MASTER BUILDERS
AUSTRALIA

Senate Economics References Committee inquiry and report into Australia's financial regulatory framework and home ownership

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About Master Builders Australia

Master Builders Australia (Master Builders) welcomes the opportunity to make a submission to the Senate Economics References Committee inquiry and report into Australia's financial regulatory framework and home ownership (the inquiry).

Master Builders is the nation's peak building and construction industry association, serving as the only representative for all three sectors of the industry: residential, commercial and engineering/civil construction.

Over 130 years, the movement has grown to over 32,000 businesses nationwide, including the top 100 construction companies.

With Master Builders Associations in each state and territory, offices in all capital cities and 34 locations throughout metro and regional Australia, Master Builders is the authentic voice of the nation's building and construction industry.

Membership of Master Builders is a stamp of quality, a demonstration that a builder values high standards of skill, integrity and responsibility to its clients.

Master Builders' vision is for a profitable and sustainable building and construction industry.

Introduction

In this submission, Master Builders acknowledges the nature of Australia's housing market with the overwhelming majority of the market being traded. Ongoing supply and affordability challenges are limiting housing tenure options and pushing more Australians into rental dwellings and social housing.

This is unsustainable.

The ability to deliver more housing is constrained by productivity and other barriers that in the view of Master Builders are key areas for reform. In this response to the seven inquiry questions, observations about the Australian situation and some recommendations are made. The key points in this submission include:

- Lending and borrowing provisions are central to the fate of home building and would benefit from a review into the scope for prudential standards to be altered, without changing the overall risk profile of lending.
- Investment generally slows when mortgage and interest rates exceed rates of return and financing is often overlooked when addressing demand and supply shortfalls.
- Existing housing supply measures are needed to address ongoing shortages and future demand.
- Scalability is crucial with the combination of housing availability and productivity its key to success.
- The Government's investment in housing, while having a positive impact on supply in its own right, will be neutralised by barriers, such as prolonged labour shortages, persistence of materials price growth and industrial measures.
- Cost escalation is occurring in social housing projects and becoming more prevalent across the industry.
- New approaches to Government investment in housing need to be tested but it will be important for cost escalation to be monitored, to better understand thecause of such increases.

- Housing is one of the most heavily taxed sectors of the economy with taxes on property making up nearly 50 per cent of state/territory and local government revenue. Adding more tax at the Federal level with changes to negative gearing and capital gains tax concessions will simply add to the tax burden and reduce housing supply.
- The Henry Tax Review identified that it would be premature to unsettle existing taxation arrangements before concrete actions are taken to address housing affordability and supply. The Government's focus therefore should continue to be on planning reform through the National Planning Reform Blueprint.
- Understanding the residential housing market would be enhanced by additional data collection specified, detailed further below.

Master Builders responses to questions

Australian Prudential Regulation Authority prudential standards and *Corporations Act 2001* provisions for lending

A good financial system allows willing lenders and borrowers to be matched in an effective way. It guards itself against serious damage**.** Bank losses can result when loans are made to borrowers who ultimately lack the capacity to fully repay them. If this happens on a large enough scale, a bank may be unable to fully meet its own credit obligations. Depending on that bank's importance to the financial system and the economy, the government may need to intervene.

During the global financial crisis, several enormous bail outs of this nature placed some governments under serious financial pressure. This is why caution must be exercised when it comes to lending policies.

However, when lending behavior is too cautious it can prevent worthwhile economic activity from taking place.

Lending and borrowing conditions are central to the fate of new home building activity in Australia.

If the rules which govern lending are too restrictive, fewer new homes will end up being built – but without any compensating benefits.

Lending policies have a practical effect of inhibiting building activity. In the current environment, builders are reporting that valuations are perceived to be too conservative and are therefore depressing the size of the loans made to finance home building. The sequencing and mechanics of staged payments for new home building projects have also changed in a way that frustrates the roll out of new homes.

The current challenge is to build 1.2 million new homes over the next five years under the National Housing Accord. This quantum has never been delivered before. To reach the target, all settings need to be as favourable as possible. This includes macroprudential standards.

Accordingly, all macroprudential standards should be subject to expert review to determine whether they are acting to prevent new homes from being built or fresh residential land from being developed. If they are, the relevant regulations should be relaxed.

