section sets out some factors that influence the demand for housing, before considering the supply of dwellings and constraints that affect its responsiveness to demand conditions, paying particular attention to the role of tax and regulatory issues.

The pace and composition of population growth affect demand for housing

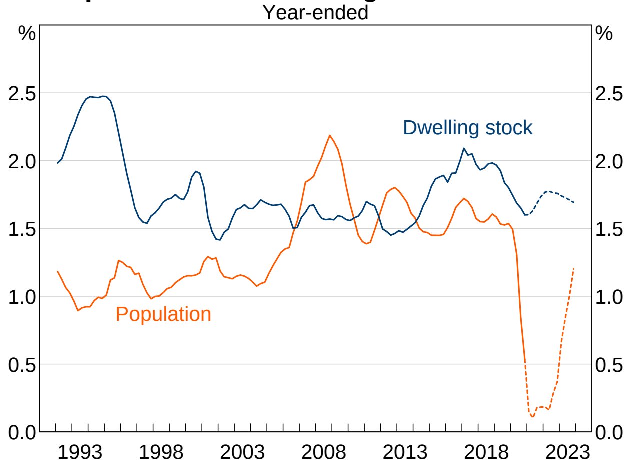
Population growth from both natural increases and net migration contribute to increases in aggregate demand for housing services. At the local market level, some of the net migration flows can come from elsewhere in Australia rather than overseas. The drivers of population growth over the past decade have differed somewhat by state.

From the mid 2000s, the Australian population grew strongly, which saw household formation rates increase, raising demand for housing services. This growth reflected increased immigration. How immigration affects local housing markets depends on the characteristics of those migrants and where they initially locate. For example, as noted in RBA (2014), much of the increase in net immigration in recent years has been people on student visas. It was therefore reasonable to expect the resulting increase in demand for housing to have been mainly in the rental markets in the major cities, especially in neighbourhoods near universities.

Over the same period interest rates have fallen, reducing financing costs and increasing the attractiveness of investment in rental property. Other things equal these factors will have raised housing demand. Through most of this period there were also steady increases in the dwelling stock. Over the five or so years leading up to the pandemic, growth in the stock of dwellings increased and exceeded the rate of household formation over some of this period (Graph 18).

Graph 18

Population and Dwelling Stock Growth*



* Forecast in dashed line

Sources: ABS; RBA

More recently, COVID-19-related border closures have led to a sharp fall in population growth, while HomeBuilder and other state-based schemes have provided incentives for new home construction, boosting the pipeline of supply of dwellings. Nevertheless there has been rapid housing price growth and strong growth in rents in some areas, suggesting that there has been at least a modest increase in household formation despite slower population growth. Increased consumption of housing per household is also likely to have contributed as some households have sought more space. Housing price growth has also been strong in other comparable economies that have not seen the same decline in population growth.

Tax settings affect the balance of supply and demand in the housing and rental markets

Households need to consume housing services and so face a choice about whether to buy or rent a home. Australia's tax and transfer system makes it favourable to own your primary residence; this is also the case in many other countries. In Australia, tax settings also make it generally favourable to own additional properties as an investment asset. These policies therefore affect the balance of demand and supply in the housing and rental markets, raising housing demand and potentially reducing rental yields. As noted in the RBA's past submissions to inquiries on this topic, Australia's tax and regulatory settings could benefit from holistic consideration. Two potential objectives of reform could be to incentivise more efficient utilisation of some of the existing stock of housing and to improve the mechanisms around constructing new supply. The Henry Review recommended a broad range of interrelated reforms to this end, including replacing stamp duty on residential property transfers with land taxes; the NSW government has also proposed this specific change.[12]

Accumulating and retaining savings in housing assets is incentivised by the returns on owning housing to live in (imputed rents) or as an asset (through the capital gain) not being taxed when it is the primary residence. Economic modelling can be used to compare the cost of homeownership versus renting. These 'user-cost' models suggest that, on the assumption that buyers hold their property for 10 years and prices increase by more than 2 per cent per annum in real terms, on average the cost of

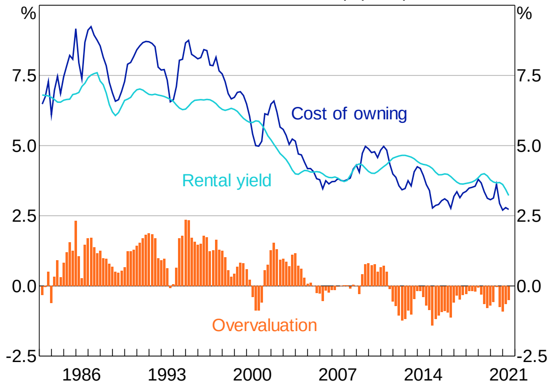
12 New South Wales Treasury (2021); Treasury (2010).

owning a home remains below the cost of renting (Graph 19), in part because of the gains from expected capital appreciation (including the benefit from current tax settings; [Fox & Tulip 2014]; [Saunders & Tulip 2019]).[13]

Graph 19

Cost of Owning and Renting

Based on Saunders & Tulip (2019)



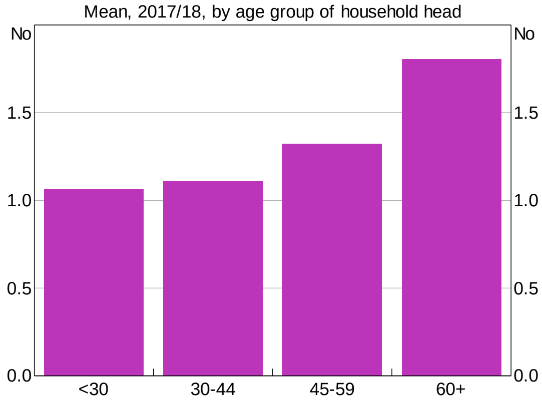
Sources: ABS; CoreLogic; RBA

Owner occupation is also incentivised because a primary residence is excluded from the means test for the Age Pension; concessional taxation treatment for an inherited primary residence also incentivises the retention of family homes. That means households may retain more housing than otherwise as they age, even if their household size declines. As the number of people aged 65 and over has increased, this could be contributing to an increase in overall demand for housing for a given population and therefore upward pressure on housing prices. The possibility of higher-than-average consumption of housing among those who own their homes outright is consistent with measures of spare bedrooms by tenure type (Graph 20).[14] Meanwhile, these same household data suggest that in some cities, many households would prefer to have more bedrooms than they currently have (Graph 21). The recent experience of lockdowns and working from home could have added to this gap.

Graph 20

Spare Bedrooms*

Mean, 2017/18, by age group of household head



* Self-identified housing appropriateness by number of bedrooms in excess of needs

Sources: ABS; RBA

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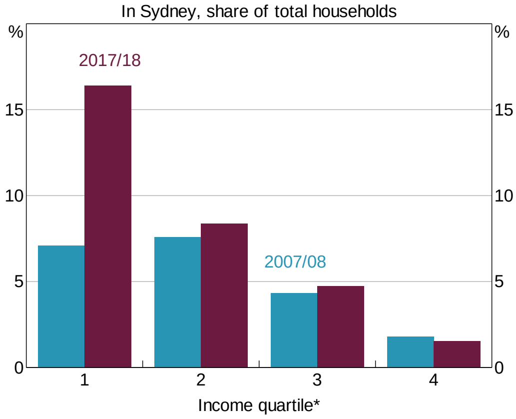
13 User cost models compare the expected costs of renting versus owning a home, including expected mortgage payments, transaction costs (e.g. stamp duty), depreciation and running costs (e.g. repairs, rates). Partly offsetting these costs is the expected appreciation in housing prices, from which only homeowners benefit.

