MASTER BUILDERS
AUSTRALIA

UNLOCKING SUPPLY

Consideration of measures aimed at improving housing supply

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CONTENTS

Denita Wawn
Chief Executive Officer
Master Builders Australia

FOREWORD

Home ownership is a cornerstone of Australian life and prosperity.

The housing sector provides shelter for Australians to raise their families, while home ownership is the single biggest contributor to the wealth of lower and middle income households.

The construction industry has also been a critical source of jobs and growth, accounting for around 9 per cent of GDP and more than 1.1 million skilled workers.

But while owning your own home remains a fundamental aspiration, it is becoming increasingly difficult to achieve.

For more than a decade, Master Builders has been the leading voice lobbying successive federal governments, to increase the housing supply, with a focus on affordability and home ownership for all Australians.

Our advocacy is informed by the experience of our members in the residential building sector, including most recently a grassroots consultation which provided confirmation of the key impediments to supply.

Master Builders previously commissioned work by Cadence Economics which modelled the impact on housing affordability of the $1 billion Housing Infrastructure Package and the $75 million Transport Infrastructure package, outlined in the 2017 Federal Budget.

However, for these measures to deliver the maximum benefit, the regulatory barriers to building more new homes that exist at the state and local government levels must be pared back.

The Federal Government is playing a role by providing financial incentives for state and territory governments to implement reforms to achieve this.

EXECUTIVE SUMMARY

We know that a shortage of shovel ready land and embedded charges and planning costs can add 30% to the cost of a new home. These costs are attributed to inadequate land supply, embedded land costs, rising developer and infrastructure charges and poor planning and zoning.

These costs have contributed to land prices growing at consistently four times faster than construction costs.

The 2017 Federal Budget included an unprecedented commitment by the Commonwealth Government to housing affordability and infrastructure investment.

Previous work by Cadence Economics, commissioned by Master Builders Australia (Master Builders), showed that this extra funding into housing and transport related infrastructure could support the construction of up to an extra 100,000 new homes by 2021 boosting supply by 41% and closing the gap on the 100,000 shortfall estimated by the Government.

However, to take advantage of this opportunity and make the most of this commitment by the Commonwealth Government, regulatory barriers at state and local government levels to the construction of new homes must be removed.

Therefore a coordinated and cooperative approach across all levels of government is required.

Subsequent modelling in this report, undertaken by Cadence Economics, and commissioned by Master Builders, presents a set of scenarios of the most critical areas for reform to boost the supply of housing. In doing so, it sets the platform for policy measures to be developed to ensure funding announced as part of the 2017 Federal Budget is best targeted.

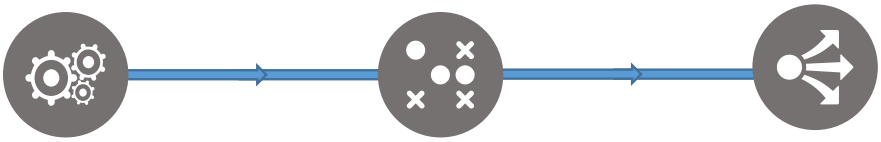
Implementing the full suite of reforms could reduce house price growth by as much as 15%.

Building a fairer housing market

A HOUSING REFORM AGENDA

Key priorities for reform to boost the supply of new housing

HOUSING REFORM ISSUES, PRIORITES AND BENEFITS



Challenges	Reforms	Benefits
Land shortages	Reduce developer charges	More responsive supply
Regulatory costs/restrictions	Reduce planning delays	Downward pressure on prices
High house prices	Relax zoning restrictions	Big economic and consumer benefits
	Housing related infrastructure	

Challenges

Land shortage

1 Land prices have grown 4 times faster than construction costs – the biggest cause of high house price growth in the last 30 years

Regulatory costs/restrictions

2 Reduces the number of houses built by taking capital which would otherwise be used to build houses

High house prices

3 The combination of land shortages and regulatory costs have had a significant negative impact on housing affordability. House price to income-ratios are at a record high

Reforms

Developer charges & planning delays

4 These charges and delays can add up to 30% to the cost of a new greenfield housing development, reducing the amount of capital going into housing construction

