Housing Affordability:

What can be done about the Great Australian Dream?

KPMG Economics

October 2016
Executive Summary – The issues

- There is no doubt that Australia is experiencing a worsening problem regarding housing affordability, a fact highlighted this week (24 October 2016) by the Federal Treasurer in a speech to the Urban Development Institute of Australia.
- The driver of reduced affordability has clearly been the rapid increase in the price of housing, relative to a more benign adjustment in household incomes.
- Many of the drivers of house price increases and affordability pressures on some households are occurring globally, are largely macroeconomic and are the product of a complex interaction of demand and supply side factors, and no single policy intervention will address the entire issue.
- About a decade ago KPMG Economics completed a detailed review into housing affordability in Australia. At the time we found that the change in median house prices were mostly influenced by the underlying strength of the economy, the performance of the share market, and the proportion of housing being purchased by investors relative to owner occupiers.
- We have just re-investigated the relationship of median housing prices in Australia to the key drivers identified a decade ago and found GDP and investor activity remain key influences, but the share market no longer had such an influential role. However, wages, interest rates and housing supply are factors whose influence on house prices have strengthened over the past decade.
- Average access to intergenerational equity – being the average amount of time a generation has access to potential wealth via inheritance from the immediately preceding generation – is anticipated to be greatest for ‘Baby Boomers’, and least for ‘Generation X’.
- We are now seeing a change in behavior by current generations regarding home purchasing which is new compared to previous generations. That is, some young people are now collaborating to buy, some are assisted by parents, while others are simply choosing not to buy because they don’t want to be committed to a location for 30 years of a mortgage.
- Low income households are only able to afford housing stock that is located on the fringe of cities, and even then this has become more difficult. However, this outwards push of the urban fringe also creates broader issues for society around provision of infrastructure into these ‘greenfield locations’, and the false economies associated with cheaper housing but more expensive private and public transport.
Executive Summary – Some solutions

- KPMG recognises the challenges associated with resolving the problem of housing affordability are complex and they involve a range of both supply and demand side factors. We have offered a number of solutions that provide a way forward for housing affordability to be improved on a permanent basis. These include:

  1. **CGT reduction**: reducing the capital gains tax discount from 50% to 25%, thereby making property investment marginally less attractive

  2. **Aggregate property tax**: abolish stamp duty on the transfer of residential property and conflate rates, land tax, insurance taxes and emergency service levies into a new Property Services Tax

  3. **Systemic reforms** aimed at maintaining the supply and diversity of land and housing in established and growth areas, through:
   - a) **Set targets**: a stronger role for target setting for “net additions to stock” to drive Local and State Government planning schemes;
   - b) **Affordable product**: target setting would also focus on encouraging greater diversity of housing stock and deliberately encouraging smaller, well designed affordable products;
   - c) **Streamline planning**: making further improvements to the planning system to capitalise on the Government’s planned use of structure plans as a means of reducing the holding costs associated with planning delays - and providing developers in both the private and public sector with greater capacity and incentives to bolster supply at times when the market is under substantial demand pressure;
   - d) **Empower public supply**: supporting a stronger role for government land authorities to focus on housing affordability for middle income households within the context of a broader sustainability agenda.

  4. **Targeted Reforms** aimed at improving access to those groups who are the most excluded from affordable home ownership. This package would focus on:
   - a) **More low cost housing**: the production of a greater volume of more sustainable, well-designed, lower cost house and land packages;
   - b) **Improve assistance**: better targeting of existing State first home owner assistance to increase the overall value and impact of that assistance;
   - c) **Promote shared equity**: the introduction of a shared equity program with a percentage of that equity exempt from rental interest charges for the life of the loan or a part of it to be provided by Government and/or the private sector.

- KPMG also believes that the solution for Australia must involve all levels of Government working together, given the factors driving the problems are not under the remit of any one level of government. It should be a priority area of public policy.
Introduction

The problem of housing affordability is not new, a point recognised by the Treasurer in a speech he gave to the Urban Development Institute of Australia (UDIA) in Sydney on 24 October 2016 titled ‘Keeping home ownership within reach’¹.

There is no doubt that Australia, like other international jurisdictions, is experiencing a worsening housing affordability problem. The driver of reduced affordability has clearly been the rapid increase in the price of housing, relative to a more benign adjustment in household incomes.

In his speech the Treasurer highlighted that a key policy goal for Governments at all levels, including the Commonwealth, “must be an improvement in housing affordability right across the housing spectrum”². Further, he also noted the Government response “must be well targeted and ensure that the actions of each level of Government is integrated and uses the levers they have in a way that best addresses the challenges faced”³.

KPMG appreciate all these sentiments, and in fact, have been advising public and private sector organisations over many years on the problems and possible solutions to housing affordability. Yet, despite it being on the mind of government and politicians, the problem remains.

