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The Australian Competition Policy Research Alliance

Housing Affordability in Australia: A Supply-Side Analysis

Discussion Paper
Housing Affordability in Australia: A Supply-Side Analysis

Discussion Paper
August 2008

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Asking The Questions About Regulation

Australia is experiencing an extended period of record economic growth and it is important to consider the impact of national policy on both metropolitan and regional areas.

The Australian Competition Policy Research Alliance (ACPRA) will ensure regional areas have a strong local voice in the national policy debate, while also considering issues of national importance.

A partnership between the business and academic communities, ACPRA brings together key decision-makers and stakeholders involved in the social and economic development of Australia.

Currently, regional input into the national and state-based economic policy and regulatory environment lacks unified representation and this will be a key aspect of ACPRA's activities.

Through a national alliance, ACPRA offers local business communities the opportunity to drive independent, credible and informed commentary and analysis of government policy.

ACPRA is inviting partners to join this exciting initiative and be part of shaping the economic and social future of regional and metropolitan communities.

ACPRA will ask questions and research alternatives to existing regulations and public sector practice to support a more efficient and effective economic environment.

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With a focus on the role of government regulation of these industries, ACPRA will:

- Identify inefficiencies from duplication and complexity of regulatory structures and processes at all levels of government.
- Examine the temporal and practical relevance of regulatory and legislative instruments.
- Measure the impact of inefficiencies on productivity, business efficiency and service provision.
- Propose alternative policies to streamline regulation, and promote economic growth and improved service delivery.

ACPRA is seeking to build partnerships with organisations that foster and act on a commitment to improving not only their organisation, but the communities in which they operate.

For information on how your business can become involved in ACPRA see The ACPRA Opportunity at the end of this document.
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Reform Recommendations

Significant supply-side reform is needed to address declining housing affordability. In order to address both underlying demand and place downward pressure on new house prices, substantial reform of the entire land and housing supply process, and a greater understanding of the critical role of supply in housing affordability, is required at all levels of government.

The following key recommendations are made:

1. **Address the impact of infrastructure charges on new house prices.**

   A number of options are presented:
   
   - The removal of GST ‘double-dipping’ on infrastructure charges. As per the UDIA NSW (2008a) Broadened GST Margin Scheme, this recommendation also applies to other state and local charges, as well as the cost of raw land.
   - The increased use of GST revenue received by the states from new housing to fund associated infrastructure costs. This would reduce the cost of producing new houses by capturing the windfall profits gained by the states from the introduction of the GST.
   - Expansion of the current federal Housing Affordability Fund into a working capital pool to be used to provide funds for infrastructure contributions. The Fund would be used to provide short-term low-cost financing to developers with repayment to begin at such time as the development begins to produce revenue. This would reduce risk and holding costs and encourage the entry of smaller developers into the market, improving competition. Access to the fund would be conditional on an agreed reduction in final land/dwelling price.
   - The determination of infrastructure contribution costs as a percentage of the final land sale price. This solution was presented by the Urban Taskforce (2008), and accounts for the ability of a particular housing market to sustain the charges, with those able to afford more expensive properties sharing a larger burden of infrastructure costs. This would serve to eliminate the regressive tendency of these types of charges.
   - The return to government debt funded infrastructure provision with the retention of the cost-location-signal of location specific infrastructure charges for areas of high provision cost. This could be achieved either through existing funding transfer mechanisms, through the creation of an Infrastructure Capital Fund or the large scale expansion of the existing federal Housing Affordability Fund. In order to guide development into areas of low cost provision, developer levies would only apply to any additional, location-specific, infrastructure costs. I.e. those costs above a level that reflects the general cost of providing for population growth regardless of its location.

2. **Address the artificial inflation of developable land prices.**

   - A substantial increase in land release targets is needed in order to place downward pressure on developable land prices by reducing vendor expectations, rent seeking, speculation and land holding behaviours.
• A non-adversarial inquiry into land use by the Council Of Australian Governments (COAG) in order to determine the current condition of land and housing supply and the appropriate level of supply increases in order to achieve significant improvements in new house prices. This is an interim step in the creation of a National Land and Housing Supply Committee.
• The creation of an independent National Land and Housing Supply Committee incorporating representatives from all levels of government to forecast ongoing land and housing supply requirements. The body will research the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations. The National Housing Supply Research Council could potentially fulfill this role however it would need to have increased interaction with state and local governments and increased political independence.
• In NSW the land and housing supply would benefit from the increased coordination provided by a state-based Land and Housing Supply Authority such as the Ministerial Council for Land and Housing Supply in Western Australia or a more broadly focussed version of Queensland’s Urban Land Development Authority. This body would work in association with the recommendations of the National Land and Housing Supply Committee.

3. Planning and development approval systems to be made more responsive, with reductions in delays, uncertainties and inconsistencies.

The following recommendations specifically target the NSW planning system however the broad direction of these recommendations – improving the efficiency and responsiveness of the planning system - are applicable to all state planning systems:

• Increased use of complying and exempt development codes.
• The creation of a Concurrence Authority tasked with the facilitation of obtaining concurrences. The Concurrence Authority would improve interaction between the NSW Department of Planning, various state agencies, and local government thereby unifying a currently inconsistent and disorganised series of intergovernmental relationships. In this regard the Authority would play a key role in streamlining the NSW development process by speeding up the approval process, providing clarity and improving applicant submission standards and through the facilitation of informed reform initiatives.
• Use of Independent Hearing and Assessment Panels (IHAPS) moved from an advisory to an approval role in an attempt to depoliticise the approval process. Councils would retain a call in power for problematic developments.
• The use of targeted assessment times to replace the current 40 day blanket ruling.
• The creation of a State Planning Resource Centre to assist under resourced councils in the creation of planning documents and the assessment of complex developments.
• The use of an independent Planning Assessment Commission for state and regionally significant approvals with the Commission able to refer decisions to the Minister where deemed necessary. The Minister would retain approval authority over critical infrastructure projects.
• A move towards merit-based appeals rather than the current predominantly process-based method in the Land and Environment Court should the proposed arbitration scheme prove unsuccessful.
4. **Planning and design requirements to be made with a greater understanding of their economic impacts.**

Policy and regulatory decisions are being made with little regard or understanding of their cost to consumers. Addressing this issue requires the inclusion of economic impacts into regulatory and policy decisions in much the same way as other outcomes are considered. It is therefore recommended that:

- Potential economic and housing affordability impacts are given greater consideration in the creation of all levels of planning schemes and regulations to ensure the efficiency of planning and decision making with regard to both costs and benefits.
- Research into these impacts to be undertaken by the National Land and Housing Supply Committee.

5. **Reductions in the centralisation of the land and housing supply process.**

Looking more broadly, a stronger link between the economic benefits of growth and the entire planning system needs to be established. Centralised planning systems are largely unresponsive to market signals, responding only when issues such as housing affordability become political. This results in inadequate, inappropriate and untimely solutions. International examples, such as Germany and Switzerland, suggest that moves towards decentralising the planning process and strengthening the link between growth and local government revenue capacity have the potential to create a highly responsive land and housing supply system. Such systems are shown to generate quality outcomes in terms of amenity and consumer preferences. However it is acknowledged that this is a substantial goal requiring significant co-operation between all levels of government. To this end the following initial recommendations are made:

- An increased role for local government in COAG in order to facilitate increased interaction between all levels of government and initiate change.
- The creation of an independent National Land and Housing Supply Committee. Incorporating representatives from all levels of government, the Committee will undertake research into the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations.
# Table of Contents

The Australian Competition Policy Research Alliance  
Co-authors  
Reform Recommendations  
Table of Contents  
Index of Figures  
Index of Tables  
Executive Summary  
1. Introduction  
2. What is Housing Affordability?  
   2.1. Domestic Affordability Indicators  
   2.2. International Affordability Indicators  
3. Factors Contributing to Declining Housing Affordability  
   3.1. Australian Urban Development, the Federal Fiscal Imbalance and the Origins of Infrastructure Charges  
   3.2. Infrastructure Charges  
      3.2.1. Infrastructure Funding Arrangements and Equity  
   3.3. Urban Consolidation  
   3.4. The Supply of Land and Land Prices  
      3.4.1. Land Supply Restriction and Urban Fringe Land Prices  
   3.5. Land as a Proportion of House Prices  
   3.6. The Housing Supply Shortfall  
   3.7. Planning Systems and Regulatory Compliance Costs  
   3.8. GST and Other Government Charges  
4. Infrastructure Costs, Land Supply and House Prices: The Situation in NSW  
   4.1. The Land and Dwelling Supply  
   4.2. Factors Influencing the Price of Developed Lots  
   4.3. Infrastructure Costs  
      4.3.1. Infrastructure Levies as a Barrier to Competition and Supply  
   4.4. Land Supply, Landholder Expectations, Land Costs and Dwelling Supply  
   4.5. The Need to Increase Land Release Rates  
5. Other State's Responses to the Housing Supply Shortfall
5.1. The Recent Victorian Response 53
5.2. The Recent Queensland Response 53

6. The Effect of the Planning System on Supply and the Need for Reform 55

7. The NSW Planning System 57
   7.1. The NSW Planning System Process 60
      7.1.1. Land Supply, Rezoning and LEPs 61
      7.1.2. Opportunities for Appeal 65
      7.1.3. Development Approvals 66
      7.1.4. Track-Based Assessment 67
      7.1.5. Assessment Panels 70
      7.1.6. Assessment Panel Use in Other States 71
   7.2. NSW Development Approval Times 75
      7.2.1. Targeted Development Approval Times 76
   7.3. State Government Agency Consultation 77
   7.4. Complexity and Delays as an Incentive to Bypass the Planning System 78
   7.5. Planning Requirements and Prices 79
      7.5.1. Land Use Restrictions 79
      7.5.2. Design Requirements 82

8. International Planning Examples 85
   8.1. Germany 85
   8.2. Switzerland 86
   8.3. Ireland 87

9. Reforming the NSW Planning System 90
   9.1. NSW Planning Reform Recommendations 91
   9.2. National Planning System Reform Recommendations 93

10. The Need for Appropriate Policy Responses 95

11. The Economic Effects of Declining Housing Affordability 99
    11.1. The Housing Industry and Employment 99
    11.2. Household Debt and Mortgage Default 100
    11.3. Household Savings and the Wealth-Effect 102
    11.4. Productivity, Competition and Migration 105
    11.5. Inflation and Monetary Policy 107