14 Greater consumption of housing for this group would also be consistent with higher wealth and income.

Graph 21

Households Requiring More Bedrooms

In Sydney, share of total households



* Equivalised household disposable income, adjusted for age

Sources: ABS; RBA

Australia's taxation policies also create incentives for investors to buy property; the effects on affordability can be mixed.

The tax system makes investment in property relatively attractive, adding to housing demand. Incentives are especially pronounced for housing assets because they can be purchased with more leverage than many other assets that produce capital gains. Investors can deduct borrowing costs and expenses from their total income, not just income from the housing asset, at their full marginal tax rate. In combination with concessional treatment of capital gains, this creates an incentive for leveraged investment in assets that produce capital gains, such as property. While the prolonged period of lower interest rates over recent years would have reduced households' scope to 'negatively gear' existing properties, this would have been partly offset by the effect of higher housing prices on rental yields. That is because, other things equal, higher house prices reduce rental yields, affecting the point at which a property becomes negatively geared.

Investors' purchases of property can, on the other hand, reduce affordability pressures in the rental market to the extent that it supports housing construction for additional rental purposes, and reduces rental yields.

The RBA recognises that the ability to deduct legitimate expenses incurred in the course of earning income is an important principle in Australia's taxation system, and interest payments are no exception to this. However as stated in previous submissions to parliamentary inquiries, the RBA believes that there is a case for considering the tax system in a holistic way, taking into account the interaction of negative gearing with other aspects of the tax system.[15]

The extent to which stamp duty affects affordability is unclear

The cost of stamp duty is small relative to the sale price of a property but, at around 5 per cent of the price of a property (Graph 22), can still be a large initial outlay for buyers. Some of the issues identified with stamp duties are that they increase the cost of housing, increase the deposit burden and are widely considered to disincentivise household mobility. As a result, the dwelling stock may not be most effectively utilised – one example would be retirees retaining a family-sized home to avoid incurring the cost of moving. Such a mismatch implies that even in the case where there is a

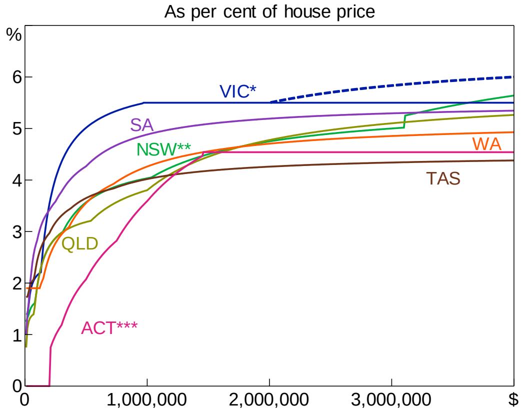
[15] The economic and financial issues associated with the tax and transfer treatment of housing are well set out in other reviews including Treasury (2014) and Treasury (2010).

sufficient number of dwellings in the market, the dwellings available might not be well matched to prospective home buyers' preferences. To the extent that stamp duties may be contributing to an inefficient allocation of the dwelling stock there is merit in considering their removal. In doing so, it should be noted that other costs and fees also contribute to the costs of purchasing and selling housing, and these total costs should be evaluated holistically. As part of such an evaluation, is also important to consider the availability of housing stock that is suitable for households that may want to downsize from a family-sized home.

Graph 22

Stamp Duty

As per cent of house price



* Dashed line shows the proposed premium stamp duty rate for properties valued over $2 million

** Includes NSW premium stamp duty for properties valued over $3 million

*** New ACT stamp duty rates for owner occupier purchases as at 1 July 2021

Sources: RBA; State Governments

There are constraints on the responsiveness of supply, including some related to policy

Demand for and supply of housing relate to the whole stock of housing. Factors such as rising incomes and changing preferences can boost demand for the whole stock of housing, while population growth affects demand for incremental, additional housing. By contrast, almost all the supply of housing already exists, and factors such as regulation affect only the supply coming from the flow of newly built housing. In any one year, newly built housing only shifts the stock of housing incrementally. Even the most flexible construction sector is therefore limited in how far it can respond to and absorb rapid increases in demand. While some regulatory and other changes could be contemplated that might improve the responsiveness of construction, and thus incremental supply, there are limits to the scope to meet increased demand with additional supply.

In previous submissions, the RBA has highlighted that the concentration of Australia's urban population in a few large cities, geographical constraints on expansion and a low density housing mix, contribute to high housing costs.[16] The RBA has also previously expressed the view that underinvestment in transport infrastructure has effectively constrained the growth in the supply of well-located land at a time when demand for this type of land has grown very strongly (Lowe 2015; Lowe 2017). The opening up of the Geelong–Melbourne corridor provides an example of how investment in transport infrastructure increases the supply of well-located land (Ellis 2019).

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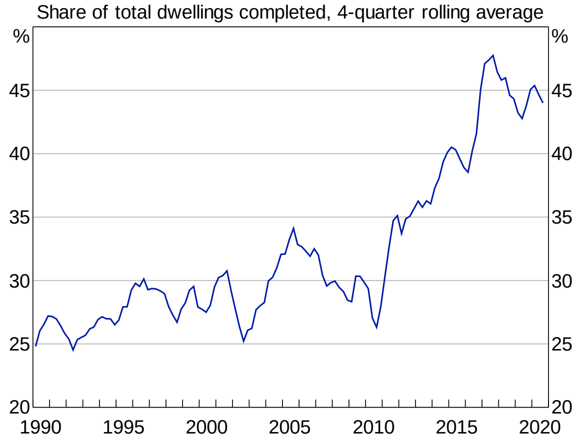
[16] Geographical constraints also discussed in Saiz (2010).

Since the previous inquiries, the urban structure of some of Australia's largest cities has shifted further. In previous decades the share of detached houses had been higher in Australia than in most other comparable countries (Ellis and Andrews 2001). However, construction of apartments increased significantly over 2010–2018. This shifted the composition of the housing stock as higher-density dwellings made up a much larger share of the flow of new housing completions (Graph 23), driven by an increase in apartment buildings of four or more storeys. In Sydney and Melbourne, increases in the stock of higher-density dwellings since 2016 were heavily skewed towards the inner and middle suburbs of these cities (Graph 24). The density of some areas has changed notably, including the inner parts of Melbourne, Sydney and Brisbane (Graph 25). This increase in higher-density supply improved affordability for renters in these city areas because around half of all apartments were rented (Evans, Rosewall and Wong 2020).