Zoning restriction

5 Reduces the number of dwellings in areas where people want to live

Housing infrastructure

6 To unlock more land for residential construction and reduce infrastructure costs on new home owners

Benefits

More responsive supply

7 More supply of land to reduce land costs which have accounted for almost all of the growth in house prices in the last decade

Downward price pressure

8 Implemented as a whole these reforms could reduce future house price growth by as much as 15 per cent

Economic benefits

9 More than $3 billion extra for households, $4.5 billion in extra construction work, and 4,200 extra jobs per year for the next 5 years

"By investing more into housing infrastructure and implementing these reforms, an extra 100,000 homes could be built in the next five years, reducing pressure on house prices" D.Wawn CEO MBA

Why is increasing supply the solution?

At a national level, the past decade has seen a significant shift in the trends for the supply of housing and population growth. Prior to 2004, growth in the supply of housing has historically been higher than population growth. However since then there has been a moderation and at times a reversal of this longer run pattern whereby population growth has outpaced housing supply.

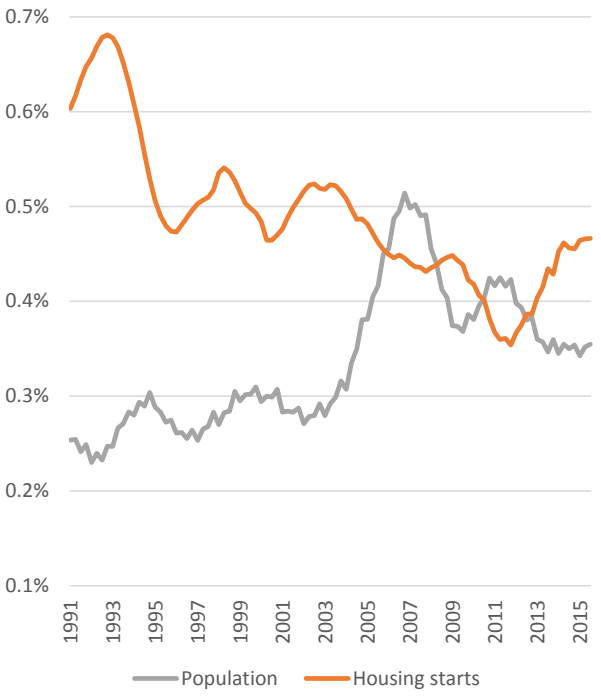
Housing investment has historically averaged around 6% of GDP. But in 2004-05 housing investment fell to around 5.5% of GDP and stayed there for the best part of the following decade. That may not seem like much, but over a decade that 0.5% difference added up to a shortfall in housing investment of close to $83 billion, enough to build an extra 165,000 new homes.

While estimates of the degree of housing shortages vary, the consequences of this historical shift were apparent in the National Housing Supply Council report *Housing Supply and Affordability – Key Indicators, 2012*, which found a sharp upturn in the net national dwelling supply gap starting in the mid 2000s.

The industry has been playing catch-up in the last two years, with new housing completions outpacing underlying demand since around 2014. But despite a recent period of higher housing investment, the Federal Government estimates Australia's housing shortage still exceeds 100,000 dwellings.

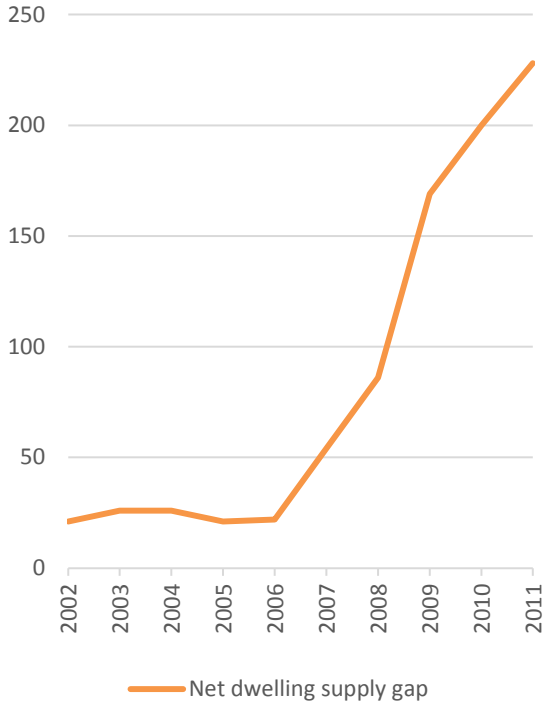
The net impact of this shortage, coupled with the growing impact of developer charges has seen the price of land spike, driving up houses prices as a result. As the chart shows below, land prices have grown much faster than the costs of construction (which have remained relatively steady for more than 30 years) and have been the biggest driver of high house prices.