12. Conclusion 112

13. Summary of Key Recommendations 115
### Index of Figures

| Figure 1: HIA-CBA Housing Affordability Index 2001 - 2007. | 5 |
| Figure 2: National House Prices and Earnings 1984 - 2006. | 6 |
| Figure 3: National Income Multiple 1984 - 2006. | 6 |
| Figure 4: National UDIA Matusik Affordability Measure Comparison 2001 - 2006. | 7 |
| Figure 5: Households in NSW with housing costs 30% or more of gross income, as a percentage of all households. | 8 |
| Figure 6: Percentage of first home buyers with a mortgage who spend more than 30% of gross income in housing costs. | 8 |
| Figure 7: Housing Affordability Trend Australia, Markets 1981 – 2007. | 9 |
| Figure 8: OECD House Price to Income Ratios, 1970 – 2005. | 10 |
| Figure 9: Interaction of Housing Supply and Demand. | 11 |
| Figure 10: Interaction of Changes in Housing Supply Responsiveness and Demand. | 12 |
| Figure 11: Government Capital Formation as a Proportion of GDP, 1984 – 2002. | 15 |
| Figure 12: Commonwealth and State Government Capital Formation, 1990 – 2002. | 15 |
| Figure 13: Investment in Economic Infrastructure by Sector as a Percentage of GDP. | 17 |
| Figure 14: Sydney Housing Development Infrastructure Charges, 1995 - 2006. | 19 |
| Figure 15: Sydney Land Supply and Average Price, 1991 - 2007. | 24 |
| Figure 16: Australian Residential Land Supply, 2000 – 2006. | 25 |
| Figure 17: Australian Land Prices, 2000 -2006. | 25 |
| Figure 18: Lot Supply v. Indicative Average Lot Price. | 26 |
| Figure 19: Sydney Land Supply Adequacy Model, 2001 – 2026. | 26 |
| Figure 20: Housing Affordability and Land Rationing in Larger International Markets. | 27 |
| Figure 21: Population of Perth and Austin, Texas, 1995 – 2005. | 28 |
| Figure 22: Housing Affordability: Perth & Austin, Texas, 1995 – 2006. | 28 |
| Figure 23: Representative Residential Urban Fringe Vacant Lot Prices. | 29 |
| Figure 24: Postcode-Level House Prices, 2006 – 2007. | 30 |
| Figure 25: Land as a Proportion of Total Dwelling Price. | 31 |
| Figure 26: The Australian Housing Market Belance, 1994 – 2010. | 32 |
| Figure 27: Pent-up Housing Demand by State. | 32 |
| Figure 28: Broadacre Development Total Per-lot Government Charges. | 34 |
| Figure 29: Medium Density Per-lot Total Government Costs. | 34 |
| Figure 30: Broadacre Development Timing. | 35 |
| Figure 31: Medium Density Development Timing. | 35 |
| Figure 32: Taxes and Charges on Sydney Greenfield Development. | 38 |
| Figure 33: Broadacre Development Costs, 2005. | 39 |
| Figure 34: Medium Density Development Costs, 2005. | 39 |
| Figure 35: State Property Tax as a Proportion of the Tax Base. | 39 |
| Figure 36: Dwelling Supply in Greenfield and Existing Areas. | 42 |
| Figure 37: Greenfield Land Supply Process. | 43 |
| Figure 38: Greenfield Lot Production in Sydney, 1990 – 2007. | 44 |
| Figure 39: Dwelling Units Commenced (National) – Total. | 44 |
| Figure 40: Private Dwelling Commenced (National) – Total. | 44 |
| Figure 41: Average Time Taken to Prepare an LEP (by Type). | 61 |
| Figure 42: LEP ‘Streaming’ and the Gateway Process. | 62 |
| Figure 43: Causes of Delays in DA Processing as Identified by Local Government. | 67 |
| Figure 44: Tailoring the Required Sign-off Level to Development Size & Complexity. | 67 |
| Figure 45: Lot Yield Under Current Land Use Requirements. | 80 |
Figure 46: Lot Yield Without Current Land Use Requirements. 81
Figure 47: Lot Yield Under as Per 1920s Development Plan. 81
Figure 48: DA Decision Making Process – NSW Government Reform Proposal. 91
Figure 49: DA Decision Making Process – NSW Alternative Option. 92
Figure 50: Building Approvals and Employment Growth - Australia, 1990 – 2007. 99
Figure 51: Building Approvals and Employment Growth - NSW, 1990 – 2007. 99
Figure 52: Household Credit as a Percentage of Nominal GDP – Australia. 100
Figure 53: Housing Debt to Average Weekly Earnings. 100
Figure 54: Housing Loan Arrears by State. 101
Figure 55: Household Savings as a Ratio of Household Disposable Income. 102
Figure 56: The Evolution of Household Savings Rates in Selected OECD Countries as a Percentage of Disposable Income, 1965 – 2005. 103
Figure 57: Household Saving Rates and Real Asset Price Dynamics, 1972 – 2002. 103
Figure 58: Real House Prices and Fundamentals. 104
Figure 59: Contributions to Growth in Nominal Australian Net Private Sector Wealth at Market Value, 1986 – 2006. 105
Figure 60: Building Approvals v. Interest Rates, 1985 – 2008. 110
Figure 61: Total Dwelling Units Approved Nationally, March 2002 – March 2008. 110
Figure 62: Dwelling Units Approved in NSW, March 2002 – March 2008. 110
Index of Tables

Table 1: HIA-CBA Housing Affordability Index, March 2005 - September 2007. 5
Table 2: Demographia Housing Affordability Ratings. 9
Table 3: National Infrastructure Costs Study: Direct and Indirect Infrastructure. 18
Table 4: Taxes and Charges on House and Land Packages. 20
Table 5: Sydney Lot Supply, Average Lot Size and Average Price, 1991-2007. 25
Table 6: Typical New House and Land Prices by Capital City, 1973 – 2006. 31
Table 7: Broadened GST Margin Scheme. 36
Table 8: Fees, Taxes and Charges on New Residential Development. 37
Table 9: Federal, State and Local Government Taxes on Housing. 38
Table 10: Revised Indicative Developer Contribution Levies. 46
Table 11: Average Per-lot Developer Costs in Sydney’s Growth Centres. 47
Table 12: Impact of Levies on Urban Development in Sydney’s Growth Centres. 50
Table 13: Cost Imposed by SEPP 65 on a Five Storey Residential Tower With Basement Car Parking and Eight Apartments per Level. 83
Table 14: Typical Developer Costs for a Two Bedroom Apartment in Sydney’s Middle to Outer Rings. 83
Table 15: Consumer Demand for an ‘Affordable’ Two Bedroom Apartment in Key Local Government Areas of Sydney (GST Exclusive). 83
Executive Summary

Housing affordability has declined severely in Australian in the past two decades. This has resulted from an increasing divergence between income and house price growth, combined with the effects of increasing interest rates on mortgage repayments. Since the mid 1980s median house prices have increased almost five fold while average wages have barely doubled (UDIA, 2007, p.10). The decline in affordability in NSW has been particularly strong with Sydney - Australia’s least affordable capital city - now less affordable than London and New York (Demographia, 2008, p.8).

By the broadly accepted measure of housing affordability - that expenditure on housing accounts for no more than 30% of disposable household income - more than 23% of Australian households are now experiencing housing stress. For recent home buyers this figure now exceeds 60% (AMP-NATSEM, 2008, p.2). A number of alternate domestic and international affordability measures have similarly captured the scale of this decline including the Housing Industry of Australia – Commonwealth Bank Housing Affordability Index which is orientated towards first home buyers.

Home ownership is of significant cultural importance in Australia and homes play a key role as the primary financial asset for the majority of Australian households. To this end, while the importance of rising rents on housing affordability is acknowledged, the key focus of housing affordability remains home ownership.

Consideration of the land/housing supply process - with an emphasis upon the situation in NSW and Sydney’s Growth Centres as a key source of new dwellings - indicates that supply-side factors have played an important role in declining housing affordability by contributing significantly to the increased price of new dwellings and restraining their supply. The general conclusion drawn is that changes in infrastructure funding, in combination with restrictions in land supply, land use and design requirements and the planning and approval systems have greatly increased the costs of new dwelling production. Acting in combination with increases in demand they have created an effective rising floor for house prices which is reducing supply in the current period of rising interest rates.

The impact of supply-side restrictions and cost increases on new dwelling prices is particularly concerning as new dwellings on the urban fringes have traditionally represented an affordable entry into the housing market for a large proportion of first home buyers. If increases in house prices were largely constrained to established and inner city areas, while entry level homes on our city’s urban fringes remained affordable, there would be little reason to refer to the current situation as a housing affordability crisis.

The origin of restricted land supply releases and developer infrastructure charges is the federal-state fiscal imbalance and the fiscal consolidation of the federal government post the 1970s economic crisis. The desire to reduce expenditure at the federal level impacted the states ability to fund infrastructure, resulting in the costs of infrastructure provision being increasingly transferred to developers. While infrastructure levies were originally established to recover the costs associated with infrastructure necessary to a particular development, over time they have been applied to an increasingly broad range of infrastructure less directly related to a specific development. This has included public pools, childcare facilities, libraries.
and museums and ‘infrastructure’ as diverse as dog euthanasia freezers (NSW DoP, 2008d, p.15).

The impact of this transfer on housing affordability is significant. For example, in Sydney per-lot infrastructure charges have increased more than fourfold in the last 10 years and now add more than $50,000 to the price of a developed lot (UDIA, 2007, p.32). In contrast the Consumer Price Index (CPI) has increased by approximately one third over the same period (ABS, 2008c) and the cost of actual house construction has increased by less than 80% (HIA, 2006b, p.2 & ABS, 2002).

The transfer of infrastructure funding from the previous method of government funded debt, recovered over time through broad-based taxes, has resulted in a significant shift in intergenerational equity. Younger Australians are now effectively paying up front in the form of increased new house prices for infrastructure older Australians had paid for by the general community.

The states similarly attempted to reduce their infrastructure expenditure by controlling the location and nature of development through policies of controlled land release and land use restriction, such as targeted growth and urban consolidation. A key aim of these policies is to direct development into areas of least cost to government in terms of infrastructure provision and there has been little regard shown for their impact on the cost of housing. This has resulted in an array of planning restrictions and the widespread use of centrally developed growth strategies which determine ‘appropriate’ land release targets and the allowable types of land use. These broad strategies then flow into locally developed land use plans.

Given the relative physical abundance of land at our city’s fringes unrestricted land prices should be more closely aligned to their alternate use value such as agriculture. However restricted land releases have greatly increased the price of developable land and encouraged speculation and land holding - an outcome that is also apparent internationally. Such restrictions promote high vendor expectations and act as a restriction to competition while maintaining high prices. Vendor expectations and land sale prices in Sydney’s Growth Centres for example reflect these restrictions, with per hectare prices as high as $1.2 million being achieved (HIA-APM, 2007b). By contrast, in comparable cities with minimal restrictions, such as Dallas Fort-Worth, urban fringe land prices are around a quarter of those in major Australian cities.

Developable land price increases drive the price of saleable lots, resulting in a dramatic increase in price, both in real terms and as a share of the cost of a new house and land package. Per-lot broad-hectare land prices have increased more than $200,000 in the last 15 years (UDIA, 2006, p.13) with land as a proportion of total house and land package price now exceeding 40% in all but one of Australia’s capital cities. In Sydney it is approaching 60% (HIA-APM, 2007b, p.2).

Land use regulation and planning requirements are affecting the productive yields of residential developments and increasing the price of lots which flows through to the price of completed house and land packages. Case studies indicate that land restrictions may result in a reduction in residential development lot yield of up to 40%. Similarly, design requirements are shown to increase the cost of residential apartments in areas of Sydney beyond market viability. While such requirements may well have significant benefits, such as increased amenity, they must be considered against their resulting costs and there is little indication to suggest that this is the
case. The economic impacts of these types of requirements need to be given more consideration particularly as their effects are greatly exacerbated by a restricted land supply and the attendant increased land costs.

The planning system, in particular the development approval process, impacts housing affordability by increasing the costs, time delays and uncertainties associated with the production of new dwellings. As all forms of significant residential development require some form of approval, overly restrictive and complex planning systems reduce the responsiveness of supply and affect the price of new dwellings by increasing production costs, an effect noted by the OECD (2005, p.10).

The situation in NSW is concerning, with the average development approval time currently 68 days – well in excess of the statutory 40 days – compared to an average of 22 days a decade ago (DIPNR, 2003a, p.18). These delays, combined with other uncertainties in the process, are estimated to contribute as much as $40,000 to the cost of a $350,000 home (NSW UTF, 2007). The implications for housing affordability are clear. The planning system in NSW in particular has become overly complex with a multiple layering of requirements from different levels of government and departments, which are sometimes conflicting. The system contains a range of inconsistent and disorganised policy and intergovernmental relationships and is prone to focusing on its own process rather than outcomes. Yet the process is often unclear and at times subjective. The result is the substantial diversion of resources into negotiating the approval process, increased costs and reduced certainty. The cost of this diversion is ultimately borne by the consumer.

The cumulative effect of infrastructure charges, land supply restrictions, land use and design requirements, and the complexity of planning and approval systems are reflected in greatly decreased housing affordability and the current failure of supply to meet underlying demand – demand stemming from population growth and changing household demographics – by an estimated 20,000+ dwellings per annum (Braddock, 2007, p.11). In NSW, which has the most pronounced shortfall of all the states, the interaction between cost-inducing supply-side restrictions and the general dwelling supply is telling.

Greatly increased leveraged purchasing power - the result of strong economic and borrowing conditions - previously enabled borrowers to meet the increasing cost of supply-side burdens. However new home buyers are now increasingly unwilling or unable to meet these costs - particularly in light of the current economic uncertainties - reducing supply in the face of strong underlying demand. This outcome can be seen in the dramatic reduction in new dwelling commencements since widespread house price increases in 2002-2003 (ABS, 2008c). A similar trend is noticeable nationally and inadequate supply will continue to place upward pressure on house prices. This implies further reductions in affordability particularly in the face of predicted further interest rate rises.