Graph 23

Higher-density Dwelling Completions

Share of total dwellings completed, 4-quarter rolling average

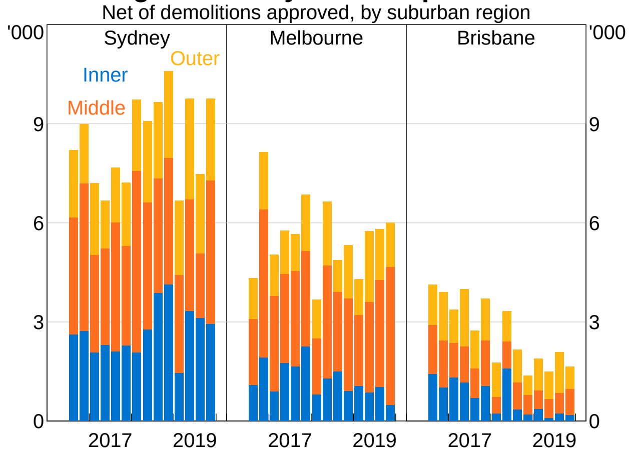


Sources: ABS; RBA

Graph 24

Higher-density Net Completions

Net of demolitions approved, by suburban region

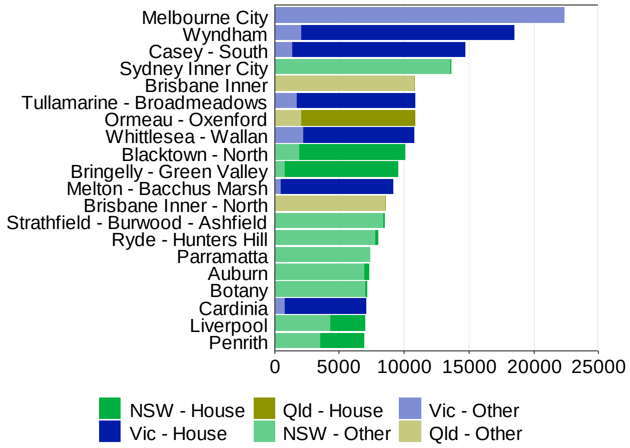


Sources: ABS; RBA

Graph 25

Cumulative Net Completions by SA3

2016–2019, top 20 regions



Previous commentary by the RBA, and research by some of its staff, has also noted that regulatory constraints, including zoning, can slow the supply response to increased demand for housing and push up the costs of new housing (Hsieh *et al* 2012, Kendall and Tulip 2018). Zoning constraints, which can include minimum lot sizes, maximum building heights and the planning approval process, limit how intensively housing can be deployed on a given plot of land. As such, zoning creates scarcity which puts upward pressure on land prices. The effect on housing prices from these constraints is most apparent for detached houses, which use the most land. However, zoning and other regulation has also been estimated to increase the price of apartments in some (but not all) Australian cities (Jenner and Tulip 2020).

There are no doubt regulatory changes that would reduce the costs and time involved in housing construction projects, including higher-density housing. However, many regulatory constraints promote other social goals, such as ensuring buildings are constructed safely and that neighbouring residents do not have costs and inconveniences imposed upon them about which they are not consulted; recent concerns about quality and safety defects in higher-density buildings, including those related to waterproofing and fire safety, demonstrate an ongoing community preference for such safeguards.[17] In addition, while lowering the cost of construction would contribute to affordability, the primary driver of high housing costs in Australia is the cost of well-located land. To improve the provision of new housing, efforts to better synchronise state and local strategic planning frameworks with the intention to quicken approval times and to address the issues raised in the Shergold Weir report could be considered. Improvements to the oversight of construction processes (as outlined in the Shergold Weir report) is likely to improve the housing supply response to increases in demand and increase buyer confidence in these assets.[18]

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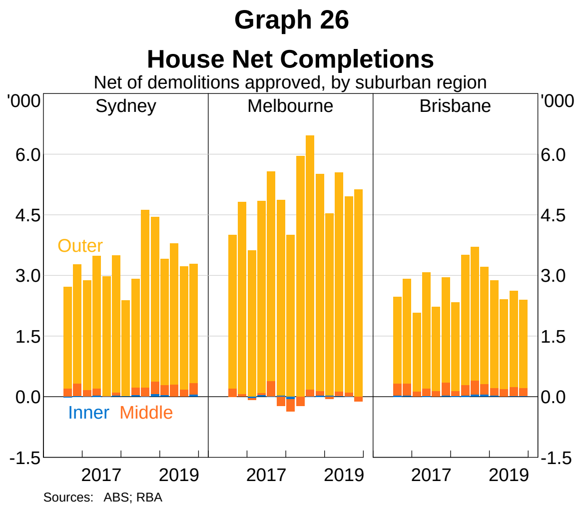
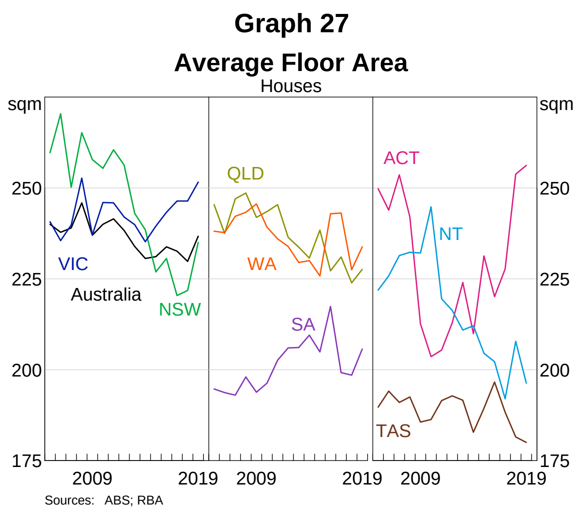
17 See Shergold and Weir (2018), Johnston and Reid (2019) and Building Ministers Forum (2019).

18 For example, New South Wales Department of Planning, Industry and Environment (2021) has established a roadmap to improve certainty on infrastructure contributions, and the Australian Government facilitated an agreement between states and territories for a nationally consistent approach in building regulation and implementing the recommendations of the Shergold-Weir report (Building Ministers Forum 2019).

Some households have changed their housing choices in response to the pandemic, at least temporarily

Australia's dwelling stock remains dominated by large detached housing, and around 1 million detached houses have been completed over the past decade.[19] Nearly all new detached dwellings have been built in the outer suburbs (Graph 26). The average size of houses has declined a little in some states over recent decades but the average house in Australia still occupies over 200m² of floor space (Graph 27), well above the average dwelling in some other countries. One of the key challenges for supply over coming decades is that as populations increase and cities expand, some households will need to live further away from the centre of major cities (necessitating new infrastructure investment) and/or accept further increases in higher-density housing.





Some elements of the response to the pandemic could affect preferences between these choices, though at this stage it is uncertain how lasting these responses will be. The ability to work from home for some households has increased the relative attractiveness of regional areas and neighbourhoods that are distant from city centres. The experience of lockdowns may also have made apartment living less attractive for some households. On the other hand, some other social distancing and movement restrictions may have made living closer to amenities more valuable.

[19] For a broader discussion of Australian preferences for detached housing, see Ellis (2014).

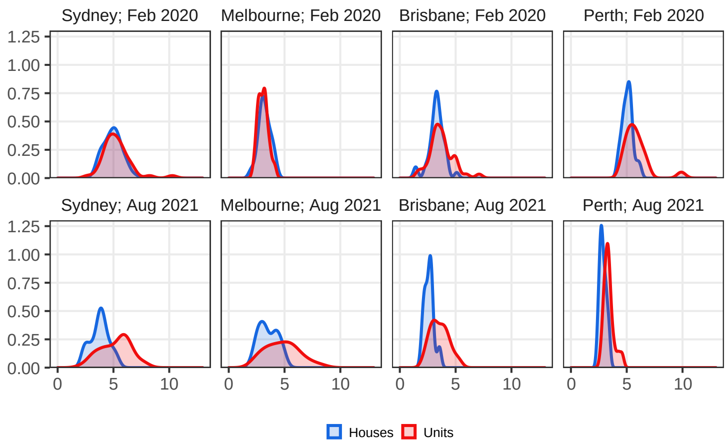
Since the onset of the pandemic, growth in advertised rents and in prices for established markets in Australia have been stronger for houses, consistent with people wanting more space as they spend more time at home. Price growth has also been unusually strong in regional areas, consistent with growth in regional populations (see Attachment A).