There is real scope for prudential standards to be altered in a way that encourages more new home building activity without changing the overall risk profile of lending institutions. This could be done by easing the standards for loans where a new home is being purchased or built. In return, more restrictive standards could be imposed on other categories of credit especially those that support expenditures with a high import content such as consumer credit.

Of course, prudential standards are not the only policy setting of influence for new home building activity. Improving the quantity of new home building also rests on enhancing the industry's supply side and leveraging demand in an effective way. Accordingly, government supports for homebuyers should be concentrated on those buying or building new homes.

The nature and type of debt and equity arrangements being used to underpin housing development

To understand the financing market, it is necessary to outline the environment underpinning Australia's housing system.

The National Housing Supply and Affordability Council (the Council) identifies in its *State of the Housing System 2024* report that 96 per cent of the housing is market traded and 4 per cent is supplied by public and quasi-public sectors.

The private market is underpinned by a legal and regulatory system that promotes strong property rights, largely financed by Australia's major banks. Government intervention has prioritised markets over government allocation of resources.

The report also identifies how housing market segments are differently financed. Larger developments are for the most part accessing wider debt and equity financing arrangements. Medium, smaller and residential developments are more dependent on bank finance.

Private market investment in housing requires a return to be a viable proposition. Investment generally slows when mortgage interest rates exceed the rate of return and for corporate investors the rate of return is generally considered below commercially acceptable levels.

The Australia Housing and Urban Research Institute (AHURI) report entitled *Financing of residential development in Australia,* provides a valuable outline of the Australian approach following the global financial crisis. It notes financing of residential developments is often overlooked in addressing the shortfall between housing demand and supply. Some of the key points in this report are:

- In times of higher risk and economic uncertainty, large developers are still able to finance their developments while small- and medium-sized developers borrow on a project-specific basis and find it difficult to access finance.
- Medium and small residential developers can overcome financial risk barriers by pursuing joint ventures with the public sector but opportunities to secure finance for affordable housing are limited.

To assist in areas where there is greater financial risk, the National Housing Financing Investment Corporation (which was established under the Coalition Government and expanded to become Housing Australia under the Albanese Government) is directly contributing to financing the delivery of social and affordable housing through guarantees, equity, availability payments, concessional loans and upfront capital grants.

Measures currently on the table to incentivise delivery of more housing are needed to address ongoing shortages in the market and future demand in low income, public and private rental and ownership.

Australia's major banks in the current parliamentary review of Australia's Four Banks have identified that renters are the housing market segment most affected by cost of living pressures and noted that the housing crisis is Australia's biggest societal and policy challenge. Scalability is seen as crucial and housing availability together with productivity are key to success.

The combination of private and public housing measures announced by the Government need to be rolled out and tested, including those currently blocked in the Senate. This, together with bringing down interest rates, inflation and unlocking barriers to supply, is critical to rebuilding confidence and improving productivity.

The appropriate involvement (if any) of corporate and institutional funds in the provision of housing

The aforementioned Council report acknowledges that the supply of non-market housing has not matched demand for several decades, while the share of national housing stock has fallen by 30 per cent.

The Council, together with industry forecasts published by Master Builders and other associations, projects that National Housing Accord targets will not be met without significant intervention.

The combined effect of systemic productivity challenges, economic shocks, the COVID-19 pandemic, constant regulatory change and fragmented/ineffective compliance frameworks are making it more challenging to build. It is also a riskier financial proposition for investors.

As a consequence, governments are taking more of a role at a state and federal level in financing the private market as well as social and community housing developments.

Intervention is needed across the spectrum of housing types. New financing approaches for social and affordable housing introduced by the previous Government and expanded by the current Government are necessary.

New approaches need time to be tested and for their impact to be evaluated. It will be important for this process to monitor cost escalations associated with new industrial and building regulatory reforms at both the state and federal level.

Master Builders has previously requested this to be a feature of reporting in its submissions on the *Housing Australia Future Fund* legislation in February 2023 and the *Housing Australia Future Fund Investment Mandate* in November 2023.