Chart 1: Population growth and dwelling investment, Australia



Source: ABS 8752.0, ABS 6416.0

Chart 2: Estimated net dwelling supply gap ('000 dwellings)



Source: National Housing Supply Commission, Housing Supply and Affordability – Key Indicators, 2012, Table 4.1

Several reports into the housing sector by the Productivity Commission, the Reserve Bank, the Treasury, and as a recommendation in the Henry Tax review, all find that the housing supply shortage must be solved as a first step in any reasonable strategy to fix housing affordability in Australia.

"A city with a high housing-price-to-income ratio (high house prices) is less a 'great city' than a supply constrained one lacking in empathy, humanitarian impulse, and increasingly, diversity."
(R. Shiller, 2017)

An alternate view posed leading up to the 2017 Federal Budget was to use the tax system to curb investor activity. The objective being to help affordability by recalibrating the tax settings to give first home buyers and home owners more room in the market.

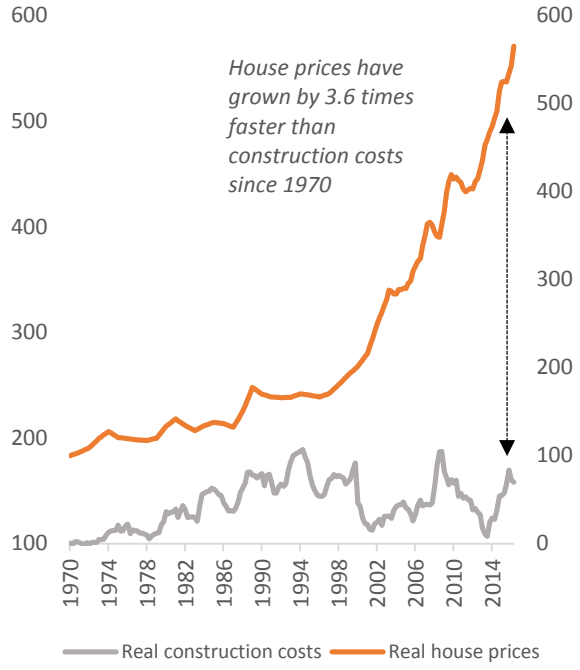
This approach is problematic for the Government. In the first instance, it is difficult to assess the exact contribution that Federal tax settings have on house prices. Attempts to do so in the past have shown tax settings have a relative small impact on house prices.[1]

But perhaps more important, Federal tax settings are not adjustable by jurisdiction. Tinkering with them to curb investor activity in Sydney and Melbourne risks further exacerbating the cyclical downturn in the housing markets in Perth and Darwin.

Changes to the tax concessional arrangements of property assets also overlook the main structural issues in the market which put upward pressure on house prices — that is a housing stock which is not sufficient to meet the growing demands of population growth and changing community demographics.