Chart 1
REIA Housing Affordability Index

<table>
<thead>
<tr>
<th>Index Number</th>
<th>AUST</th>
<th>NSW</th>
<th>VIC</th>
<th>QLD</th>
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<tr>
<td>2008-2018</td>
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Source: KPMG Economics, REIA
The problem

At the outset, it is important to acknowledge that many of the drivers of house price increases and affordability pressures on some households are occurring globally, are largely macroeconomic and are the product of a complex interaction of demand and supply side factors. No single policy intervention will address the entire issue, because as the Treasurer rightly acknowledged in his speech, “there is no single housing market in Australia”\(^4\).

As shown in Chart 1, the relative affordability of housing ebbs and flows over time, dependent not only on the price of houses, but also our ability to pay for them. In general, periods of high wage growth, low interest rates, or declining (or stagnant) house prices, all contribute to making housing more affordable to purchasers, and conversely when wages growth is low, interest rates are high and house prices are rising, then these are times when purchasers find it most challenging to buy a home, particularly those entering the market for the first time.

About a decade ago KPMG Economics completed a detailed review into housing affordability in Australia. This review, and our subsequent work on the topic, highlighted a range of factors influencing the demand and supply side of the housing market in Australia.

In particular we found the factors contributing to housing demand include:

- household formation, or the change in occupied dwellings, which is itself driven by population growth (natural increases, net overseas migration and net interstate migration), changing age structures; and trends to smaller households, including a substantial increase in the number of single-person households;
- changes in the stock of unoccupied dwellings;
- ease of obtaining finance;
- household incomes; and
- the role of investors in the property market.

Further, we also found that housing supply is inherently slow to adjust to changes in demand. While this is true, KPMG Economics also found that differences in tax systems, the structure of the financial systems, legal systems, government housing policies, and geographical features are all factors that not only have an impact on the responsiveness of housing supply to an increase in demand for extra dwellings, but also the speed, magnitude and duration of house price escalation.

There is also an extensive body of literature which indicates that the urban planning system and urban planning policies of a country contributes to house price outcomes through their impact on housing supply. These studies suggest that urban planning policy and regulation is an important policy lever for addressing systemic barriers to the production of affordable housing.
The economic drivers

As part of our earlier study we also completed detailed empirical analysis using sophisticated econometric modelling techniques, and at the time we found that the change in median house prices were mostly influenced by the underlying strength of the economy, the performance of the share market, and the proportion of housing being purchased by investors relative to owner occupiers.

Interestingly, we have just reinvestigated the relationship of median housing prices in Australia (as shown in Chart 2) to the key drivers identified a decade ago and found GDP and investor activity remain key influences, but the share market no longer had such an influential role. However, wages, interest rates and housing supply are factors whose influence on house prices have strengthened over the past decade.

The fact that wages and housing supply are now statistically significant factors influencing house prices suggest housing affordability has become exacerbated due to increased planning restrictions on residential development and the growth in low-wage and part-time employment. Local land use regulations that limit lot size and density have also helped to drive up housing prices and rents relative to incomes.
One point that seems to be intuitively understood but not often discussed is a point associated with the impact of ageing on the housing market. Home ownership provides more than shelter to a population – it is a store of wealth, it allows the risk of variations in costs associated with accommodation to be reduced, and it provides a security of accommodation more than renting.

While housing wealth acts as a store of value for households, it has the capacity to do this intergenerationally as parents die and pass on the family home to their children via inheritance. However, with improvements in health outcomes, which is enabling individuals to live longer, that intergenerational access to housing wealth is being delayed, and potentially eroded.
As Chart 3 illustrates, average access to intergenerational equity – being the average amount of time a generation has access to potential wealth via inheritance from the immediately preceding generation – is anticipated to be greatest for ‘Baby Boomers’, and least for ‘Generation X’.

In the context of housing affordability, family wealth which has traditionally been inherited by successive generations and is often utilised for investing in dwellings, is therefore not being accessed by current generations as readily.

This point is particularly relevant for people who need to save for a deposit to purchase a property. If house prices are growing more rapidly than wages, then a potential purchaser’s ability to save the minimum deposit – which is expressed as a percentage of the house prices – becomes harder and harder. So access to intergenerational family wealth becomes more important in these circumstances.

Further, as ‘Baby Boomers’ live longer, and potentially draw down on the equity of their housing investment to fund their retirement, it is also likely that ‘Gen X’s’ will not only access family wealth relatively later in life, but it may also be of lesser value, relative to the inheritance ‘Baby Boomers’ received from their ‘Frugal’ parents.

A consequence of this is that we are now seeing a change in behavior by current generations regarding home purchasing which is new compared to previous generations. That is, some young people are now collaborating to buy, some are assisted by parents, while others are simply choosing not to buy because they don’t want to be committed to a location for 30 years of a mortgage.

Another challenge associated with the housing affordability story is that low income households are only able to afford housing stock that is located on the fringe of cities – and even then this has become more difficult as shown by the analysis completed by AMP and NATSEM (see Chart 4).