The supply of new dwellings is ultimately dependent on the private sector which transforms developable land, zoned for residential development by the government, into saleable dwellings. If supply is to be ensured policies which potentially increase the cost of this process must be considered within the context of the commercial viability of development. A variety of policies and planning regulations appear to have been made with little, if any, consideration of the economic effects, specifically on housing affordability, and often focus solely on reducing costs to government. These outcomes are symptomatic of a centralised and unresponsive planning system.
In NSW the recently proposed changes to attributable infrastructure charges and the planning system are an acknowledgement of many of these issues. However these changes will have limited impact in the current economic climate, and do not go far enough to address the significant impact of infrastructure charges on new house prices. As a result, the costs of production will remain dangerously close to viable limits. Land release targets are still overly restrictive and are aimed at ‘meeting’ demand with little margin for error. This strategy is currently resulting in a substantial housing shortfall and needs to be rethought in order to place downward pressure on developable land prices. This will improve the price at which new houses can be brought to market and the viability of development. Proposed planning system reforms have some promising aspects - such as the increased use of complying development to free up resources for the assessment of more complex development. However there is a focus on the centralisation of consent which, as examples of overseas planning systems suggest, reduces the responsiveness of the system to changes in the market. Consent requirements from a variety of government agencies and conflicting planning requirements receive little consideration yet form a considerable barrier in the approval process.

The decline in housing affordability has significant social and economic implications for the nation. It is associated with declining levels of young Australians entering into home ownership and increasing mortgage default rates. Increased house prices have greatly increased the interest rate sensitivity of those paying off mortgages, with home buyers now almost twice as sensitive to interest rate changes as they were twenty years ago due to the greatly increased cost of houses (Kryger, 2006). This is particularly concerning in the face of predicted interest rate rises and has significant implications for the continued social and political acceptance of anti-inflationary monetary policy.

Monetary policy is also affected by the consumption-increasing wealth-effect associated with house price increases. House price growth functions as an increase in wealth for existing homeowners, encouraging reduced saving and increased consumption expenditure. Further, the displacement of traditional forms of saving into housing affects the availability of domestic investment capital and has potential implications for national productivity. All of these issues are made more concerning by the fact that house prices have been inflated beyond fundamentals by artificial restrictions and the relatively easy availability of credit in a period of favourable economic conditions. As a result, both government and individual decisions are being made on the basis of inaccurate wealth estimations.

The excessive restriction of the housing supply - through a combination of land release, land use and development regulation - has created a structural flaw in Australia’s housing market. This flaw has been able to develop to its current extent as a result of the wide availability of leveraged purchasing power. The current uncertain economic conditions are revealing the full extent of problem as home buyers become increasingly unable or unwilling to meet the increased new house prices. The result is a perverse situation in which the supply of new houses is failing to meet underlying demand as the price of new homes reach and exceed the practical limits of buyer borrowing capacity.

The conclusion drawn is that substantial reform of the entire land/housing supply process is necessary in order to address this flaw, improve the responsiveness of the housing supply to demand and address housing affordability, particularly for entry level buyers.
Key Supply-Side Factors

The following key supply-side factors are identified as contributing to new house price increases:

1. **Infrastructure cost transferral to the private sector in the form of developer levies**. Infrastructure levies now add significantly to the cost of producing new dwellings, with NSW, and Sydney’s Growth Centres in particular, having the highest levies nationally. The magnitude of these levies has risen sharply in recent years and the inclusion of non-directly related infrastructure is particularly concerning.

2. **Restrictive land supply releases in the form of targeted growth strategies**. Attempts to direct growth through such strategies and their attendant policy mechanisms has resulted in the excessive restriction of developable land. This has resulted in significant increases in the cost of land as an input to new dwellings and encouraged/enabled speculative investment and land holding behaviours.

3. **The complexity, inconsistency, and delays associated with development approval processes**. Both the cost and supply of new dwellings are impacted by the approval system. Development must be commercially viable in order to ensure the adequate supply of new dwellings. The approval process affects the commercial viability of development by producing extensive delays, which increase holding costs; complex and conflicting requirements, which create both time delays and compliance costs; and inconsistent outcomes, which increase the risk and uncertainty of development.

4. **Restrictive and costly planning and design requirements**. The extensive array of planning and design requirements place costly requirements upon residential development. These requirements reduce lot yields and increase the production costs of dwellings, placing upward pressure on new dwelling prices and further impacting development viability.

5. **A centralised system of planning and revenue that is unresponsive to market signals**. Current planning and fiscal arrangements between the three levels of government have severed the link between the costs and benefits of development. State and local governments are predominantly responsible for the costs associated with development yet their revenue is not strongly linked to growth. This has resulted in a broad focus on managing the costs to government that result from development – hence developer levies and land supply restrictions – and little incentive to improve and streamline planning and approval processes.
Reform Recommendations

Significant supply-side reform is needed to address declining housing affordability. In order to address underlying demand and place downward pressure on new house prices, substantial reform of the entire land and housing supply process and a greater understanding of its critical role in housing affordability is required at all levels of government.

The following key recommendations are made:

1. **Address the impact of infrastructure charges on new house prices.**

   A number of options are presented:
   
   - The removal of GST "double-dipping" on infrastructure charges. As per the UDIA NSW (2008a) Broadened GST Margin Scheme, this recommendation also applies to other state and local charges and the cost of raw land.
   - The increased use of GST revenue received by the states from new housing to fund associated infrastructure costs; this would reduce the cost of producing new houses by capturing the windfall profits gained by the states from the introduction of the GST.
   - Expansion of the current National Housing Affordability Fund into a working capital pool to be used to provide funds for infrastructure contributions. The Fund would be used to provide short-term low-cost financing to developers with repayment to begin at such time as the development begins to produce revenue. This would reduce risk and holding costs and encourage the entry of smaller developers into the market, improving competition. Access to the Fund would be conditional on an agreed reduction in final land/dwelling price.
   - The determination of infrastructure contribution costs as a percentage of the final land sale price. This solution was presented by the Urban Taskforce (2008) and accounts for the ability of a particular housing market to sustain the charges with those able to afford more expensive properties sharing a larger burden of infrastructure costs. This would serve to eliminate the regressive tendency of these types of charges.
   - The return to government debt funded infrastructure provision with the retention of the cost-location-signal of location specific infrastructure charges for areas of high provision cost. This could be achieved either through existing funding transfer mechanisms, the creation of an Infrastructure Capital Fund or the large scale expansion of the existing National Housing Affordability Fund. In order to guide development into areas of low cost provision, developer levies would only apply to any additional, location-specific, infrastructure costs. I.e. those costs above a level that reflects the general cost of providing for population growth regardless of its location.

2. **Address the artificial inflation of developable land prices.**

   - A substantial increase in land release targets is needed in order to place downward pressure on developable land prices by reducing vendor expectations, rent seeking, speculation and land holding behaviours.
• A non-adversarial inquiry into land use by COAG in order to determine the current condition of land and housing supply and the appropriate level of supply increases in order to achieve significant improvements in new house prices. This is an interim step in the creation of a National Land and Housing Supply Committee.

• The creation of an independent National Land and Housing Supply Committee incorporating representatives from all levels of government to forecast ongoing land and housing supply requirements. The body would research the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations. The National Housing Supply Research Council could potentially fulfil this role however it would need to have increased interaction with state and local governments and increased political independence.

• In NSW, the land and housing supply would benefit from the increased coordination provided by a state-based Land and Housing Supply Authority, such as the Ministerial Council for Land and Housing Supply in Western Australia or a more broadly focussed version of Queensland’s Urban Land Development Authority. This body would work in association with the recommendations of the National Land and Housing Supply Committee.

3. Planning and development approval systems to be made more responsive, with reductions in delays, uncertainties and inconsistencies.

The following recommendations specifically target the NSW planning system however the broad direction of these recommendations – improving the efficiency and responsiveness of the planning system - are applicable to all state planning systems:

• Increased use of complying and exempt development codes and private certifiers.

• The creation of a Concurrence Authority tasked with the facilitation of obtaining concurrences. The Concurrence Authority would improve interaction between the NSW Department of Planning, various state agencies and local government, thereby unifying a currently inconsistent and disorganised series of intergovernmental relationships. In this regard the Authority would play a key role in streamlining the NSW development process by speeding up the approval process, providing clarity and improving applicant submission standards and through the facilitation of informed reform initiatives.

• Use of Independent Hearing and Assessment Panels (IHAPS) moved from an advisory to an approval role in an attempt to depoliticise the approval process. Councils would retain a call in power for problematic developments.

• The use of targeted assessment times to replace the current 40 day blanket ruling.

• The creation of a State Planning Resource Centre to assist under-resourced councils in the creation of planning documents and the assessment of complex developments.

• The use of an independent Planning Assessment Commission for state and regionally significant approvals with the Commission able to refer decisions to the Minister where deemed necessary. The Minister would retain approval authority over critical infrastructure projects.

• A move towards merit-based appeals rather than the current predominantly process-based method in the Land and Environment Court, should the proposed arbitration scheme prove unsuccessful.
4. **Planning and design requirements to be made with a greater understanding of their economic impacts.**

Policy and regulatory decisions are being made with little regard or understanding of their cost to consumers. Addressing this issue requires the inclusion of economic impacts into regulatory and policy decisions in much the same way as other outcomes are considered. It is therefore recommended that:

- Potential economic and housing affordability impacts are given greater consideration in the creation of all levels of planning schemes and regulations to ensure the efficiency of planning and decision making with regard to both costs and benefits.
- Research into these impacts to be undertaken by the National Land and Housing Supply Committee.

5. **Reducing the centralisation of the land and housing supply process.**

Looking more broadly, a stronger link between the economic benefits of growth and the entire planning system needs to be established. Centralised planning systems are largely unresponsive to market signals, responding only when issues such as housing affordability become political. This results in inadequate, inappropriate, and untimely solutions. International examples, such as Germany and Switzerland, suggest that moves towards decentralising the planning process and strengthening the link between growth and local government revenue capacity have the potential to create a highly responsive land and housing supply system. Such systems are shown to generate quality outcomes in terms of amenity and consumer preferences. However it is acknowledged that this is a substantial goal requiring significant co-operation between all levels of government. To this end the following initial recommendations are made:

- An increased role for local government in COAG in order to facilitate increased interaction between all levels of government and initiate change.
- The creation of an independent National Land and Housing Supply Committee. Incorporating representatives from all levels of government, the Committee will undertake research into the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations.
1 Introduction

Australian society has traditionally placed great importance on home ownership. Our clear historical preference for owning our own homes is reflected in our consistently high rates of ownership (ABS, 2004). This preference has become so ingrained in the national culture that owning your own home is referred to as the "Great Australian Dream". Australia’s high rate of typically suburban home ownership has been praised for its role in the maintenance of Australian society by a range of Australian social figures including Sir Robert Menzies and John Howard. The cultural preference for owning our own homes in the suburbs was at first imported from England, however it was enabled by Australia’s high wages and favourable economic conditions (Froat & Dingle, 1995, p.23). High incomes combined with low land prices resulted in one of the highest home ownership rates in the world for many decades (Powell & Withers, 2004, p.1). Given Australia’s clear historical preference for home ownership this assessment of housing affordability will primarily focus on the home ownership aspect of housing affordability.

Home ownership plays an important role by providing for fundamental needs, such as shelter, safety and stability. Moreover the benefits home ownership provides in terms of quality of life include a sense of well being, financial stability and the generation of a sense of community. These factors are not easily measured in a quantitative sense (Powell and Withers, 2004, p.1).

Beyond the societal and individual benefits of home ownership an efficient and functional housing market is important to the nation’s economy in a number of ways. Housing accounts for around 80% of total Australian household debt and is the primary asset for most Australian households (Treasury, 2007). Changes in house prices therefore have significant implications for national savings as an increasing percentage of Australians appear to view housing as an alternative to traditional forms of saving. This in turn has implications for investment, consumer spending via the wealth-effect\(^1\) and the effects of inflation-targeting monetary policy. Further, the economic importance of the residential building sector to Australia’s economy should not be underestimated; new housing construction contributed over $31 billion to the Australian economy in 2005-06 (ABS, 2008a), with around 400,000 people directly employed in residential construction (Bond, 2003, p.2). The housing construction industry is strongly linked to other parts of the Australian economy (ABS, 2007f), and the housing sector is considered to be a leading indicator of the state of the general economy (ABS, 2003). The affordability of housing, and land in general, also has implications for Australia’s competitiveness both internally, between states and regions, and internationally.