These preference shifts, and the closed international border, have contributed to a surplus of housing supply in some higher-density markets in inner cities. The shift in preferences is apparent when the distribution of vacancy rates for houses and units by small geographic areas (SA3) for the past year are compared to the distribution of vacancy rates in the year before the onset of the pandemic. Before the onset of the pandemic, the distribution of vacancy rates for houses and units were broadly similar in Sydney and Melbourne. Since the pandemic, the distribution for units has shifted to the right (that is, on average vacancy rates have increased) and become flatter (Graph 28), indicating more heterogeneity (that is, for some SA3 unit vacancy rates are very high, and in others quite low). Despite materially lower population growth, vacancy rate distributions for houses have shifted to the left in Sydney, Brisbane and Perth (on average rental markets for houses has become tighter).

Graph 28

Vacancy Rate Distribution*

12-month average**



* Height of the distribution indicates relatively more SA3s in each capital city with the corresponding vacancy rate
** Kernel density distribution of vacancy rates by SA3
Sources: CoreLogic; RBA

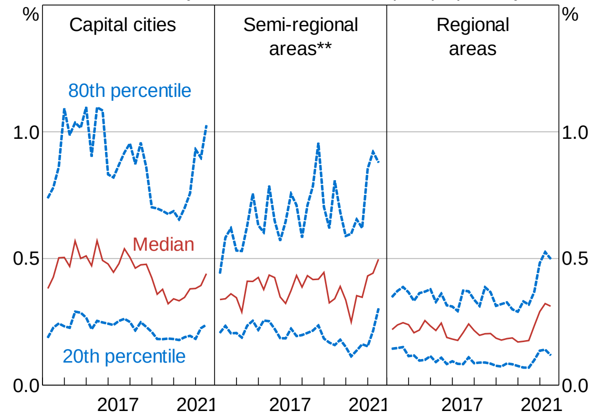
These developments over the past 18 months have contributed to apartments in Sydney and Melbourne becoming more affordable through an adjustment in prices. The shift in preferences through the pandemic has also raised the prospect that the Australian population could become less concentrated around major cities. This is likely to further complicate questions around housing affordability and the appropriate policy solutions, at least in the transition. If sustained, it is also likely to shift the balance of incremental housing supply back to detached housing.

There has been some adjustment in the supply of housing over recent years

Building approvals have increased across the majority of regional areas around Australia over the past year (Graph 29); the increase in approvals was most noticeable in areas around 25–75km from a capital city (Graph 30). This may in part reflect preference shifts from the pandemic, but would also reflect the increase in new approvals alongside fiscal support payments, which have underpinned a pick-up in detached approvals, as well as lifestyle choices for other reasons.

Graph 29
Residential Building Approvals*

Distribution by statistical area level 3 (SA3), quarterly



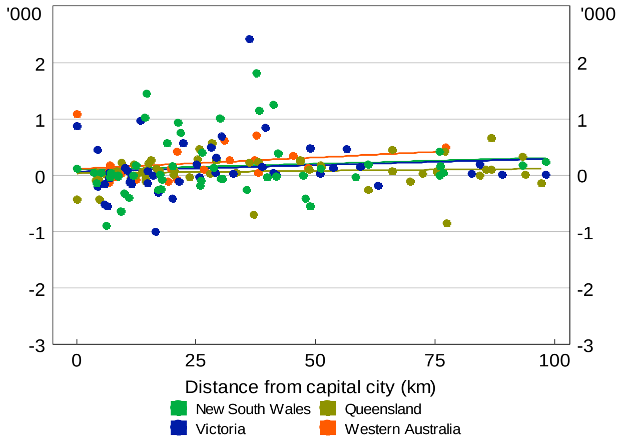
* New residential building approvals as a share of 2016 housing stock; not seasonally adjusted

** SA3s with a weighted population centre (by SA2) within 120 kms of the geographical centre of the nearest capital city

Sources: ABS; RBA

Graph 30
Residential Building Approvals

Annualised*



* Each dot refers to an SA3; 6-month rolling sum annualised residential detached building approvals net of 2019 average annualised residential building approvals.

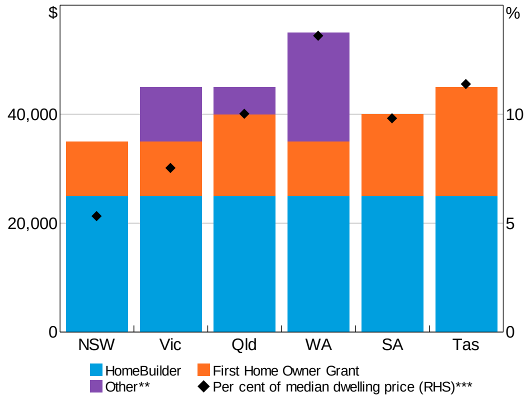
Sources: RBA, ABS

Temporary schemes announced by federal and state governments as part of the fiscal response to the pandemic have supported an increase in building approvals that is expected to boost housing supply over coming years. The level of grant funding support following the pandemic was sizable and expected to have meaningfully increased eligible households' capacity to pay (Graph 31). Many banks are understood to have allowed the funds from federal and state government grants to contribute towards the deposit for borrowers with a history of past saving, significantly reducing the deposit hurdle. Loans for the construction of new dwellings increased notably following the introduction of these schemes (Graph 32). Because such schemes increase both demand and supply simultaneously, the effect on housing prices more broadly could be either positive or negative, depending on the timescale of the increases and the capacity in the home-building industry at the time.

Graph 31

Maximum Grants Available*

From 4 June 2020 to 31 December 2020



* Subject to eligibility criteria including first-home buyer status, income caps and property price caps

** Other includes regional bonuses in Vic and Qld, and the WA Building Bonus grant

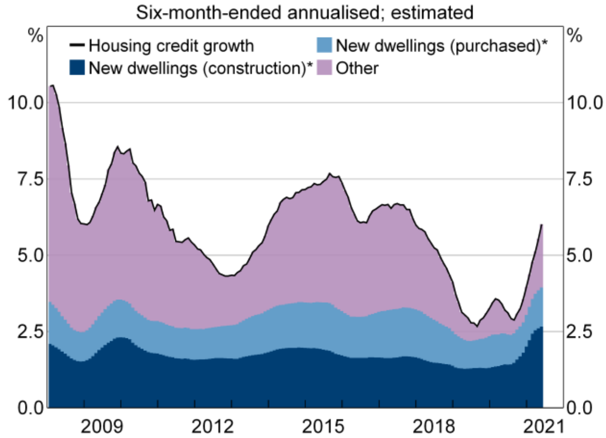
*** Median price of all new and established dwelling sales across the state in June 2020

Sources: CoreLogic; Federal and State Governments; RBA

Graph 32

Contribution to Housing Credit Growth

Six-month-ended annualised; estimated



* Estimated using housing loan commitments for the construction and purchase of new dwellings as a share of housing credit outstanding.

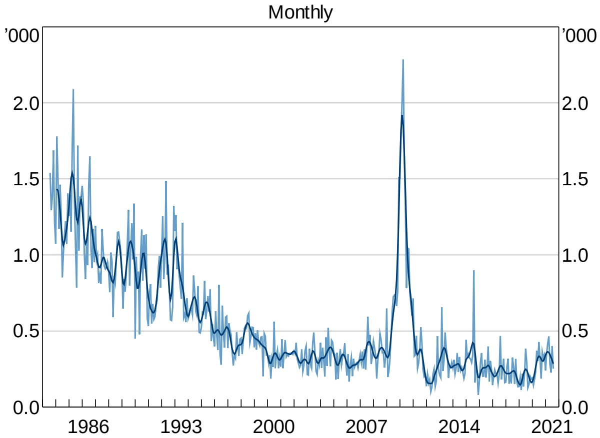
Sources: ABS; APRA; RBA

Social housing changes and low income growth have contributed to a meaningful deterioration in housing affordability for more vulnerable households

While most Australians have shelter, not all Australians have suitable shelter. Through the RBA's liaison program, a number of issues related to the supply of housing have been raised in relation to social or 'affordable housing', which usually refers to dwellings available through housing assistance programs that provide housing at a below-market price to households on low income. Liaison suggests that demand for social housing has increased significantly in recent years as rising housing prices and rents have made housing unaffordable for many on low incomes. The reduced availability of affordable housing has caused lower-income households to live further away from major employment centres.