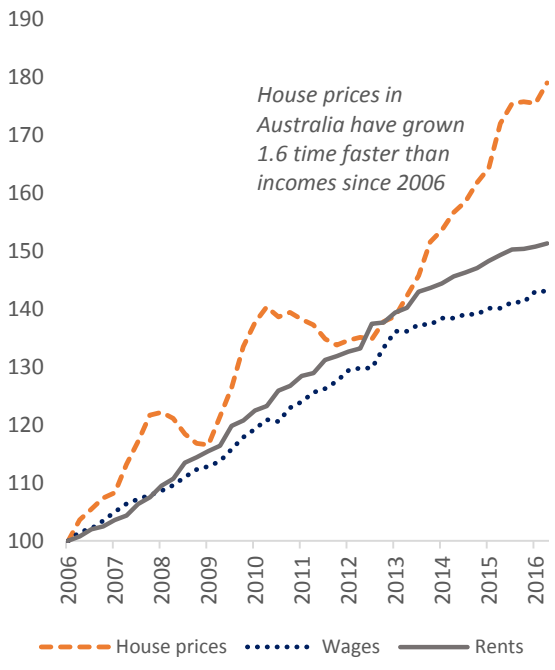
We must put the housing sector back in balance if we are going to seriously tackle housing affordability.

Chart 3: House prices and living costs (Index: 1970=100)



Source: Master Builders Australia estimates

Chart 4: House prices and construction costs (Index: 2006=100)



Source: Master Builders Australia estimates

[1]Grattan Institute article 2016, estimates house price may be up to 2% lower if negative gearing was removed completely and the CGT concession was lowered to 25% for property investors.

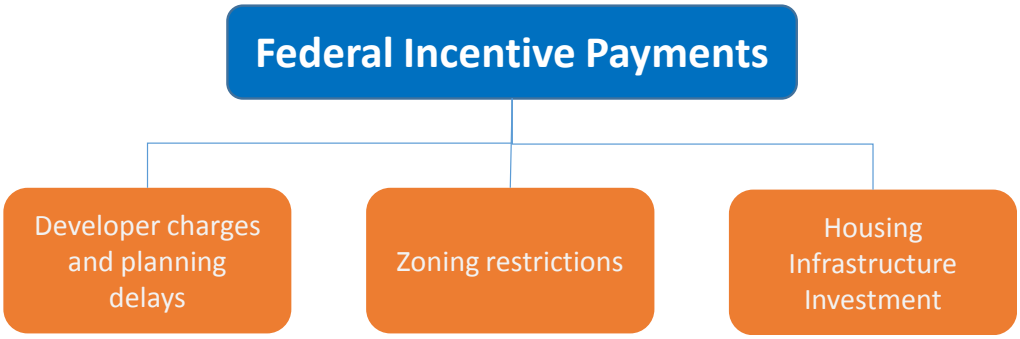
What can the Federal Government do?

There is an important role the Federal Government can play in supporting reforms, with a number of programs announced as part of the 2017 Federal Budget slated to do just that. The Federal Government has successfully used an incentive model to support reforms at a State/Territory level in the past, perhaps most notably following recommendations of the Hilmer review (1993) into national competition policy.

In this report, incentive payments which support targeted reforms to boost the supply of new housing are examined under three scenarios; (1) measures to reduce the direct costs of residential land development (either through reduced developer charges or more streamlined planning processes); (2) reducing transportation costs through better infrastructure investment; and (3) reducing restrictions on planning and zoning in inner city markets, focussing on residential density ratios.

These three scenarios were selected following a rigorous consultation process with Master Builders membership of residential builders, construction workers and building suppliers, across every State/Territory in Australia, and hence represent the priority issues for reforms which currently limit the supply of more new housing.

Figure 1: Priorities for Federal Incentive Scheme



Developer Charges and Planning Delays

A significant contributor to the cost of new housing developments comes in the form of charges levied on new land developments for utility, transport, communication and other supporting infrastructure. In addition, embedded land costs, including land shortages caused by inadequate land release policies and planning delays all contribute to increasing the costs of development of new residential land.

In Sydney it is estimated that government infrastructure charges alone contribute 12% to the cost of a greenfield new housing development and 5% to an infill two bedroom apartment, while the average across Sydney, Melbourne, Brisbane and Perth is 7% for greenfield and 4% for infill respectively.