While Australia has a long history of widespread and affordable home ownership, in recent years there has been a substantial reduction in housing affordability - to the point where widespread media reports indicate that an increasing number of younger Australians now consider home ownership to be out of reach. The potential exists for home ownership in Australia, particularly in the capital cities and major centres, to become divided between the wealthy and middle income earners, who were fortunate enough to have purchased prior to the decline in affordability, and those on middle to lower incomes who will be unable to enter the market. Further, it is clear that the increase in house prices represents a substantial

\(^1\) The wealth-effect refers to the tendency for an increased proportion of income to be used for consumption as individual (or household) wealth increases.
devaluation of the future earnings of those who did not purchase prior to this period. Regrettably this means that a large proportion of younger Australians will struggle to purchase a house even if they hold good jobs. Australian Bureau of Statistics (ABS, 2007d) data indicates the impact of declining housing affordability on young first home buyers, with the percentage of first home buyers as a proportion of the total market falling from 21.8% to 17.5% over the period June 1996 to Feb 2007. The number of 18-34 year olds purchasing houses has also fallen, from 48% to 44% in the decade 1994-2004 (ABS, 2006). Declining housing affordability then may be seen as expressing and reinforcing inequality (particularly intergenerational inequality) in Australian society (Berry & Dalton, 2004, p.70).

Given the significance of housing affordability and its strong decline it is important to determine whether this is a legitimate outcome of a functional housing market or whether there are structural issues within the housing market that are resulting in price distortions. While it is acknowledged that there are a number of issues specific to the housing market - such as housing having consumptive and investment aspects, the tendency of house and land prices to resist downward movements and issues of substitution and location – the housing market is fundamentally the same as all markets. Price is determined by the interaction of supply and demand, with an increase in demand resulting in an increase in price if not met by a commensurate increase in supply. While the importance of demand factors in the recent decline in housing affordability is readily acknowledged, it is noted that increases in consumer credit enabled by a combination of favourable economic conditions and financial deregulation are not a factor contained to the Australian housing market. As international examples demonstrate, such demand increases need not result in a widespread decline in affordability. Explanations of the current housing affordability situation solely in terms of demand factors ignore the role of supply in providing affordable housing for those seeking to enter the market and do not address the current failure of supply to meet underlying demand\(^2\). The resulting shortfall will continue to place upward pressure on house prices and rents. Importantly, such explanations imply a course of inaction that will do little to prevent a reoccurrence, barring a dramatic regression in the Australian financial system, and a sustained period of national economic malaise.

There are a number of supply-side factors that have contributed to declining housing affordability by increasing the cost of producing new dwellings, reducing the responsiveness of supply and, through their interaction with current economic conditions, reducing the new dwelling supply. These factors include the transfer of infrastructure costs to the private sector via developer levies, the restriction of the supply of developable land and attendant price increases, restrictive and costly regulations and the complexity and inconsistency of the development approval process. Consideration of the situation in NSW indicates the dramatic increase in new dwelling prices that have resulted from these factors and the on-flow effect on supply under current market and broader economic conditions. New dwelling prices have reached the limit of new home buyer’s capacity to borrow and consequently new dwelling commencements have fallen off dramatically. These factors are greatly affecting affordability.

The origins of these factors-particularly infrastructure charges and restricted land releases-resides in the imbalance between the revenue and expenditure responsibilities of the different levels of government; the federal fiscal imbalance. Associated with this imbalance is an unresponsive, restrictive and centralised planning system and a lack of consideration of the impacts of regulation on housing affordability. Decisions are made with an emphasis on the

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\(^2\) Demand resulting from population growth and demographic changes.
reduction of costs to government that stem from development and little concern for their economic impacts due to the weak link between the benefits of growth and the cost of development to state and local governments.

Far from being a new occurrence, the supply of land/houses is a recurring Australian historical issue, as is government intervention. Australia's earliest land supply controls and land use regulations dates back to Governor Arthur Phillip, with land in Sydney being made available for housing on the basis of its use meeting Governor Phillip's ideas of town planning (Marsden, 2000, p.27). Interestingly, Sydney was also the location of Australia's first attempt to control sprawl and infrastructure costs using strategic planning; the 1948 County Cumberland Plan (Searle, 2007, p.1). Recent land price increases are also not without historical precedent, nor are price increases associated the government restriction of the land supply and accompanying speculation, which has been noted as early as the 1830s in Melbourne (Sandercock cited Paris, 1993, pp.134-135). In the late 1940s and 1950s the lack of housing production was so severe it had become a political campaigning issue. At the time under supply was the result of under production during the depression and WWII. Combined with strong immigration levels this resulted in a shortage of around 300,000 houses nationally (CHC cited Bourassa & Grieg, 1995) and spiralling prices. These conditions triggered widespread increases in new dwelling construction as government's scrambled to deliver land and infrastructure. It also pre-empted a number of quick fix solutions, notably a broad increase in the number of low-amenity high-rise flat blocks. This type of rapid - yet ultimately problematic - solution has recently occurred in Ireland in response to their affordability crisis and appears to be symptomatic of heavily controlled and centralised planning systems. These types of recurring issues provide a historical context to the current housing affordability crisis and suggest there has long been a trend towards short-term and reactive solutions to housing problems in Australia, with ineffective government intervention a common theme. Addressing the current housing affordability crisis will require appropriate reforms if they are not to result in yet another short-term solution.

With recent analysis (Yates, Kendig, Phillips, Milligan & Tanton, 2008, pp.2-3) suggesting that the situation in the Australian housing market is unsustainable and further declines in affordability assured in the absence of reform, questions regarding which factors are driving the decline in affordability are of interest only in so far as they can inform solutions to mitigate impacts and prevent continued decline. To this end consideration must be given to the supply-side of the housing market within the context of an increasingly deregulated and innovative banking sector, and with respect to varying economic conditions.
What is Housing Affordability?

The broadly accepted measure of housing affordability is that expenditure on housing accounts for no more than 30% of household income (AMP-NATSEM, 2008, p.2; Rudd, 2008b & Australian Government, 2008, p.4). This measure is historically based on both general housing and financial institution lending practices. Households spending beyond this level, be it on rent or servicing mortgage repayments, are typically considered to be suffering from housing (or mortgage) stress – where housing payments are impacting upon their ability to consume normally particularly if interest rates fluctuate (HIA, 2007b). This measure reflects the underlying disparity between the rates of income and house price growth and changes in interest rates.

A number of alternate domestically-produced affordability measures are considered in this report, including the Housing Institute of Australia–Commonwealth Bank of Australia Housing (HIA-CBA) Housing Affordability Index, the UDIA/Matusik Affordability Measure and the Deposit Power/REIA Home Loan Affordability Report. Each of these measures has a different focus and they use differing methodologies. The HIA-CBA Housing Affordability Index measures the accessibility of home ownership for an average first time home buyer by measuring the ratio of average household disposable income to the income required to qualify to make payments on a typical house (HIA-CBA, 2007). The UDIA/Matusik Affordability Measure is based on the average household being able to afford to buy 51% or more of the housing for sale in their local area assuming 30% of household income is used to make mortgage payments. The UDIA also compare average full-time earnings and median house prices to create a National Income Multiple measure of house prices (UDIA, 2007). The Deposit Power/REIA Home Loan Affordability Report calculates the proportion of family income needed to meet home loan repayment requirements based upon the median weekly family income, the average size of a new home loan and the average variable interest rate over the quarter (REIA, 2007).

Also reported is the internationally produced Demographia Median Multiplier - which is similar to the UDIA National Income Multiple and compares the number of multiples of the median family income per annum needed to pay for a median priced home –as well as OECD comparisons of nominal house prices to per capita disposable incomes.

Regardless of the measurement method adopted housing affordability in Australia has been steadily declining over the past decade, with Prime Minister Kevin Rudd recently noting that housing affordability is currently the worst it has been in living memory (Rudd, 2008b). The combination of greatly increased house prices and twelve straight interest rate rises have eroded income growth, with affordability declining to such an extent that it is now a topic regularly covered in the mainstream media. The decrease in affordability has been accompanied by an increase in mortgage repossessions and the recent downturn in new building approvals suggests that the supply of housing will remain constrained in the short to medium term. Calls for action from both housing industry representatives and community groups are becoming increasingly common. With a current national housing supply shortfall,
and the potential for continued interest rate rises in response to inflation and the global credit crunch, further reductions in housing affordability are predicted.

2.1 Domestic Affordability Indicators

Various domestically produced government and industry reports illustrate the downward trend in affordability.

The widely publicised HIA-CBA Housing Affordability Index\(^5\) 2007 September Quarter Report indicates that affordability is continuing to fall, maintaining a downward trend that has been the norm for at least the past seven years. The 2.1% fall in the quarter was the result of a 1.7% increase in median house prices combined with a 0.25% interest rate rise which offset strong household income growth. The changes put housing affordability at 8.3% lower than the same period in the previous year:

![Housing Affordability Index Australia](image)

Figure 1: HIA-CBA Housing Affordability Index 2001 - 2007. (Source: HIA-CBA, 2007)

<table>
<thead>
<tr>
<th>Month</th>
<th>First Home Buyer Price</th>
<th>First Home Buyer Rents</th>
<th>Monthly Rental Payment</th>
<th>Average Annual Household Income</th>
<th>Qualifying Annual Income</th>
<th>Housing Affordability Index</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td>$</td>
<td></td>
</tr>
<tr>
<td>March</td>
<td>334,100</td>
<td>9.58</td>
<td>2,110</td>
<td>83,500</td>
<td>82,300</td>
<td>22,800</td>
</tr>
<tr>
<td>April</td>
<td>337,000</td>
<td>6.75</td>
<td>1,800</td>
<td>83,500</td>
<td>74,500</td>
<td>24,100</td>
</tr>
<tr>
<td>May</td>
<td>360,100</td>
<td>6.75</td>
<td>2,010</td>
<td>89,000</td>
<td>70,700</td>
<td>24,100</td>
</tr>
<tr>
<td>June</td>
<td>368,100</td>
<td>6.75</td>
<td>2,310</td>
<td>87,000</td>
<td>70,700</td>
<td>24,100</td>
</tr>
<tr>
<td>July</td>
<td>370,000</td>
<td>6.75</td>
<td>2,040</td>
<td>88,200</td>
<td>71,500</td>
<td>24,100</td>
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<td>358,200</td>
<td>6.75</td>
<td>2,170</td>
<td>90,400</td>
<td>71,900</td>
<td>24,100</td>
</tr>
<tr>
<td>Sept</td>
<td>367,300</td>
<td>7.17</td>
<td>2,220</td>
<td>91,000</td>
<td>72,400</td>
<td>24,100</td>
</tr>
<tr>
<td>Oct</td>
<td>397,300</td>
<td>7.56</td>
<td>2,350</td>
<td>90,000</td>
<td>74,100</td>
<td>24,100</td>
</tr>
<tr>
<td>Nov</td>
<td>333,800</td>
<td>7.16</td>
<td>2,380</td>
<td>90,900</td>
<td>75,600</td>
<td>24,100</td>
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<td>Dec</td>
<td>343,200</td>
<td>7.75</td>
<td>2,605</td>
<td>97,100</td>
<td>80,200</td>
<td>24,100</td>
</tr>
</tbody>
</table>

Table 1: HIA-CBA Housing Affordability Index, March 2005 - September 2007. (Source: HIA-CBA, 2007)

The latest fall puts the Housing Affordability Index at 94.9, having fallen over 50% in the past decade. Typical monthly loan repayments have increased nearly $400 since the same period in 2006 and now account for 31.7% of total first home buyer income (HIA-CBA, 2007).

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\(^5\) Recall that the HIA-CBA Home Affordability Index measures the accessibility of home ownership for an average first time home buyer by measuring the ratio of average household disposable income to the income required to qualify to make payments on a typical house. For further information regarding the methods of compilation see [http://economics.hia.asn.au](http://economics.hia.asn.au)
The Australian Bureau of Statistics (2007d) has noted similar increases, finding that between 2002/03 and 2005/06 there was an increase in average weekly housing costs (adjusted for inflation) for first home buyers with a mortgage of over $110.