The supply of new public housing has been much lower in most periods since 2000 than in previous decades (Graph 33).[20] Growth in social housing has not kept pace with growth in the number of households and has declined as a share of the dwelling stock. As a result, more low-income households have been pushed into the relatively expensive private rental market (Graph 34). The expected waiting time for social housing in New South Wales is usually around 5 to 10 years or more.[21] Troy, van den Nouwelant and Randolph (2019) estimate that there is a shortage of 440,000 homes that are affordable for the homeless and people in the lowest 20 per cent of household incomes.

Graph 33
Public Residential Building Approvals



Source: ABS

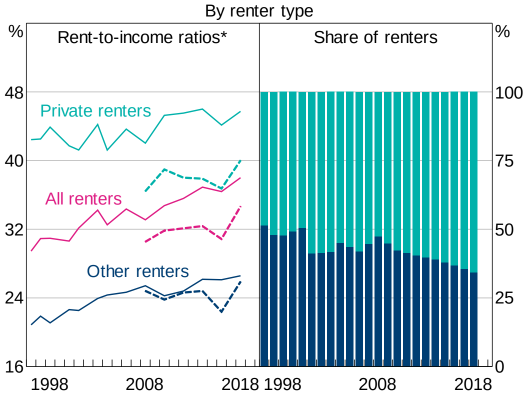
As part of their pandemic response, state governments have since announced additional spending on social housing.[22] This has been welcomed by the RBA's liaison contacts in this field. Given council or state government restrictions on land supply and zoning affect both public and private dwelling supply, changes to land use policy and other regulation should consider the holistic effect on housing supply, including both social housing and private dwellings. Policies that may be relevant to addressing these issues are the quantum of rental assistance provided, the supply of public housing and eligibility for such housing. As for land supply, this suggests that a holistic review involving all levels of government could be useful.

20 The exception was the spike in public housing activity from 2009 to 2012 associated with the Social Housing Initiative, which was part of the Australian Government stimulus package to the global financial crisis.

21 NSW Department of Communities and Justice (2020).

22 In November 2020, the Victorian government announced a $5.3 billion package to build 12,000 new dwellings for social housing. This is expected to boost Victoria's social housing supply by 10 per cent in 4 years. The New South Wales and Queensland governments announced similar packages of $812 million and $526 million respectively for new and upgraded social housing, while the South Australian government announced a $76 million construction stimulus aimed at social and affordable housing. The Western Australian government recently announced an $875 million package for around 3,300 social housing dwellings.

Graph 34
Low-income Renters
By renter type



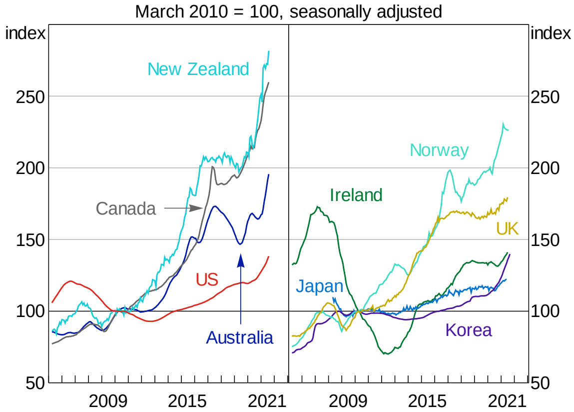
* Dotted lines include an adjustment for rent assistance received
Sources: ABS; RBA

International issues of relevance

As part of examining the effectiveness of initiatives to improve housing supply in other jurisdictions and their appropriateness in an Australian context, some facts can be provided for context. First, many other advanced economies have seen sharp rises in housing prices over recent decades, alongside the low interest rate environment; this has also been true in the period since the pandemic began. Second, Australia's high housing prices relative to other economies are partly due to the large share of the population in major cities. Third, planning and regulatory constraints are a feature of many major urban centres globally. Fourth, in response to rising house prices some countries have enacted restrictions targeted at certain purchasers while others have moved to reduce limits on supply.

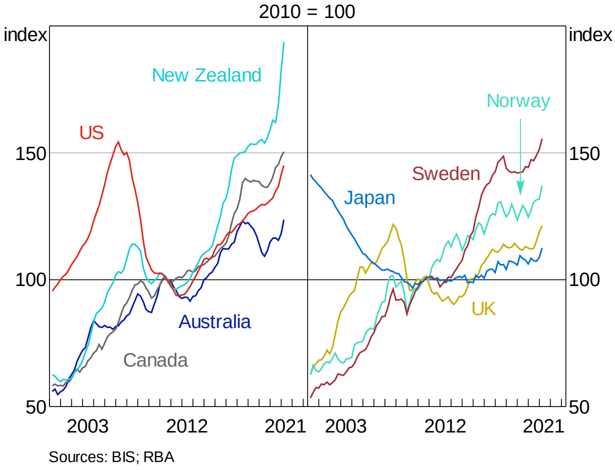
Strong housing price increases have been seen in most advanced economies in recent decades in both nominal and real terms (Graph 35; Graph 36). The low interest rate environment globally has added to the demand for housing by increasing the purchasing power of borrowers and increasing the attractiveness of the future flow of rental income to investors. These fundamental factors have combined to increase the returns to owning property via capital gains. The extent this has led to higher housing prices depends on each jurisdiction's institutional arrangements such as financial liberalisation, tax arrangements for investors and the responsiveness of supply.

Graph 35
Housing Price Indices — Most Populous Cities*
March 2010 = 100, seasonally adjusted



* Auckland, Dublin, London, New York, Oslo, Seoul, Sydney, Tokyo, Toronto
Sources: National Sources; RBA; Refinitiv

Graph 36
Real Housing Price Indices



Some jurisdictions have sought to address rising house prices through policies targeting demand or supply. Recent examples include Canada and New Zealand who have enacted measures targeting demand for housing from investors and foreign purchasers, including changes to the tax system. These include measures such as restricting foreigners from buying houses and increased taxes for investors. Other jurisdictions, for example the Republic of Ireland, have focused on increasing supply. In some countries where policy responses have focused on supply, this has taken the form of encouraging higher-density development; in others, the focus has been on enabling low-density development over a larger area. Whether a particular policy change reduces prices and enhances affordability depends on the nature of existing restrictions and the characteristics of the current housing stock relative to population needs.