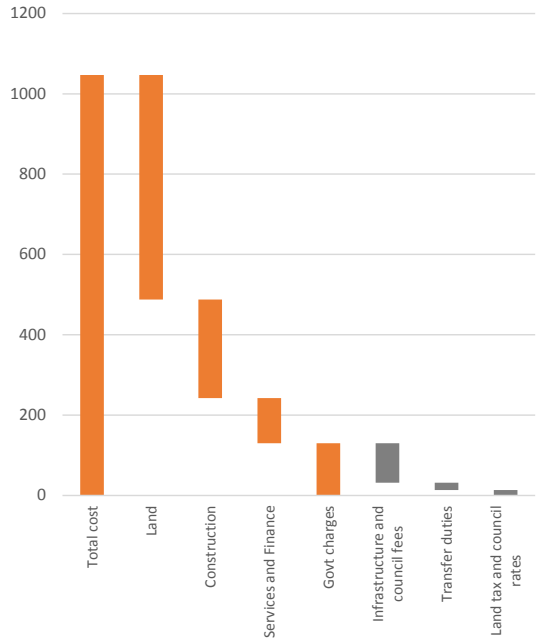
Expressed in dollar terms, charges regularly exceed $100,000 in a typical Sydney greenfield development, while adding in the 'embedded' costs of planning delays and regulated shortages can amount to an additional $300,000.

The economic benefits of reductions in developer charges and delays are compelling. Based on a conservative assumption that $500 million in either developer charges or equivalent planning delay costs can be removed, and considered individually, each of these reforms has the potential to add $850 million to Australia's gross domestic product (GDP), in net present value (NPV) terms over the next four years. Household consumption is projected to increase by $1.4 billion in NPV, bringing forward the construction of approximately 36,000 dwellings over this period.

House prices would also be 0.5 per cent lower as a result of these reforms. However, it could be expected that if greater reductions in developer charges or planning delays were achieved that they would be accompanied by a relative reduction in house prices. For example, if developer charges were reduced further, say by $2 billion (still a relatively small fraction of total developer charges) then house prices would fall by a comparable amount.

The case for reductions in unnecessary planning delays, or regulatory impost, is particularly compelling, as it comes with no first-round reduction in public sector revenues, and indeed would likely increase government revenues in line with increased activity.

Chart 5: Development inputs costs ($'000), Sydney greenfield development



Source: Master Builders Australia

Table 1: Impacts of reduced developer charges or planning delays

	2017/18	2018/19	2019/20	2020/21
Dwelling completions	15,820	32,985	34,584	36,074
NSW	4,978	10,380	10,883	11,352
VIC	4,094	8,536	8,950	9,336
QLD	3,128	6,522	6,838	7,133
SA	1,069	2,229	2,337	2,438
WA	1,778	3,706	3,886	4,053
Tas, NT, ACT	773	1,611	1,689	1,762

Source: Cadence Economics Estimates

Notes: All figures are shown as deviations from a counterfactual baseline. NPVs calculated using a 7% discount rate

Relaxing Zoning Restrictions

Policies to limit housing density (such as building height or plot ratio restrictions) reduce the supply of housing to people in those areas, placing upwards pressure on housing prices in inner city regions and shifting the population further towards the urban fringe.

This shift outwards has two impacts — in the first instance, it increases the level of urban density in the mid and outer city regions. In the second instance, the inner city supply restriction and the shift outwards of the population increases house prices across the entire city, both due to the supply constraint in the inner city and the demand increase in the mid to outer city region.

Table 2: Impacts of zoning restriction removal on dwelling completions

	2017/18	2018/19	2019/20	2020/21
Dwelling completions	4,472	9,312	14,513	20,076
NSW	1,673	3,483	5,428	7,509
VIC	1,408	2,933	4,571	6,323
QLD	619	1,289	2,009	2,778
SA	258	538	838	1,159
WA	395	822	1,281	1,772
Tas, NT, ACT	119	248	387	535

Source: Cadence Economics Estimates

Notes: All figures are shown as deviations from a counterfactual baseline. NPVs calculated using a 7% discount rate

To illustrate this differentiated impact by city size we consider comparable zoning restrictions between large, medium and small cities. In a large city this decreases housing prices per square metre by 2.31%. By comparison, in a medium city this same shock leads to a 1.47% decrease, while in a small city the impact is 0.53%.