The Deposit Power/REIA Home Loan Affordability Report shows a similar overall trend with home loan affordability at a 22 year low and 36.6% of family income being required to meet average home loan repayments. The situation in NSW is even worse with 38.3% required\(^6\) (REIA, 2007).

The Urban Development Institute of Australia’s (UDIA, 2007) recent affordability report indicates the increasing divergence between earnings and house prices, with house prices rising approximately 490% in the period 1984 – 2006 while earnings have only risen approximately 180% over the same period:

![Graph showing national house prices and earnings from 1984 to 2006.](Figure 2: National House Prices and Earnings 1984 - 2006. (Source: UDIA, 2007, p.10))

The divergence of average full time adult earnings and annual median house prices is captured in their National Income Multiple:

![Graph showing national income multiple from 1984 to 2006.](Figure 3: National Income Multiple 1984 - 2006. (Source: UDIA, 2007, p.10))

\(^6\) Recall that the Deposit Power/REIA Home Loan Affordability Report calculates the proportion of family income needed to meet home loan repayment requirements based upon the median weekly family income, the average size of a new home loan and the average variable interest rate over the (September) quarter.
The decreases in housing affordability\footnote{Recall that the UDIA/Matusik Affordability Measure is based on the average household being able to afford to buy 51\% or more of the housing for sale in their local area assuming 30\% of household income is used to make mortgage payments. Further information on the measure is available in the report.} are dramatically illustrated in a comparison of state-by-state affordability changes in the 5 years between 2001 and 2006:

![Map showing affordability changes in 2001 and 2006.](image)

Figure 4: National UDIA Matusik Affordability Measure Comparison 2001 - 2006.
(Source: UDIA, 2007, p.13)

According to the UDIA (2007, pp.28-29) report housing affordability in NSW has decreased markedly, with Sydney having the unenviable status of being Australia's least affordable city - median mortgage repayments in Sydney are 40\% higher than the national median, while incomes are only 12\% higher. Median home loan repayments in Sydney have increased 77\% in the 10 years from 1996 to 2006, as have rental costs, with Sydney's median weekly rent rising 50\% over the same period. Of the 70 key metropolitan centres the report focuses on there was a recorded decline from a level of 96\% affordability to 39\% affordability in the five years from 2001 to 2006 (UDIA, 2007, p.14).

Latest research commissioned by the Rudd Government (FaHCSIA, 2008) shows that, by the broadly accepted measure, 1.1 million lower to middle income households are in housing stress and are therefore spending over 30\% of their household income on housing. This figure has risen by 220,000 households since 2004. Over the same period the number of Australian families with children in housing stress has more than doubled to 575,000.
The following diagram from the Australian Bureau of Statistics (2007a) indicates the percentage of households in NSW whose housing costs exceed 30% of their gross household income:

Figure 5: Households in NSW with housing costs 30% or more of gross income, as a percentage of all households.
(Source: ABS, 2007a)

ABS (2007c) data also indicates that the percentage of first home buyers with a mortgage spending greater than 30% of their gross income on the costs of housing has been steadily increasing in recent years:

Figure 6: Percentage of first home buyers with a mortgage who spend more than 30% of gross income in housing costs. (Source: ABS, 2007d)
2.2 International Affordability Indicators

The recently released *Demographia 4th Annual International Housing Affordability Survey: 2008* provides a comparative international assessment of Australia's declining housing affordability. The survey uses an alternative measure of housing affordability; the Median Multiple, which is a ratio of median house prices to median household incomes. As shown in Table 2, a result of three or less indicates affordable housing, i.e. the (median) price of a house will represent three or less years of (median) household income:

<table>
<thead>
<tr>
<th>Rating</th>
<th>Median Multiple</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severely Unaffordable</td>
<td>5.1 &amp; Over</td>
</tr>
<tr>
<td>Seriously Unaffordable</td>
<td>4.1 to 6.0</td>
</tr>
<tr>
<td>Moderately Unaffordable</td>
<td>3.1 to 4.0</td>
</tr>
<tr>
<td>Affordable</td>
<td>3.0 or Less</td>
</tr>
</tbody>
</table>

Table 2: Demographia Housing Affordability Ratings. (Source: Demographia, 2008, p.1)

According to the survey, housing affordability in Australia has steadily degenerated over the past 25 years. House prices in Australia now considered ‘severely unaffordable’ and the overall Median Multiple for Australian housing is now 6.3, indicating that the cost of a home is equal to 6.3 years of household income, over double the minimum ‘affordable’ ratio. In comparison Canada’s overall Median Multiple is 3.1, placing it just above the ‘affordable’ level of 3.0 or less.

The survey places Sydney (with a Median Multiple of 8.6) an equal 11th with the Gold Coast in the list of the 50 most unaffordable housing markets surveyed. This places Sydney’s housing market as less affordable than either the New York or London markets. Of even greater concern, there were found to be no affordable or even moderately affordable housing markets in Australia, and over a quarter of all the severely unaffordable markets in the survey were located in Australia*8 (Demographia, 2008, pp.9-13).

The Demographia (2008) analysis confirms the affordability trend denoted in domestic reports with the following diagram showing the capital city housing market trends for the past sixteen years:

![Graph showing housing affordability trend in Australia](image)

Figure 7: Housing Affordability Trend Australia, Markets 1981 – 2007.  
(Source: Demographia, 2008, p.13)

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*8 Demographia countries surveyed: Australia, Canada, Ireland, New Zealand, United Kingdom & United States.*
OECD (2005) analysis of nominal house prices to per capita disposable income confirms the trend indicated in the Demographia (2008) report:

![Australia graph](image)

*Figure 8: OECD House Price to Income Ratios, 1970 – 2005.*  
(Source: OECD, 2005, p.128)

A range of domestically and internationally produced measures confirm the significant decline in Australian housing affordability. House prices have risen substantially faster than incomes and the effect of this divergence on affordability has been exacerbated by sustained interest rate rises. Home loan repayments and housing costs are demanding an increasingly large proportion of household income, the number of households suffering housing stress is steadily increasing and a recent international survey indicates that there are no longer any affordable housing markets in Australia’s capital cities.
3 Factors Contributing to Declining Housing Affordability

From the perspective of economic analysis market prices are fundamentally determined by the interaction of supply and demand. However any analysis of the housing market is complicated by the enormous variety of influences on both supply and demand. Macroeconomic conditions in particular, such as interest rates and economic growth, play an important role, as do federal policies on issues such as immigration and fiscal expenditure. While the role of demand factors has been undeniably significant, as noted by the Productivity Commission (PC, 2004a, p.17), cost-increasing supply-side factors have reinforced and exacerbated this impact, particularly with regard to the cost of new dwellings. Such cost-increasing supply-side factors appear to have had their growth enabled by the increases in demand resulting from increased borrowing power. Increases in the cost of producing new dwellings on the urban fringes are particularly concerning as such houses have long fulfilled the role of providing an affordable entry-level option for those young Australians seeking to enter the housing market.

The basic interaction of supply and demand is illustrated in Figure 9. The illustrated increase in demand represents a combination of both underlying and credit enabled demand, with the change in supply reflecting increases in the cost of supplying new dwellings and supply restraints.

![Figure 9: Interaction of Housing Supply and Demand.](image)

Prices may also be affected by changes in the responsiveness of supply that have resulted from time delays and the lack of an effective mechanism that links demand increases (as reflected in increasing house prices) to supply. As Figure 10 illustrates, restrictions in the
supply process that reduce its responsiveness to price signals (elasticity) result in smaller supply increases and larger price increases for a given increase in demand.

Figure 10: Interaction of Changes in Housing Supply Responsiveness and Demand.

The potential for government regulation to contribute to increased house prices by affecting the supply-side of the market has been widely noted (Sundig & Swoboda, Ben-joseph, Glaeser & Gyourko, Dewey, Baden & Coursey, Green & Malpezzi, Luger & Temkin, Meyer & Somerville, Phillips & Goodstein, Green, Levine Salma, Schill & Stark cited U.S. DHUD, 2005, p.4).

There are a number of such regulatory-induced supply-side issues that have contributed to declining housing affordability in Australia by reducing the housing supply and increasing the costs associated with producing new homes. These include restrictions in land releases and land use, infrastructure charges, planning and design requirements, the development approval process and the general unresponsiveness of planning and land supply systems. These types of regulatory-induced supply-side issues have been acknowledged as playing a role in increasing house prices and diminishing affordability in the Australian context, particularly for younger market entrants (PC, 2004a).
3.1 Australian Urban Development, the Federal Fiscal Imbalance and the Origins of Infrastructure Charges

Despite its vast size and low overall population density Australian has one of the most urbanised populations in the world, with approximately 85% of the population living in cities on approximately 1% of the land mass. In NSW over 75% of the population live in the greater metropolitan region which includes Newcastle, Sydney and Wollongong (EPA NSW, 2000). These statistics emphasise the importance of cities in Australian society, and how fundamental the development of Australia's key urban areas are to the nation and housing affordability.

Since the end of WWII the Australian population has shown consistent growth, primarily as the result of a sustained attempt by the federal government to develop and populate the country via broad immigration policies (Troy, 1995, pp.2-4). Such growth has predominantly been concentrated in state and national capitals and has largely occurred in new outer suburbs - the 'urban fringes'. Since the 1970s the majority of growth in all the capital cities has been in terms of the expansion of its geographical area rather than via increased population densities (ibid pp.2-4).

Low density suburban housing developed partly as a response to the issues of high density urban areas such as noise and pollution. In fact the desire to live in clean and uncrowded suburbs has been expressed from a very early stage of Australian settlement with Governor Phillip's first town plan for Sydney specifying wide streets with broad frontages (Frost & Dingle, 1995, p.23). The Australian cultural preference for the suburbs was imported from England; however it was enabled by the high wages resulting from Australia's favourable economic conditions. Between 1911 and 1947 Australia's urban population more than doubled, along with the stock of housing. Most of this urban growth was concentrated around the outer suburbs of Sydney and Melbourne, which accounted for 72% of capital city population growth between them (ibid pp.23-28). Until the post WWII era the extension of public transport services was far more influential in allowing the expansion of suburban areas than the development of roads and the use of the private car, as was the case in America (ibid p.29).

The relatively high level of affluence was in large part the result of protectionist policies which supported manufacturing. For example, in the 1950s 37% of Sydney's workforce was employed in manufacturing (ibid p.33). A general push from the state and federal governments to encourage and facilitate home ownership, and the 'long boom' of the post WWII years combined with increased immigration levels (attracted by jobs in manufacturing), further stimulated urbanisation. Of Sydney's total population growth from 1947 to 1961, 38% was attributable to immigration (ibid p.34). The development of new suburbs created strong demand for infrastructure such as roads, electricity, hydraulic services (water and sewerage), schools, and other public services (Coombs & Roberts, 2007, p.8). However shortages during the depression and WWII meant relatively little infrastructure work had been undertaken and councils began to make the provision of hydraulic services and roads by developers a condition of approval for housing developments. As noted, part of the reason for capital shortages was the dramatic increase in immigration promoted by the federal government. The states increasingly argued that, as immigration was a federal issue, the Commonwealth should be contributing to the costs of infrastructure provision (Neutze, 1999, pp.67-68). Nonetheless, public sector infrastructure investment by both state and federal governments strengthened as a response to the backlog that had accumulated during the 1930s and the war years, remaining strong until the late 1970s. This investment peaked at just over 6% of GDP in the mid 1960s (ibid p.3).
However the economic crisis of the 1970s marked the end of protectionist policies and the importance of the manufacturing sector (Frost & Dingle, 1995, p.37), ushering in a new era of fiscal restraint at the federal level. State and local governments responded to the reduction in federal income by transferring infrastructure costs onto developers. This initially applied to hydraulic services and local roads in the 1950s then to area roads, footpaths and drainage in the 1960s (Troy, 1996, p.6) and eventually expanded to include the wide array of infrastructure charges which currently add significantly to cost of producing new dwellings.