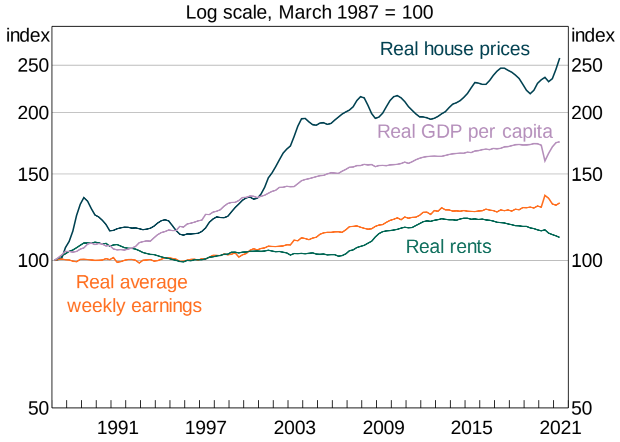
Reserve Bank of Australia
13 September 2021

Attachment A

Graph A1

Real House Prices and Fundamentals

Log scale, March 1987 = 100

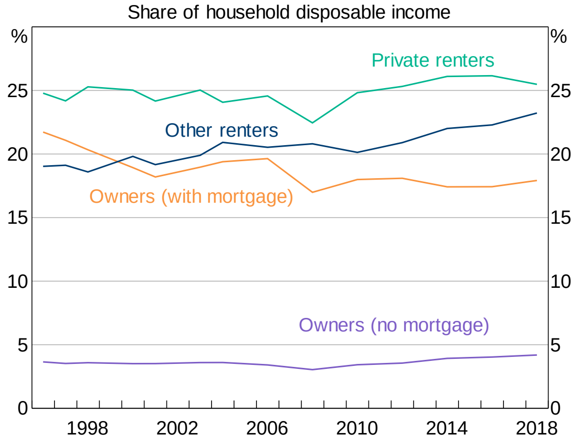


Sources: ABS; CoreLogic; RBA

Graph A2

Housing Costs by Tenure Type*

Share of household disposable income



* Includes mortgage repayments (principal and interest), rent and council rates

Sources: ABS; RBA

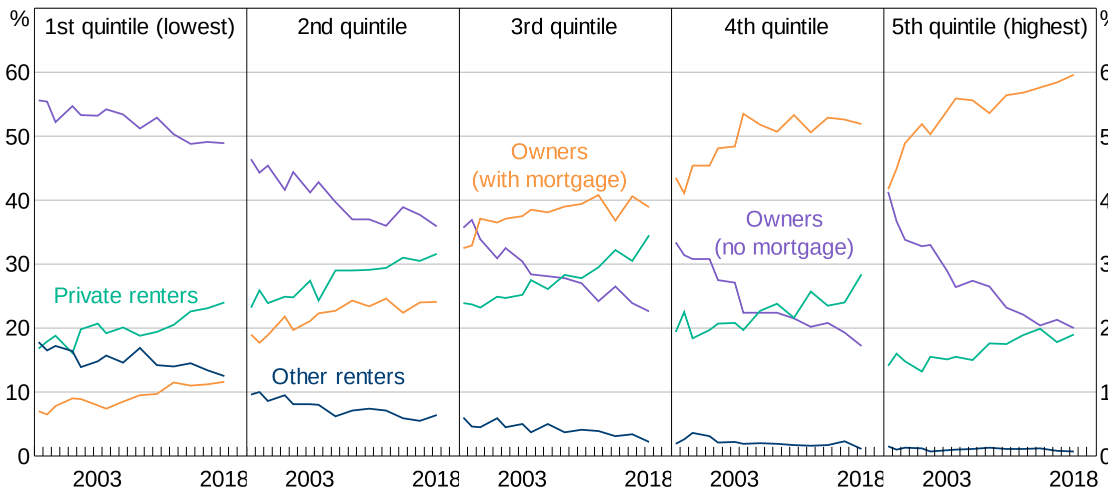
Since the early 2000s, real housing price growth has significantly exceeded real income growth on average. Real rents have declined over the past 5 years, consistent with an increased supply of new dwellings.

That said, housing costs for renters have increased over the past decade, while costs for owners have remained broadly steady.

Graph A3

Housing Tenure Type by Income Quintile

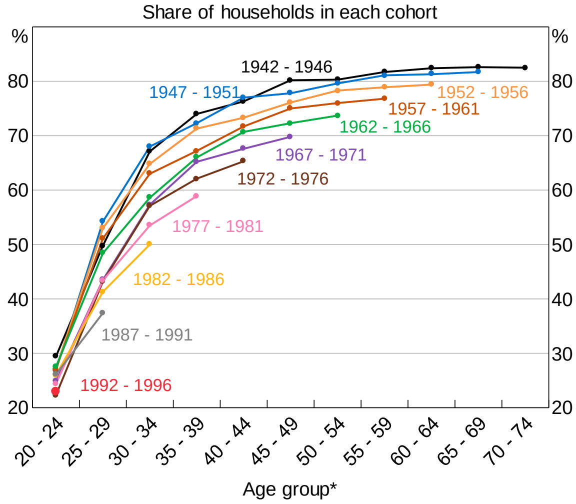
Share of households



Sources: ABS; RBA

Renters tend to be from the lower income quintiles. That said, most households in the lowest income quintile are owners without a mortgage. This reflects the large share of older households (i.e. high-wealth, low-income households) in the lowest income quintile. Over the past 10 years the share of owners with a mortgage has increased most notably for the upper income quintiles, consistent with their greater purchasing power.

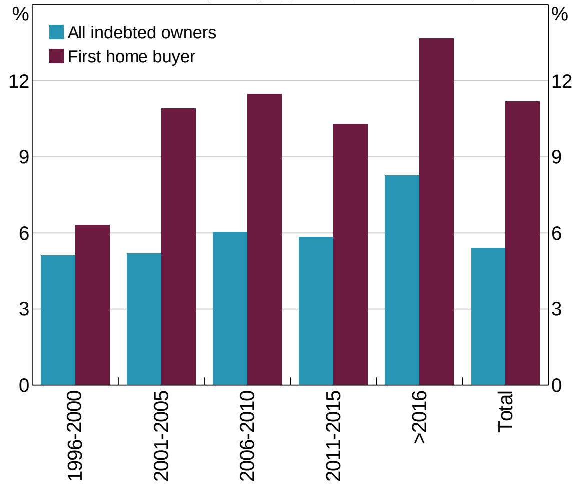
Graph A4
Home Ownership Rates by Cohort
Share of households in each cohort



* Age of household reference person
Sources: ABS; RBA

Home ownership rates by birth cohort have declined over the past half century

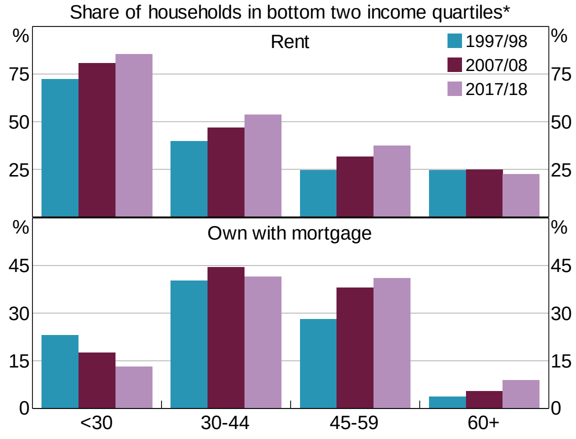
Graph A5
Home Buyer that borrowed from Family or Friends
Share of all home buyers by type and year of home purchase



Sources: HILDA Release 19.0; RBA

The share of homebuyers that have borrowed from family or friends has increased over the past 20 years

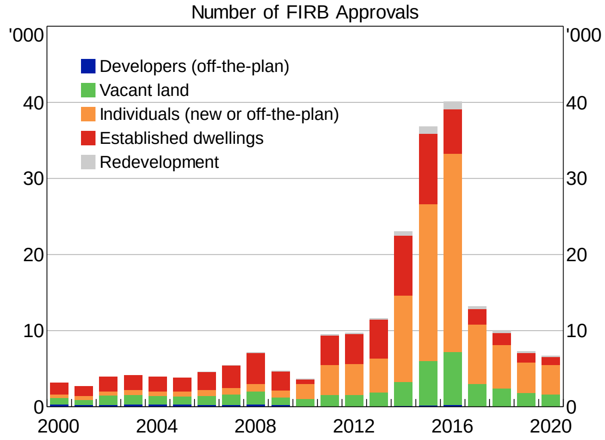
Graph A6
Housing Tenure By Age Group
Share of households in bottom two income quartiles*