Importantly, this scenario leaves open the possibility of several ways to achieve the outcomes above and is largely a representation of the impact of allowing for greater density within existing city limits. This may be achieved in a number of ways. For example, through relaxing building height restrictions, rezoning inner city suburbs for medium and high density construction, or perhaps by rezoning industrial and commercial land for residential use.

Finally, planning restrictions such as height or density restrictions are not generally uniformly binding across a city, with the impost likely to be experienced in high growth pockets.

Our estimate of a phased-in relaxation of planning restrictions finds that the potential impacts are significant, with a net present value of household consumption of over $500 million and an additional 20,000 dwellings built.

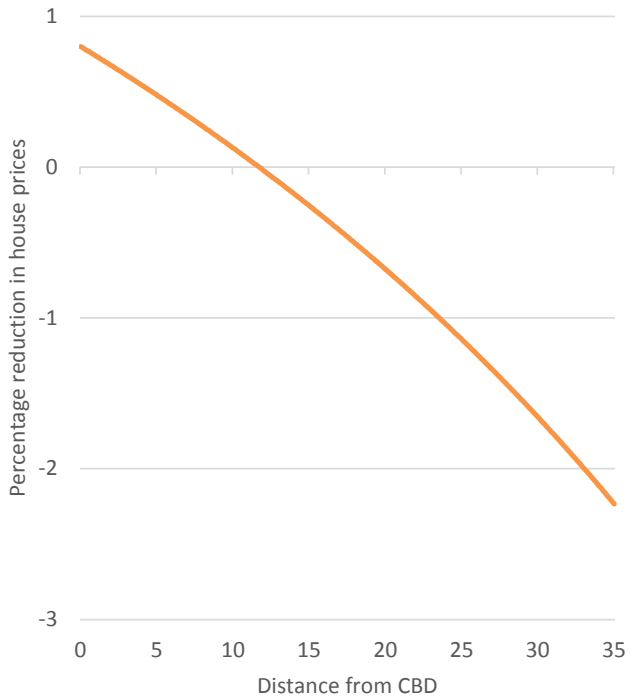
Improvements in Transportation Infrastructure

Announced in the 2017-18 Federal Budget was a range of measures intended to improve housing and transport related infrastructure, including the $1 billion National Housing Infrastructure Facility, and $75 billion from 2017-18 to 2026-27 for critical road, rail and airport infrastructure.

Previous analysis by Cadence Economics, in *Unlocking Supply: Keeping Home Ownership Within Reach of all Australians*, showed that the combination of funding under these programs could support the construction of as many as an additional 100,000 new homes over the next five years if invested properly.

This subsequent analysis is more targeted to show the net impact of transport related infrastructure investment and only includes funding, assumed in the form of incentive payments, under the $1 billion National Housing Infrastructure Facility. As noted by the Reserve Bank Governor, Phillip Lowe:

Chart 6: House price reductions due to 1% transport cost reduction in a large city



Source: Cadence Economics Estimates

"Nothing Increases the supply of well-located land like good transport links."

Importantly, the analysis also gives a stylised estimate of the impact of greater transport infrastructure on house prices across a city. A fall in transport cost of 1% across an entire (large) city (as shown below) will cause housing prices to fall for all housing within 12 kilometres of the city CBD, due to a lower opportunity cost of transport – reducing house prices where people want to live.

Moving further out past the 12 kilometre ring, shows house prices increase due to better transport links into the outer suburbs. This increase however is more than offset by the reduction in travel costs, and a reduction in house prices in the inner city regions leaving a net welfare increase for households across the city.

Perhaps more importantly, over the long term better transport infrastructure puts downward pressure on house prices by increasing the amount of available land for residential development, in areas where people want to live.

However it is important to note that these results are derived on a stylised example of a large city. The real impact of transport infrastructure spending on house prices in different parts of a city will differ due to differences in city structures.