In NSW developer funding of infrastructure progressed slowly from the provision of graded unsealed roads, through to the 1950s & 1960s when some developers volunteered service extensions in order to reduce development times in the post war period of strong demand (McNeill & Dollery, 1999, p.62). By the early 1970s developer funding/provision of on-site infrastructure such as roads, drainage, open space, hydraulic and electrical services and footpaths was widespread and, by the end of the decade, developer contributions for off-site infrastructure were also being sought. The process was formalised by the Environmental Planning and Assessment Act 1979 and, with the exception of the removal of the ability to levy for water and sewerage (now charged through an alternative Act), the use of developer charges has continued to expand - particularly in recent years (McNeill & Dollery, 1999, pp.62-68). The eventual outcome of this process is the current broad array of developer infrastructure levies on new dwelling production via section 94 & 94A and State Infrastructure Contributions9. The range of which has become increasingly disconnected from actual developments, with charges being sought for works as varied as traveller information, lookouts and dog euthanasia freezers10 (NSW DoP, 2008d, p.15).

Federal-state conflict and the fiscal imbalance in particular have significant implications for urban development, and hence housing affordability in Australia. While the powers of the federal government are constitutionally constrained it has enormous practical influence as a result of its large revenue raising capacity. Much of the federal government's revenue raising power is the result of the state's acquiescence of their income tax powers to the federal government to fund Australia's involvement in WWII (Stilwell & Troy, 2000, pp.909-913). Despite its officially limited power the federal government has legislated broadly since its inception to provide finance to a wide variety of urban services such as transport, education, health, sewerage and housing as well as developing standards and regulations. The fiscal imbalance arises from the fact that, while the federal government is empowered to raise the vast majority of revenues, it is the state governments that are responsible for the majority of expenditures. Since the 1970s the fiscal dominance of the federal government is evident, with it raising roughly 75% of total tax revenues (Stilwell & Troy, 2000, pp.915-921). However the move towards fiscal responsibility post the economic instability of the 1970s has, as noted, resulted in the reduction of infrastructure spending by the federal government. Figures 11 & 12 illustrate the decline in public infrastructure expenditure as a percentage of GDP11.

9 State Infrastructure Contributions apply to greenfield areas identified in regional and subregional strategies, the Metropolitan Development Program, or approved local strategies. Their most widespread use is in Sydney’s Growth Centres.
10 The NSW State Government has recently acted to limit the scope of infrastructure for which charges may be applied and these changes will be the subject of further consideration in this report. It is important to note that all infrastructure charge figures used in this report that predate these changes do not reflect the savings associated with these changes unless otherwise specifically noted.
11 Note that neither chart captures the resulting increases in private investment which have occurred largely in response to this decline.
At the same time the percentage of the state’s expenditures accounted for by federal transfers – the traditional method by which the states have funded the larger part of their expenditures – has declined, falling from 52% to 40% from 1972/73 to 1994/95 (Stilwell & Troy, 2000, pp.915-917). This has effectively increased state (and local) government expenditure responsibilities. An important element of the fiscal imbalance is that prior to the introduction of the GST, in July 2000, the states lacked a broad-based income source with which to fund their infrastructure expenditure. The combination of stamp duties, payroll, gambling and land taxes having proven inadequate in the past (Stilwell & Troy, 2000, p.918).

The provision of hydraulic services provides an informative example of the early effects of funding arrangements on house prices. The state’s increasingly found their borrowing rights limited by the federal government in order to control macroeconomic concerns such as inflation and international payments (Neutze, 1999, pp.67-68); this reduction in state borrowings was in turn passed down to service authorities and local governments. For example, the Sydney Water Board’s equity ratio of assets to loans rose from 47% in 1985-86 to 86% in 1994. Service authorities responded by increasing developer charges and requirements. However, these increased costs are then passed onto new home buyers in the form of increased house prices while established home owners have been largely unaffected (Neutze, 1999, pp.67-68). In fact, it may be argued that they have actually benefited from the resulting increased house prices, with the potential for increased new house prices to act as a rising floor for existing house prices (UDIA, 2007, p.17 & Moran, 2006b, p.4). While the increased financial squeeze faced by hydraulic service providers has to some degree resulted in development being guided into lower provision cost areas - which may be seen as a

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Note that state’s borrowing rights are currently limited by their credit ratings (Neutze, 1999, pp.67-68).
legitimate objective of land use planning that results in more economically efficient outcomes - it is becoming apparent that the process is now overly influencing planning decisions (Neutze, 1999, pp.67-68).

In a brief study of water and sewerage costs in Melbourne, Troy (1996, p.68-71) points out that this type of long-lived infrastructure is being fully funded by up-front private charges, as well as users having to pay for existing infrastructure - and the cost of the loans used to fund it, due to the way user fees are structured - for which older existing sites have never had to pay for directly. A recent newspaper article – ‘Water rip-off sucks west dry’ (Daily Telegraph, 8th February 2008) - highlights the inequity of such charges, with families purchasing new homes in Sydney’s west paying up to $10,000 (which totals more than $30,000 over the life of a typical home loan) for water connection, while those in established wealthy suburbs pay as little as $40 per month.

While the state governments have the primary constitutional responsibility for urban development, the federal government introduced the national competition policy in the 1990s under which state governments have been heavily pressured to introduce contestable markets into the provision of urban infrastructure. This has resulted in the privatisation of services, such as water, power and public transport (Stilwell & Troy, 2000, p.920). However, as noted in a recent industry report (UDIA, 2007, pp.17-18), these measures, which were undertaken to improve the accountability, openness, and competition in the provision of services, have resulted in a philosophy of user-pays that demands a wide variety of infrastructure be paid for by the private sector in the form of up-front charges. Traditionally, infrastructure such as water, sewerage and transport systems would be funded by the broader community via rates and taxes over an extended period. Bodies, such as the Australian Local Government Association (cited UDIA, 2007, pp.17-18), also note the importance of the federal-state-local government fiscal imbalance in limiting the ability of state and local government’s to provided services and infrastructure. Inadequate funding has created pressure on state and local governments to shift the cost of provision of infrastructure and services to the private sector in the form of up-front developer charges. Moreover there appears to be a belief in government that urban infrastructure expenditure is predominantly the result of new development on the urban fringes, resulting in a focus on determining how best to ensure such development ‘pays its way’. In reality this type of development actually accounts for around one third of total housing activity and its benefits generally positively contribute to the existing community (Fehring, 2005, pp.16-17).

A further side effect of the federal fiscal imbalance is that, due to the division of revenue and expenditure responsibilities, there is broad scope for ‘buck-passing’ between levels of government. At the same time the method of distribution of the federal government’s payments, via the Commonwealth Grants Commission is an ongoing source of tension. While the operating principle of the Commission is to ensure that no state is unfairly disadvantaged via the grants system, the systematic management of fiscal transfers in the public sector tends to shift competition between the states into the private sector (Stilwell & Troy, 2000, pp.918-919). This can result in states engaging in ‘beggar-thy-neighbour’ competition for private capital investment. Typically such competition is undertaken through lowered property and business tax rates and other financial incentives. To the extent to which states provide incentives to attract mobile capital they reduce available resources that could have been used for the provision of infrastructure/services (ibid, p.919). A prime example of this type of activity was Victoria’s policies under the Kennett Government. While the economic health of cities depends
increasingly on this type of competition, the longer term health of cities is also highly dependent
upon the appropriate provision of infrastructure and services (ibid, pp.919-920).

3.2 Infrastructure Charges

The transfer of infrastructure funding from the public to the private realm impacts housing
affordability through the associated increases in infrastructure charges applied to new dwelling
production. These increased charges may also then affect the quantity of supply via the
interaction of minimum viable sale prices and the practical limits to borrowing for new home
buyers\textsuperscript{13}.

Concurrent to the previously noted decline in public infrastructure provision is the pronounced
increase in private infrastructure spending\textsuperscript{14} which has more than offset the reduction in public
spending:

![Figure 13: Investment in Economic Infrastructure by Sector as a Percentage of GDP.
(Source: Coombs & Roberts, 2007, p.4)](image)

Over the past decade there has been a substantial increase in the private funding of
infrastructure associated with residential development in the form of developer levies (PCA,
2006a, p.2)\textsuperscript{15} suggesting that developer levies represent an increasing component of the
funding of public infrastructure. However it must be noted that, as developer levies are not
separately identified in government revenue statistics, their growth and exact contribution to
public infrastructure provision is difficult to estimate. Nonetheless the increase in levies and
their importance to government, particularly at the local level, is becoming increasingly

As a result of the shift in infrastructure funding it is becoming increasingly apparent that an
expanding component of ‘publicly funded’ infrastructure at both state and local government
levels is now privately funded via developer levies. These levies are then being passed onto
new house prices (Neutze,1996, p.231) and hence are reflected in declining affordability. In
effect previously publicly funded infrastructure is now being financed by developers and funded
by home buyers. Various industry reports have noted the increase of these levies and their
impact upon the cost and viability of new home production. In NSW infrastructure charges take
the form of Section 94 & 94A and State Infrastructure Contribution levies and are the highest in

\textsuperscript{13} This effect is currently apparent in NSW and receives further consideration in Section 4 of this report.

\textsuperscript{14} It must also be noted that changes in infrastructure expenditure are, to some degree, a reflection of changes in
Australia's economic structure away from infrastructure intensive sectors, such as manufacturing and agriculture,
to the services sector. Changes also reflect increased investment in export commodity infrastructure and National
Competition Policy reform (Coombs & Roberts, 2007, pp.3-8).

\textsuperscript{15} Study based on infrastructure charges on new homes and units in Sydney, Brisbane and Melbourne.
Australia, sometimes exceeding $70,000 per residential lot. In contrast per-lot infrastructure charges in Queensland total around $16,000 and around $14,000 in Victoria (UTF, 2008, p.47).

In Sydney the UDIA Industry Report into Affordable Home Ownership in Australia (2007, p.32) found that in the last ten years per-lot infrastructure charges have increased 466% - equating to $56,000 per-lot. These increases are directly attributable to State Infrastructure Contributions and Section 94 levies. Clearly such indirect taxes on new land and housing have increased much faster than general inflation over the period. By way of comparison the CPI increased around 33% over the same period (RBA, 2008a). These indirect taxes also dramatically exceed increases in housing construction costs. The nominal cost of constructing a typical house in Australia rose 80% in the 13 years from 1993 to 2006 (HIA, 2006d, p.2). Similarly the increase in project home prices for the 12 years from 1989/90 to March 2002 was less than 50% (ABS, 2002).

Despite the stated aims of increasing openness, accountability and competitiveness in the provision of infrastructure and services industry reports suggest that there is limited consistency, transparency or relativity in the way infrastructure charges are being levied (PCA, 2006a, p.2). Significantly, it is the increase in indirect infrastructure charges - those costs which are not essential to the production of a new dwelling, such as roads and public transport systems, parklands, childcare facilities, and libraries - which are driving the greatly increased developer contribution levies.

Table 3 indicates the distinctions made by the Property Council of Australia (PCA) National Housing Infrastructure Costs Study (2006a, p.1) between direct and indirect infrastructure.

<table>
<thead>
<tr>
<th>Direct infrastructure</th>
<th>Indirect Infrastructure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Water works upgrades</td>
<td>Parkland and open space</td>
</tr>
<tr>
<td>Water reticulation</td>
<td>Streetscape</td>
</tr>
<tr>
<td>Sewerage works upgrades</td>
<td>Drainage systems</td>
</tr>
<tr>
<td>Sewerage reticulation</td>
<td>Roads and public transport facilities</td>
</tr>
<tr>
<td></td>
<td>Pedestrian and cycle paths</td>
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<tr>
<td></td>
<td>Libraries and museums</td>
</tr>
<tr>
<td></td>
<td>Childcare facilities and public pools</td>
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<tr>
<td></td>
<td>Recreation and entertainment facilities</td>
</tr>
<tr>
<td></td>
<td>Other community infrastructure specifically identified</td>
</tr>
</tbody>
</table>

Table 3: National Infrastructure Costs Study: Direct and Indirect Infrastructure. (Source: PCA, 2006a, p.1)

The study notes that of the $68,000 total infrastructure costs incurred by a typical new Sydney house, over $66,000 is for indirect infrastructure. Over the 11 years 1995 - 2006 it is reported that indirect infrastructure charges have increased by over $55,000 - an increase in excess of 500%. Figure 14 illustrates these increases.