However, this outwards push of the urban fringe also creates broader issues for society around provision of infrastructure into these ‘greenfield locations’, and the false economies associated with cheaper housing but more expensive private and public transport.
The elephants in the room

It is not hard to pinpoint the genesis of the Global Financial Crisis on the fact that the United States sold the idea to its population that you must own your own home, and if not for the fact that Australia has a range of prudential controls and recourse financing, the promotion of the ‘Great Australian Dream’ could have pushed us down the same path.

As shown in Chart 5, even with the prudential controls found in our banking system, investment decisions in Australia are heavily biased towards housing.

One might reasonably ask why should the government be worried about the affordability of home-ownership? Is owning your own home some sort of virtuous right that government should facilitate for the Australian population?

There is a social standard in Australia that people have a right to adequate and affordable shelter. The real question in this standard is whether ‘adequate’ shelter is affordable, not whether you own the shelter or someone else does.

Also, the question of ‘adequate’ has to address the issue of ‘quality’—how many bedrooms and bathrooms per inhabitant is adequate? In today’s world it seems that a couple ‘need’ three bedrooms and two bathrooms to survive, while in the 1970’s a family of six happily lived in a house with three bedrooms and one bathroom. So, if we measured housing capacity by the number of bedrooms we might find that there is significant ‘over-supply’ of accommodation for our population.

So the ‘elephants in room’ regarding the problem with housing affordability relate to:

- Taxation and regulatory arrangements that distort investment decisions.
- Recognising there is nothing wrong with promoting the virtues of home-ownership, but whether Governments should focus on the affordability of adequate accommodation, irrespective of ownership.
- Societal norms of ‘adequate’ has exacerbated the problem, and could be partially resolved by the community accepting that less is better than more.
Some solutions

KPMG recognise the challenges associated with resolving the problem of housing affordability are complex – even without tackling the ‘elephant in the room’ issues – and they involve a range of both supply and demand side factors that need to be resolved.

We also recognise that a more aggressive and comprehensive national reform agenda would need to tackle macroeconomic factors and the affordable rental market.

KPMG understands that some types of interventions in fact create perversity, worsening the situation rather than improving it. For example, increasing access to finance can produce demand side pressures which, if not combined with an increase in supply, can in and of themselves lead to an escalation in prices and a decline in affordability levels.

In our submission to the Commonwealth Treasury in July 2015, KPMG outlined a number of tax reform options, which included a number that would contribute to alleviating the problem of housing affordability. These proposed reforms included:

1. **CGT reduction**: reducing the capital gains tax discount from 50% to 25%, thereby making property investment marginally less attractive; and

2. **Aggregate property tax**: abolish stamp duty on the transfer of residential property and conflate rates, land tax, insurance taxes and emergency service levies into a new Property Services Tax.

In addition to these taxation based reforms, we have also recognised there are reforms, both systemic and targeted, that are readily available for Government to implement that has the potential to improve the Australian housing market for prospective home owners. Such reforms include:

3. **Systemic reforms** aimed at maintaining the supply and diversity of land and housing in established and growth areas through:

   a. **Set targets**: a stronger role for target setting for “net additions to stock” to drive Local and State Government planning schemes;

   b. **Affordable product**: target setting would also focus on encouraging greater diversity of housing stock and deliberately encouraging smaller, well designed affordable products;

   c. **Streamline planning**: making further improvements to the planning system to capitalise on the Government’s planned use of structure plans as a means of reducing the holding costs associated with planning delays and providing developers in both the private and public sector with greater capacity and incentives to bolster supply at times when the market is under substantial demand pressure; and

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Final thoughts
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The challenges associated with housing affordability have been problematic in Australia and many countries for decades. Solving them will take time, and involve a comprehensive reform agenda that targets both supply side and demand side factors as piecemeal solutions are only likely to exacerbate the problem.

It seems politicians and bureaucrats have acknowledged affordability is a fundamental barrier for many in society to be able to purchase and enjoy their own homes, but haven’t been able to offer any tangible reforms to help the situation. Rather, the solution adopted appears to be one where if we wait, the problem will decline as the economy strengthens, wages grow and affordability improves – until of the course house prices rise and interest rates increase, pushing affordability back down from that brief window of hope.

KPMG has offered a number of solutions that as a start provide some way forward for housing affordability to be improved on a more permanent basis. However, we also believe that the solution for Australia must involve all levels of Government working together given the elements that are driving the problem are not under the remit of any one level of government control. And this collective action by Government should be an immediate priority, otherwise a generation will miss out on experiencing the ‘Great Australian Dream’.
Endnotes

2. Ibid
3. Ibid
4. Ibid
5. Insights contributed by Bernard Salt
6. The Great Australian Dream: Just a dream, AMP and NATSEM, July 2011
7. Tax Reform, KPMG submission to Treasury, July 2015
Contacts

Brendan Rynne
Partner and Chief Economist
Ph: 03 9288 5780
Email: bjrynne@kpmg.com.au