Table 3: Impact of lower transport costs on dwelling completions

	2017/18	2018/19	2019/20	2020/21
Dwelling completions	11,972	22,468	32,290	38,368
NSW	3,882	7,285	10,470	12,441
VIC	3,167	5,943	8,541	10,148
QLD	2,252	4,226	6,074	7,217
SA	825	1,548	2,224	2,643
WA	1,330	2,497	3,588	4,264
Tas, NT, ACT	516	969	1,393	1,655

Source: Cadence Economics Estimates

Notes: All figures are shown as deviations from a counterfactual baseline. NPVs calculated using a 7% discount rate.

APPENDIX

Modelling Details

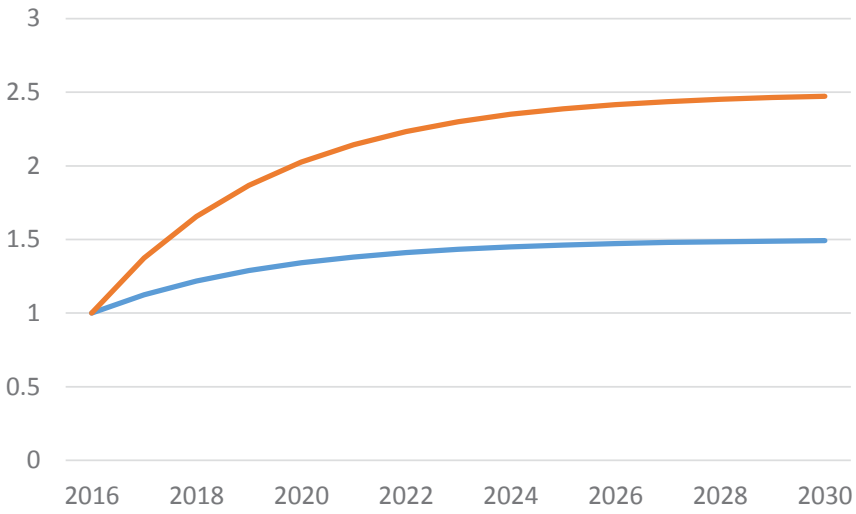
The analysis undertaken in this report relies on a combination of two separate models. The first is the Alonso-Muth-Mills model adapted from the Reserve Bank of Australia's research discussion paper "*Urban Structure and Housing Prices: Some Evidence from Australian Cities*" (Kulish, Richards and Gillitzer, RDP 2011-03). The functional structure of the model is unchanged from that used by Kulish, Richards and Gillitzer, with a detailed description of the model provided in Appendix A of that paper.

The second model used is the CEGEM model, Cadence Economics' in-house Computable General Equilibrium (CGE) model. CGE models are widely used and accepted, having been applied by Australian governments at the state and federal levels for policy issues including the impacts of trade liberalisation, carbon pricing and for taxation efficiency analysis.

The CEGEM model is used to estimate the indirect and economy wide impacts of the specific housing market impacts revealed by the Alonso-Muth-Mills model.

Set against the reference case scenario is a 'scenario projection'. This scenario represents the impacts of imposing a policy shock. The impacts of the policy change are reflected in the differences in the variable at time T. It is important to note that the differences between the reference case and policy intervention scenario are tracked over the entire timeframe of the simulation.

Dynamic simulation using CEGEM



Master Builders Australia

Master Builders Australia is the nation's peak building and construction industry association which was federated on a national basis in 1890. Master Builders Australia's members are the Master Builder state and territory Associations. Over 125 years the movement has grown to over 33,000 businesses nationwide, including the top 100 construction companies. Master Builders is the only industry association that represents all three sectors, residential, commercial and engineering construction.

The building and construction industry is a major driver of the Australian economy and makes a major contribution to the generation of wealth and the welfare of the community, particularly through the provision of shelter. At the same time, the wellbeing of the building and construction industry is closely linked to the general state of the domestic economy.

UNLOCKING SUPPLY

Consideration of measures aimed at improving housing supply

Master Builders Australia
Level 3, 44 Sydney Avenue
FORREST ACT 2603
PO Box 7170, YARRALUMLA ACT 2600
T: 02 6202 8888, F: 02 6202 8877
E: enquiries@masterbuilders.com.au
W: www.masterbuilders.com.au

https://www.facebook.com/MasterBuildersAustralia/

@MBA_Aust