---

16 A standardised 230sqm home.
Had these indirect infrastructure charges increased in line with the New Engineering Construction Index (an ABS non-house building construction index) they would be substantially lower; $24,500 compared to $66,000, a difference of over 170% (PCA, 2006a, p.4). Home unit developments have been similarly, though not quite as heavily, impacted by increased infrastructure charges, with a 170% increase in indirect infrastructure charges in Sydney (PCA, 2006a, p.6). The estimated impact of these indirect infrastructure charges on a standard monthly mortgage in Sydney is $479 per month (or 15.4%) (PCA, 2006a, p.8). While some increase in charges may be expected in response to increased community infrastructure expectations, the almost exponential growth in costs do not appear to have been anticipated by either industry or the state government, under whose legislative frame work local governments have acted (UDIA, 2007, p.18).

Direct and indirect infrastructure charges are in addition to the residential development charges already applied to new home buyers by state and federal governments through stamp duty, the GST and land taxes. The effect of transferring infrastructure costs to developers, and subsequently on to new home buyers, is illustrated by UDIA NSW (2007) in the following example; given the financial ceiling of a first home buyer in Sydney of $300,000 - $350,000, Table 4 indicates the magnitude of charges which would apply to a new house and land package17.

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17 Note there has been a recent downward revision of State Infrastructure Contributions of approximately $10,000. Additionally, under the First Home Benefits Scheme, first home buyers may now be eligible for Land Transfer Stamp Duty and Mortgage Duty exemptions where applicable.
<table>
<thead>
<tr>
<th>$2,000</th>
<th>Stamp Duty (Developer)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$17,000</td>
<td>Stamp Duty (Sale)</td>
</tr>
<tr>
<td>$33,000</td>
<td>State Infrastructure Contribution</td>
</tr>
<tr>
<td>$40,000</td>
<td>S94 Contribution</td>
</tr>
<tr>
<td>$12,000</td>
<td>Sydney Water Charges</td>
</tr>
<tr>
<td>$35,000</td>
<td>GST</td>
</tr>
<tr>
<td>$139,000</td>
<td>Total</td>
</tr>
</tbody>
</table>

Table 4: Taxes and Charges on House and Land Packages.
(Source: UDIA NSW, 2007, p.12)

State Infrastructure Contributions have been applied to growth areas for a variety of direct and indirect infrastructure, such as schools, hospitals and rail infrastructure. Given that the Western Sydney Growth Centres are intended to be key providers of over 180,000 new dwellings in the next 25 years, it is significant to note that, prior to the recently proposed changes, they were subject to a levy of up to $485,000 per hectare for residential land in order to fund 75% of the cost of significant infrastructure at a total cost of over $7.5 billion (UDIA NSW, 2007, p.10).

The changes to attributable infrastructure announced on 12th October 2007 by the NSW DoP (2007c) are estimated by the NSW Treasury to provide for a 30% per-lot reduction in these charges. However it is too early at this stage to confirm the magnitude of these savings. It is important to note that such taxes and charges, which, assuming the accuracy of NSW Treasury saving estimates, amount to around one third of the cost of the house and land package and clearly reduce housing affordability, also act to restrain housing supply. As the UDIA (2007, pp. 32-33) notes, using the charge rates applicable at the time of writing, the charges render the example development financially unviable and it would therefore not go ahead. Making such development unviable impacts the housing supply and excludes first home buyers from the market.

3.2.1 Infrastructure Funding Arrangements and Equity

On initial inspection developer infrastructure levies may appear to adhere to the economically efficient user-pays principle. However, due to the methods of application and the long-lived nature of much infrastructure, they result in a small section of the community bearing the cost of providing infrastructure and services that are of benefit to others. As noted in a HIA (2003) housing affordability report, certain charges, such as a $15,000 per-lot transport levy, imposed by the NSW Government for certain SW and NW release areas, are glaring examples of a social good – which has positive externalities for the broader community – being charged to new home purchasers.¹⁸

Similarly it is not clear that residents of new developments should be made to pay for costs which would arise from a general population increase regardless of its location (Applied Economics, 2003). Certain components of infrastructure provision costs would occur regardless of where the increased population was located. These costs are most appropriately funded by general tax revenues given that population increases, assuming a certain proportion of young persons and workers, ultimately make a positive contribution to the tax-base and to economic growth (Applied Economics, 2003).

¹⁸ Concerns regarding the nexus and accountability of this levy have also been raised by Applied Economics (2003).
The PCA (2006a, p.9) study concludes that the move away from public-sector debt funding to user-pays infrastructure levies over the past 11 years has contributed to reduced housing affordability by capitalising the cost of a variety of infrastructure charges into the cost of a new house. Additionally they note that the current methods of charging for infrastructure are inconsistent and not relevant to those who are being impacted by it.

As previously noted, a further concern with such infrastructure charges is that the infrastructure they fund is generally long-lived. In this respect we can see further inequity in charging new home buyers up front for infrastructure that may be providing benefit to the general community for several decades. By contrast, funding such infrastructure through broad-base taxes, such as rates, results in a more equitable association of costs with those who use and benefit from it. A modified version of this funding method which retains the efficiency of an infrastructure cost-location-signal benefit to guide development will receive further consideration as one of a range of potential reform measures in a later section of this report.

A recently published comparison by the PCA (2007b, pp.22-24) goes some way in illustrating the inequity of the current funding arrangements. The study compares the charges associated with the purchase of two houses in the Sydney area. The first house is a $1.8 million residence in Mossman. The house, which would typically be considered an upgrade purchase for a high income household, has never had to contribute directly via levies for infrastructure or comply with strict environmental or building codes. It was also built at a time when land prices were not artificially inflated by current land supply restrictions. Its sale would generate approximately $84,000 in revenue (stamp duty) for the NSW State Government. In contrast the second house, in a typical housing estate in Sydney’s north-west growth corridor, costs $570,000. This house, as a detached dwelling on the urban fringe, would traditionally be considered a first home for a new family. It is subject to just under $200,000 in total taxes, fees, charges and compliance costs.

The intergenerational inequity of the charges applied to these homes is immediately apparent, with the change in infrastructure funding from public-sector debt serviced over time by broad-based taxes and charges to an up-front user-pays method resulting in a substantial shift in intergenerational equity. Earlier generations had much of their infrastructure funded via the previously mentioned broad-based methods. These traditional funding arrangements essentially constituted an implicit social contract; each generation contributes to the infrastructure costs of the following generation in return for the help they had received from the preceding generation19 (Neutze, 1999, p.66). As Tanner (2005) points out:

The primary rationale for government debt as a means of financing infrastructure is intergenerational equity. As future generations enjoy the benefits of infrastructure constructed now, it is appropriate that they contribute to the cost.

Traditional funding arrangements resulted in a far easier entry to the property market than is the case with the current up-front system. Since such charges only apply to new houses they have a dramatic effect on the cost of producing new homes. However there is a further imbalance; charges paid on a new house on the urban fringe serve to increase the price of existing houses through the substitution effect. Since new and existing homes are to a certain degree substitutable goods (i.e. to some degree they both satisfy the same need) the price of

19 Note that Neutze was specifically referring to the funding of hydraulic services, however it is argued that the principle applies to a broad range of long-lived infrastructure.
existing homes is affected by the increased price of new homes\textsuperscript{20}. As the UDIA (2007, p.17) notes, when demand outweighs supply, as is currently the case nationally, there is limited market incentive for existing homes to be sold at prices below that of new homes hence the potential for increased cost of new home production to increasing exist house prices acting as an effective ‘floor’ to general house prices. At the same time those purchasing the new higher-priced houses are paying for part of the broad-based debt funded infrastructure costs of the older established houses via rates (Troy, 2008).

It is import to recall that these types of house and land packages on the urban fringe have represented the typical entry level home since at least the 1950s. As such the highest incidence of these charges fall on those with who are unlikely to have benefited from the capital gains that resulted from rising house prices and generally have limited financial capacity.

Beyond the intergenerational inequity illustrated in the above example, a further concern regarding infrastructure charges is their potential to act as regressive barrier to affordable housing (U.S.DHUB, 2005, p.8). In this sense, infrastructure charges are regressive when the same charges are applied on a per unit basis to different priced houses; i.e. if two new houses in the same development are priced at $300,000 and $600,000 respectively, infrastructure charges of $100,000, on both houses form a far higher effective rate of taxation on the less expensive of the two houses. The ability of these types of charges to sterilise a particular house market - i.e. create a situation where houses cannot be viably produced at marketable prices - has been noted by the Urban Taskforce (2008). Similarly this method of fee allocation has been shown to prevent the creation of affordable housing projects in the U.S. (U.S.DHUS, 2005, p.8).

Changes in infrastructure funding arrangements are significantly impacting the cost of producing new houses with an attendant impact on housing affordability. Current funding arrangements raise serious questions regarding the equity shifts that result from new house buyers funding infrastructure through up-front levies.

3.3 Urban Consolidation

Urban consolidation primarily impacts housing affordability through its influence on the supply of land and the regulation of its use. The origins of urban consolidation in the Australian context are rooted in the previously noted fiscal responsibility of the states for the provision of infrastructure\textsuperscript{21}.

Despite the previously noted increased ability to raise funds via developer charges, state governments reached a point in the early-to-mid 1980s where they still faced increasing demands for funding for urban services. They responded by attempting to moderate demand with the most commonly used method being a policy of consolidation (Troy, 1996, pp.6-8 & Searle, 2007, p.2). The policy, which is still followed today, was thought to be able to reduce demand in the following ways: Firstly, by increasing density in inner city areas to make use of excess capacity in existing infrastructure systems, thereby delaying the need for new infrastructure; secondly, by increasing the effective density of new housing developments by reducing lot size and increasing the proportion of medium and high density dwellings thereby

\textsuperscript{20} It is acknowledged that the degree of substitutability between houses depends on a variety of factors, size, location, social amenity, etc, with homes on the urban fringe are unlikely to be considered directly substitutable for homes in particularly desirable locations, such as beach front suburbs.

\textsuperscript{21} It is acknowledged that the movement and its motivations have greatly expanded in recent times.
reducing infrastructure costs by reducing the distances involved in service provision; thirdly, increasing density was anticipated to increase public transport use; and finally, a more compact city would reduce travel distances (Troy, 1996, p.7).

While these consolidation policies, which were first introduced in Sydney in the early 1980s, were initially presented in terms of cost savings, they became increasingly rationalised in other terms - notably in terms of their potential environmental benefits by the state governments. Consolidation policies were increasingly seen as an answer to sprawl22 and were favoured by some environmentalists in the belief that they would reduce greenhouse gas emissions by reducing car use and trip distances (Troy, 1996, p.7). Consolidation arguments were further tied to demographics changes, such as reduced household sizes and population ageing, in an attempt to show that the traditional suburban development of detached dwellings would no longer meet the needs of an increasing number of Australian households (Troy, 1996, pp. 8-9).

However the benefits of urban consolidation are highly contended, with authors such as Troy (1996) arguing that the existence of many of these benefits has been assumed rather than quantified and have proven illusory as a result. Conversely, proponents contend that there are a myriad of benefits associated with consolidation and that much of the opposition is the result of ideological concerns or vested interests. While determining the potential outcomes of urban consolidation is obviously important, even a cursory consideration of the available material indicates that many of the outcomes are highly dependant upon a wide array of factors. These include the method and speed of implementation, existing economic and regulatory conditions, demographic and geographical differences and cultural/social preferences. It is beyond the scope of this report to undertake an extended analysis of the theoretical and empirically proven costs and benefits associated with urban consolidation. Rather this report will constrain its focus to the effects of urban consolidation and its relationship to land supply, land use, infrastructure funding and housing affordability in the Australian federal context.

3.4 The Supply of Land and Land Prices.

In addition to the burden of infrastructure costs, the cost of developable land23 has increased significantly since the beginning of the 1990s - both in real terms and as a share of the cost of a new house and land package. These increases are greatly impacting the affordability of new houses and are increasingly affecting the new dwelling supply.

Land price increases are the result of the interaction between increased demand and a restricted supply. In large part the restrictions to land supply are the result of the attempt by state governments to reduce their infrastructure funding costs. As previously noted, despite changes in infrastructure funding, the states found they were increasingly unable to fund the infrastructure costs associated with new residential development. They responded by restricting land releases to areas where infrastructure provision would be less costly to government, while at the same time using land use restrictions to encourage urban consolidation, which they considered would reduce infrastructure demand. These targets were then enforced upon local government authorities (Troy, 2008).