In particular, Master Builders raised the following points which remain applicable:

- Significant practical implementation issues need to be coordinated in a coherent and consistent way. It will be important to recognise these as core elements on the journey to improving housing supply and affordability.
- In research and reporting, other matters that might be considered should be performance of the housing sector; building a strong evidence base; specific impacts on the sector including credit conditions, taxation, macro-prudential regulation, rental market regulation, other regulation (land use planning, zoning and building codes), climate and demographic change, social policy; availability and quality of data, role of intergovernmental forums, improving housing outcomes for vulnerable groups, climate resilience and supply.

There is also an opportunity for Housing Australia-supported projects to lead the way in terms of a pioneering approach involving a fairer and more sustainable model of risk-sharing with those building and construction businesses involved in the procurement process. This was also raised in previous submissions by Master Builders.

Since those submissions were made, building and construction enterprise bargaining agreements have been, and continue to be executed across the country with annual pay increases (such as to 26 per cent in Queensland, 22 per cent in New South Wales and 20 per cent in Victoria). These also include conditions ranging from:

- Inclement weather and emergency work bonuses
- Increased travel and accommodation allowances
- Increased rates and holiday period loading
- Income protection and industry training levies
- Technology allowances
- Greater accrual of rostered days off
- Weather guidelines and temperature related stop work thresholds
- Air quality procedures
- Creation of new standard form contracts
- Casual contract conversion
- Labour hire restrictions.

On top of this, productivity in the industry is declining.

Earlier this year Master Builders published a report entitled *The Cost of Letting Productivity Slip* to outline the impact of productivity constraints (after almost a decade of negative productivity) on the Australian building and construction industry and the wider economy over five years.

The report included analysis by the Centre for International Economics that measured the impact of prolonged labour shortages, persistence of excessive materials price growth and elements of industrial relations reform on progressing Federal Government housing initiatives. The research found that while investment in housing by Government was having a positive impact, that impact was neutralised by the three areas measured.

Over the five years used for modelling, Federal Government housing measures would boost new home building starts by 42,882 dwellings, but that would be reduced to 8,654 dwellings should the above factors prevail.

Master Builders members are reporting that they are experiencing cost escalation of around 30-40 per cent. One example from North Queensland is that the construction cost of a basic finish, two-bedroom apartment in a social housing project was $830,000 per dwelling. This is 30 to 40 per cent above what the builder had anticipated and is a result of higher costs for the various trades involved in the construction, which is in turn caused by critical and chronic labour shortages across the industry.

The effectiveness of mechanisms to monitor investment in the residential property market

There have been welcome improvements in the residential lending data published by the Australian Bureau of Statistics (ABS) in recent years. Since July 2019, monthly figures on the number and value of different housing loans have been published and show a breakdown for owner occupiers and housing investors. The data also looks at the purpose of the loans.

It appears that the residential property market could be enhanced in a number of ways, including but not limited to:

- Enhancing industry capacity to understand and interrogate investment in the residential property market by providing geographic breakdown on an even more detailed basis (such as SA2 or LGA), in the ABS monthly home lending data (which is currently broken down by state and territory only).

- Providing a better breakdown of loan data relating to First Home Buyers (FHBs) such as whether loans are used to build new homes, purchase newly built homes or acquire established dwellings.
- Delivering a nationally consistent data series on residential land transactions as well as the stock of residential land in each of the stages of the delivery pipeline.
- Publishing nationally consistent data on the performance of each LGA with respect to processing times for building and development approvals.
- Providing detailed geographic data (by SA2 and/or LGA) on the tenure of the housing stock (such as owner occupied, rented or other).

The tax treatment of residential property and impacts on demand and house prices

Housing is one of the most heavily taxed sectors of the economy. Taxes levied on properties and conveyancing stamp duties constituted nearly 50 per cent of the revenue base in 2022/23 of state, territory and local governments. This is where the focus should be for tax reform, once supply constraints are addressed. The table below shows a state and territory breakdown of these taxes by state and territory.