* Equivalised household disposable income quartiles, adjusted for age
Sources: ABS; RBA

Most older households own their home outright, a large share of household heads under 45 rent

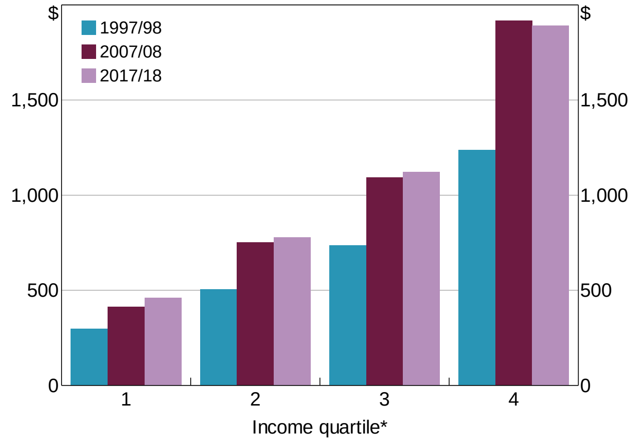
Graph A7
Foreign Investment in Residential Real Estate*
Number of FIRB Approvals



* Excludes approvals for annual programs
Sources: FIRB; RBA

Foreign buyer approvals increased notably between 2014 and 2016, but has since declined. The composition of foreign buyer activity is also now more skewed to new or off the plan purchases

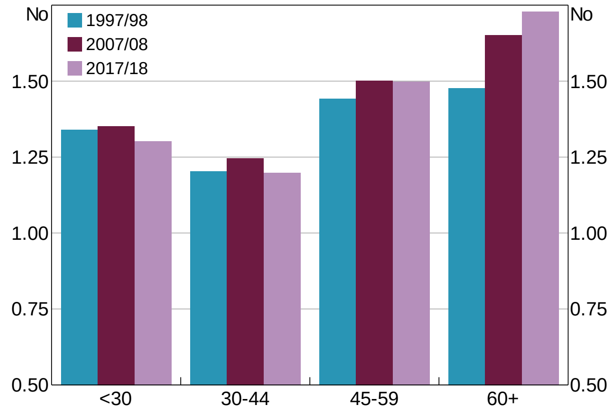
Graph A8
Household Disposable Income*
2019/20 dollars



* Equivalised household disposable income, quartiles are adjusted for age
Sources: ABS; RBA

Income levels of renters vary considerably.

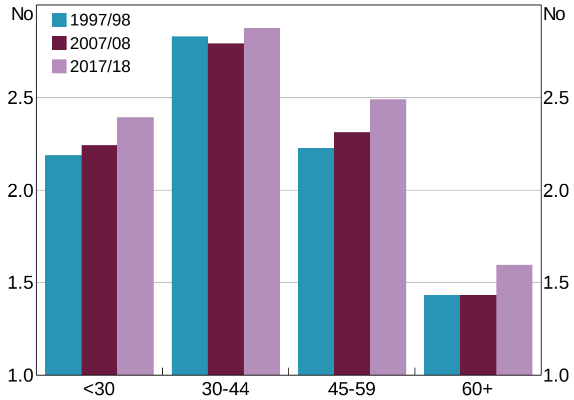
Graph A9
Bedrooms Per Person By Age Group
Renters, mean



Sources: ABS; RBA

The number of bedrooms per person have increased for older renters over time.

Graph A10
Household Size by Age Group
Renters, mean



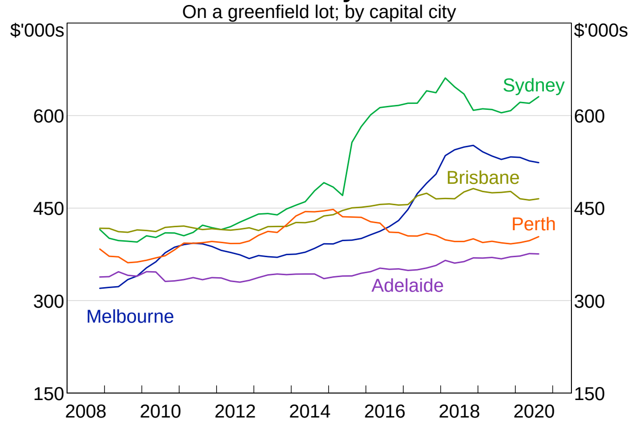
Sources: ABS; RBA

Household size has increased for renters.

Graph A11

Cost of a New Entry Level House*

On a greenfield lot; by capital city



* Defined as a 3 bedroom, single storey, weatherboard project home

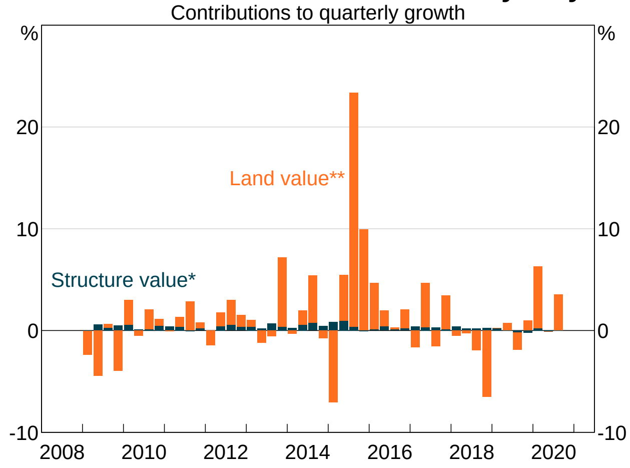
Sources: ABS; BMTQS; Research4; Finder.com.au; RBA

The cost of an entry-level new house has increased most in Sydney and Mebourne.

Graph A12

Growth in New House Prices in Sydney

Contributions to quarterly growth



* Defined as a 3 bedroom, single storey, weatherboard project home

** Lot sizes fixed at 2009-19 average

Sources: ABS; BMTQS; Research4; Finder.com.au; RBA

Almost all of the change in new house prices in Sydney over recent decades has been driven by changes in land prices, rather than construction costs.

Figure A1: ABS Building Activity Process*

Work done / Dwelling investment

Detached dwelling

Building approval → (0.7q) → Commencement → (2.2q) → Completion

Higher-density dwelling

Townhouse

Building approval → (0.9q) → Commencement → (3.4q) → Completion

Apartment

Building approval → (1.6q) → Commencement → (6.7q) → Completion

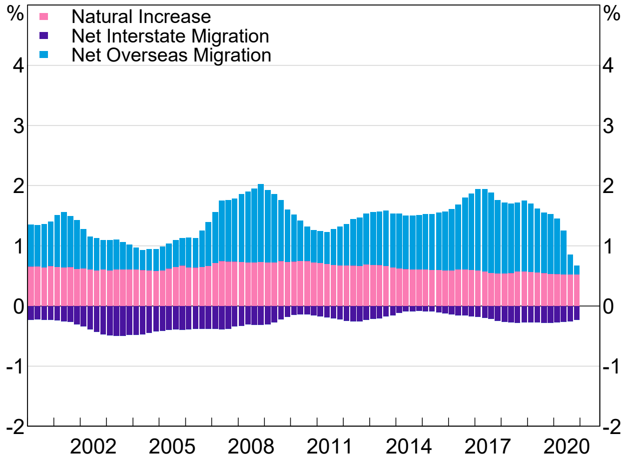
* Numbers in brackets indicate mean approval-to-commencement and commencement-to-completion times from ABS unit record data

Apartments take longer to progress from approval to commencement, and take longer to complete, than detached dwellings or townhouses.

Graph A13

Population growth in NSW

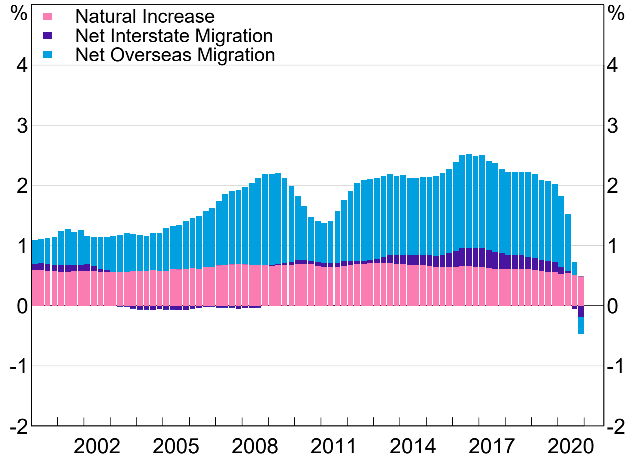
Year-ended with contributions



Graph A14

Population growth in Vic

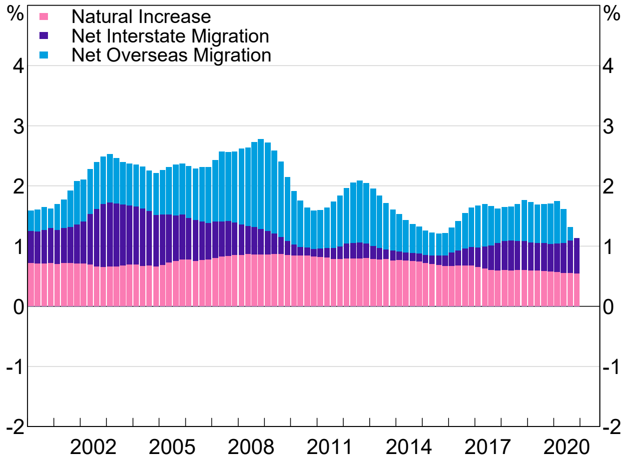
Year-ended with contributions



Graph A15

Population growth in QLD

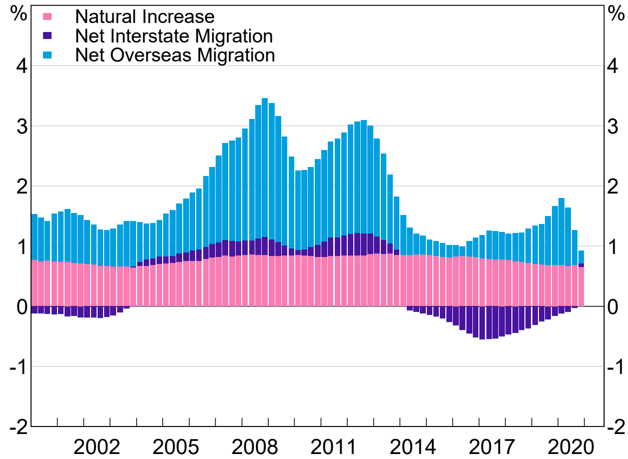
Year-ended with contributions



Graph A16

Population growth in WA

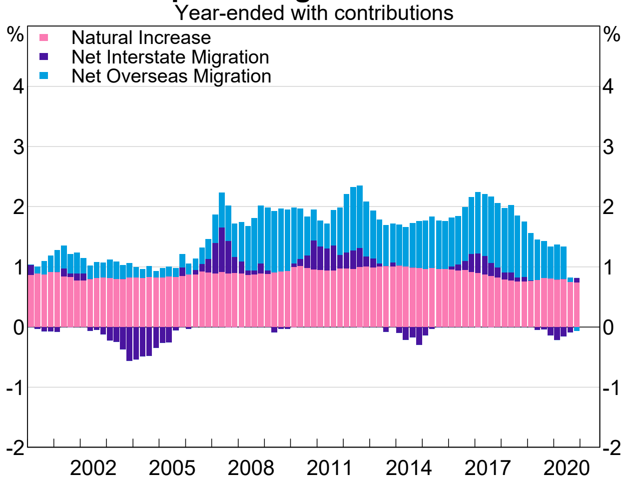
Year-ended with contributions



Graph A17

Population growth in ACT

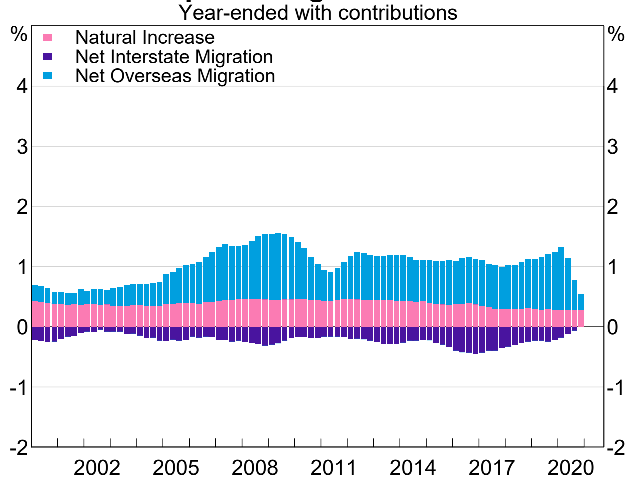
Year-ended with contributions



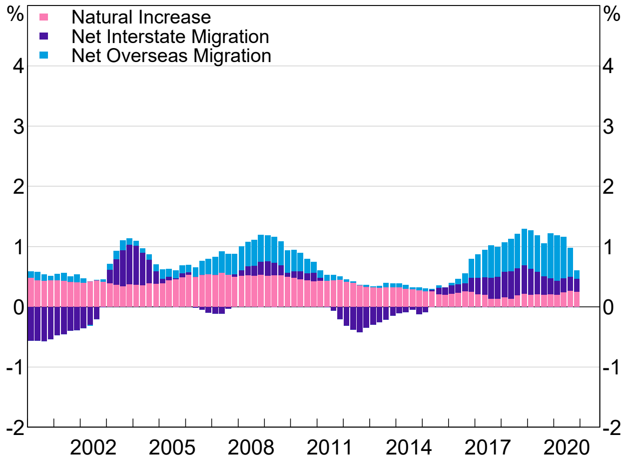
Graph A18

Population growth in SA

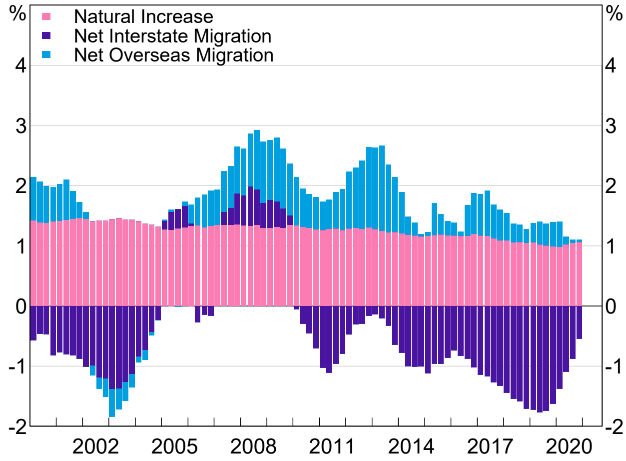
Year-ended with contributions



Graph A19
Population growth in Tas
Year-ended with contributions



Graph A20
Population growth in NT
Year-ended with contributions



The drivers of population growth vary over time and by state and territory.

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