Sources of income, state, territory and local government, 2022/23

	Stamp duties on conveyances	Taxes on properties	Share of total taxation revenue
NSW	$9,712	$11,653	46.8%
VIC	$8,998	$12,603	55.5%
QLD	$5,204	$7,294	49.1%
SA	$1,210	$2,633	48.9%
WA	$2,448	$4,074	43.3%
TAS	$364	$693	50.5%
NT	$171	$158	37.7%

The Henry Tax review looked closely at stamp duty, land tax and other inefficient taxes and concluded that transfer taxes on property should be reduced, and ultimately removed, with revenues replaced by efficient taxes, preferably annual land tax. It also identified that it would be premature to unsettle existing taxation arrangements before concrete actions are taken to address housing affordability and supply.

The report specifically noted that taxation is not the major source of supply constraints in the Australian housing market and that housing affordability would be best promoted through wider reforms that facilitate housing supply.

Master Builders continues to advocate for the retention of existing negative gearing and capital gains tax housing concessions because any changes that increase the tax from these measures will reduce, not add to housing supply. These reductions would be a direct consequence of the marginal excess burden of these tax increases.

Master Builders commissioned research on the Labor Party's 2019 property tax reform proposal to limit negative gearing to new housing and halve the capital gains tax discount to 25 per cent for all properties. The analysis found that these changes would reduce new housing supply and jobs in building and construction. They would not increase supply which was the claim made at the time.

Specific findings of the analysis included:

- New housing construction would fall by between 10,000 and 42,000 dwellings.
- There would be between 7,500 and 32,000 fewer jobs.
- Value dwelling activity would fall by between $2.8 and $11 billion.
- Renovation activity would reduce by between $50 and $210 million.

Master Builders considers any changes to negative gearing and capital gains tax concessions that increase tax will reduce housing supply and economic growth.

Adding tax would be a significant disincentive to smaller investors to put housing stock into the rental market.

Government's priority should be to address the supply constraints contributing to today's productivity maelstrom. The *National Housing Reform Blueprint* is a good start that should be continued and improved in the future.

Master Builders understands the need for restraint on lifting taxes on private rentals by not changing tax settings for negative gearing and capital gains tax on investment properties. Master Builders also acknowledges the need to reduce taxes on private investment for developments that can deliver more scale, such as Build to Rent (BTR) properties.

BTR housing is seen as a nascent asset class that could accelerate capacity for middle market home purchasers and supercharge rental housing supply but it requires the right tax settings for this to happen.

Parliament therefore needs to pass legislation that will put withholding tax and capital works deductions for managed investment trust (MIT) BTR properties on par with other property asset classes. Ideally this includes a revised MIT rate concession of 10 per cent to provide for affordable tenancies targeted towards low- and middle-income earners.

Master Builders supports proposals put forward by the Property Council of Australia, the Community Housing Industry Association and National Shelter to deliver an effective BTR tax regime.

The adequacy of metrics available to policymakers for monitoring the ratio of new housing supply relative to population growth

In addition to the potential for extra data collection identified above, it is the view of Master Builders that the linkage between population growth and new housing supply could be better understood by expanding the geographic breakdown of the following ABS Building Activity indicators to SA2/LGA level, including:

- Dwelling starts
- Dwelling completions
- Number of homes still under construction
- Number of homes approved but not yet commenced.

While the monthly ABS Building Approvals series offers an excellent geographic breakdown (to SA2 and LGA level), there is not a clear linkage between the volume of approvals and the number of new home starts and completions which eventuate.

The ABS Building Activity data set is currently broken down by state and territory, but no more detailed than this. If it were available to the same level of detail as building approvals currently are, it would allow for localised delays and stumbling blocks to be identified more readily and allow for policy solutions to be developed.

In terms of population data, the ABS's annual Regional Population series is commendably detailed and provides a snapshot of population on an SA2 basis once yearly, including analysis of the components of population change. One potential improvement would be to provide a breakdown of population by age on this basis.

Examples of effective priority treatment for aspiring Australian homeowners that do not compromise financial stability

Master Builders supports the continuation of targeted incentives through the Home Guarantee Scheme and home equity schemes at the state/territory and national level. These are measured approaches that assist first home buyers in greatest in need of support, whilst minimising inflationary impacts.

Master Builders welcomes the opportunity to provide this input to the Inquiry. If there is any further information that would be of use, please contact Ms Alex Waldren, National Director Industry Policy ([redacted]) or Mr Shane Garrett, Chief Economist ([redacted]).