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22 In reference to the use of the term sprawl it must be noted that this is essentially an imported term that refers to the American phenomena of highly uncoordinated and inefficient development. This type of development has not been an issue in Australian housing except for a brief time in the early post-war period (Troy, 1996, p. 8 & Glosen, 2005, p.4).
23 Undeveloped land; generally rural or semi-rural, approved for release by government strategies.
State governments control the supply of land available for residential development via zoning. In NSW for example, the Department of Planning creates a series of regional strategies that reflect broader government targets, policies and anticipated population growth. The strategies outline areas targeted for growth which, in the case of greenfield areas, will be rezoned from rural classifications to residential, becoming 'developable' land. Strategies also determine areas for infill development, increased density, commercial development, etc. Regional strategies are then used as guides for Local Environment Plans (LEPs) which are drawn up by councils. LEPs are required to be consistent with the regional strategies and form the basis for more specific local planning regulations, such as Development Control Plans (DCPs). As a result of this hierarchy the state government has effective control over the land supply via the rezoning process.

As previously noted, infrastructure costs are an increasingly significant concern to the state governments, and are greatly influencing decisions regarding the location and rate of land release. The land supply, particularly in terms of greenfield releases, has been increasingly constrained and prices have increased significantly, a fact exacerbated by the increased buyer borrowing capacity resulting from strong economic conditions and low interest rates. In addition to these direct restrictions, the efficiency and effectiveness of the planning system also plays an important role in the cost and responsiveness of the land supply and ultimately the price of new houses.\textsuperscript{24} (Berry & Dalton, 2004, p.77).

Recent industry reports (HIA, 2006d, UDIA, 2006, PCA, 2007a & 2007b) illustrate the extent of this land price growth and its impact on housing prices. These reports similarly contend that land price growth is largely the product of restricted land supply practices. A recent international survey provides similar conclusions (Demographia, 2008), as do a number of U.S. studies (Glaeser & Gyourko, 2003 & Glaeser, Gyourko & Saks, 2004). According to UDIA (2006, pp.12-13) there is a strong correlation between land supply restriction, which can be linked to urban consolidation policies, and increased land prices in the Sydney region:

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{sydney_land_supply_price.png}
\end{figure}

\textsuperscript{24} This aspect of the housing supply process will receive further consideration in Sections 6 & 7 of this report, specifically with regard to the situation in NSW.
(Source: UDIA, 2006, p.13)

Table 5 shows that per-lot broadscale land prices have increased almost $200,000 in the preceding 10 years. Land supply restrictions and increased land prices are not a phenomena limited to Sydney, rather they are an Australia-wide occurrence:

Figure 16: Australian Residential Land Supply, 2000 – 2006.
(Source: UDIA, 2006, p.14)

Figure 17: Australian Land Prices, 2000 - 2006.
(Source: UDIA, 2006, p.15)
While the relationship between land supply and land prices is the subject of much debate the following graph from The UDIA 2006 State of the Land report shows a strong correlation between the two factors from the 2002/03 period onwards:

Figure 18: Lot Supply v. Indicative Average Lot Price. (Source: UDIA, 2006a, p.16)

PCA (2007a, p.2) analysis suggests that unless there is a substantial change in policy there is the potential for an 185,000 lot land supply shortfall nationally over the next 25 years. They conclude that inadequate land supply has contributed almost $29,000 (or 9%) on average per dwelling Australia-wide (PCA, 2007a, p.2). The HIA-APM Land Monitor’s (2007b) assessment of the demand and supply of zoned and developed land concurs, noting that the continuing shortfall has contributed to rising land costs as a proportion of total house and land packages as well as overall increased new home costs.

Sydney’s land supply situation is particularly concerning; it has the greatest land supply shortfall in the PCA’s (2007a, p.4) national study. In the Sydney region in the period 2001-2005 there was an availability shortfall of almost 15,000 lots. Similarly in the 2005-2006 year the PCA (2007a, p.4) found an underlying demand trend of around 5,700 lots compared with the available supply of around 3,100 lots - a short fall of over 2,600 lots for the year. Based upon underlying supply and demand an increasing land supply shortfall over the next two decades is predicted:

Figure 19: Sydney Land Supply Adequacy Model, 2001 – 2026. (Source: PCA, 2007a, p.4)

25 However it must be noted that an explanation is required for the 2001/03 period, during which both supply and prices rose.
An analysis of housing affordability in some of the larger international markets by Demographia (2008) supports arguments that diminishing housing affordability is related to land supply restriction and the transfer of infrastructure costs associated with urban consolidation policies. Figure 20 illustrates the relationship between land-use controls and housing affordability.

![Figure 20: Housing Affordability and Land Rationing in Larger International Markets. (Source: Demographia, 2008, p. 23)](image)

Analysis of the U.S. housing market supports these conclusions, finding that restriction of the supply of land available for housing via land use and zoning controls is strongly correlated to high costs (Glaeser & Gyourko, 2003, p.35). In fact one of the more interesting examples of the impact of regulation on the cost of housing comes from an area in the U.S. that has almost no supply of undeveloped land remaining – Manhattan. While Manhattan has essentially no developable land left, it does possess what is an effectively near infinite amount of air space available in which to construct new dwellings. Despite this availability supply has become increasingly constrained and prices have greatly increased. In their 2004 study Glaeser, Gyourko & Saks determine that these increases are the result of regulatory burdens and land use restrictions that have driven the price of new apartments to twice that of their value in terms of actual building costs.

Demographia's (2007a & 2007b) case study comparisons of Perth with Austin and, more recently, Sydney with Dallas-Fort Worth, provide further confirmation of the link between land use regulation, regulatory burdens and high prices. Both Austin and Dallas-Fort Worth are located in the state of Texas, which has a similar population to Australia. However Texas has a number of factors which, broadly speaking, would be expected to place more upward pressure on house prices than is the case in Australia; Texas is experiencing higher population growth, has higher per capita income and productivity levels, higher population density, as well as a higher concentration of its population in its 5 largest cities (Moran, 2006b, p.66).
Mirroring the above broad trends the cities of Austin and Perth both also have relatively similar populations, with Austin’s population growing faster at an average growth rate of 3% pa compared to Perth’s average of 1.5% pa:

![Population Graph](image)

Figure 21: Population of Perth and Austin, Texas, 1995 – 2005.
(Source: Demographia, 2007a, p. 25)

As noted, Austin’s higher rate of population growth would, by convention, be expected to be associated with higher demand for housing and therefore higher housing prices all other things being kept equal. However the difference in housing affordability between the two cities is both counter intuitive and pronounced; Perth’s Median Multiple of 8.3 (extremely unaffordable) is well over double that of Austin’s (3.1):

![Affordability Graph](image)

Figure 22: Housing Affordability: Perth & Austin, Texas, 1995 – 2006.
(Source: Demographia, 2007a, p. 26)

The study suggests that the differences in affordability are generated by the two city’s land regulatory schemes. Austin’s relatively liberal regulatory scheme has maintained its affordability despite strong growth, whereas in Perth a restrictive scheme has limited land supply, driving up land costs and drastically reducing housing affordability (Demographia, 2007a, pp.25-27).

Comparison between the cost of urban fringe new starter homes in Sydney and Dallas-Fort Worth further illustrate the effects of constraining land supply; in Dallas-Fort Worth new starter home and land packages on the urban fringe are being produced and supplied to the market at a cost of approximately A$700 per square meter compared to around A$2,500 in Sydney.
(Demographia, 2007b). Similar to the comparison between Austin and Perth, Dallas-Fort Worth is experiencing much stronger population growth than Sydney. However it has significantly more affordable housing; Dallas-Fort Worth has a Median Multiple of 2.5 vs. Sydney’s 8.6 (Demographia, 2007a). With regard to questions of demand-induced price increases due to the liberalisation of lending practices and low interest rates it is noted that in cities where supply has not been restrained these factors have not resulted in significant price increases (Demographia, 2008, p. 18).

3.4.1 Land Supply Restriction and Urban Fringe Land Prices

Interestingly, it has been noted that the price of land on the urban fringes of Australia’s cities may constitute a disincentive to the building of new housing stock, thereby contributing to increased prices of the existing housing stock in the medium term (Richards, 2008). By way of comparison entry lots in Australian capital cities are generally in excess of $150,000:

![Figure 23: Representative Residential Urban Fringe Vacant Lot Prices. (Source: Richards, 2008)](image)

Equivalently located lots in Dallas, which are also several times larger, start around US$50,000 or less (Richards, 2008). As Richards (2008) notes, supply should act to dampen the effects of demand. This response should be most notable in prices on the urban fringe where land is less scarce relative to city centres and land prices should account for a lower proportion of total dwelling price. In principle, house prices in these areas should be close to marginal cost, with the price of raw land being reasonably close to its alternative use value (most commonly agriculture) in the absence of supply restrictions. However this is not the case, with strong real price growth in suburbs distant to the CBD, as Figure 24 illustrates.
Richard's (2008) conclusion is that the data suggests restrictive land use policies that create an artificial scarcity of residential-zoned land, in combination with the complexity of the development process and the fees and charges imposed on development, have played a role in increasing house prices. Richards (2008) makes the same argument as this report - that any benefits from policies such as zoning, land supply, infrastructure charges, growth boundaries, etc., must be weighed against the cost of increased house prices. While it is clear that prices for established homes in desirable locations, the supply of which is 'limited'\(^{26}\), have been greatly influenced by increased 'upgrade' demand enabled by widespread increases in credit (as argued by Robertson (2006)), increases in house and land prices on the urban fringe are not so clearly explained by such arguments. Given that upgrade demand for such houses due to their desirable locations would conceivably be quite limited, price increases in urban fringe and non-city centre areas must increasingly be seen in terms of increased demand versus an artificially constrained supply.

3.5 Land as a Proportion of House Prices.

Due to the dramatic increase in land prices, land costs now form an increasing percentage of total house and land prices. As Figure 25 illustrates, land as a proportion of total house and land package prices now exceeds 40% in all but one of our capital cities and sits at 57% in Sydney, compared to around 40% in 1994.

\(^{26}\) While the supply of such dwellings is clearly theoretically more limited than that of dwellings on the urban fringes the substantial role played by infill development must also be acknowledged.
By contrast, in 1973 the cost of land, as a percentage of the total cost of a typical house and land package, was just over 30% (Institute of Public Affairs, cited UDIA, 2006, p.12, see also Table 6).

Vacant developed land prices in Sydney have increased 11.7% over the preceding quarter to an average price of $357,500 and, while there has been a small increase in land supply in Sydney, supply remains inadequate (HIA-APM, 2007b, p.5). Slow sales are a reflection of the lack of land available below the $250,000 per-lot mark and HIA-APM (2007b, p.1) analysis of future development suggests there will be an inadequate supply of reasonably priced land for the next five or so years at least. Indicative recent sales suggest englobo land prices are likely to rise, with per hectare prices in Sydney’s Growth Centres as high as $1.2 million (HIA-APM, 2007b, p.1). As the key input factor in the production of developed land the price of raw land is critical to the price of developed lots and therefore to supply, particularly at lower price points.

Table 6, which lists typical new house and land price increases, illustrates the dramatic increase in the price of land relative to CPI:

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Sydney</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$9,100</td>
<td>$29,400</td>
<td>$107,100</td>
<td>$323,338</td>
<td>28.9</td>
</tr>
<tr>
<td>House</td>
<td>$16,900</td>
<td>$43,200</td>
<td>$121,500</td>
<td>$315,252</td>
<td>11.4</td>
</tr>
<tr>
<td>Melbourne</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$5,900</td>
<td>$15,900</td>
<td>$40,000</td>
<td>$133,712</td>
<td>10.4</td>
</tr>
<tr>
<td>House</td>
<td>$14,000</td>
<td>$35,000</td>
<td>$75,000</td>
<td>$195,015</td>
<td>13.8</td>
</tr>
<tr>
<td>Brisbane</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$7,000</td>
<td>$27,000</td>
<td>$80,000</td>
<td>$141,000</td>
<td>20.2</td>
</tr>
<tr>
<td>House</td>
<td>$16,000</td>
<td>$37,000</td>
<td>$70,000</td>
<td>$101,000</td>
<td>17.9</td>
</tr>
<tr>
<td>Perth</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$5,600</td>
<td>$17,300</td>
<td>$50,974</td>
<td>$245,407</td>
<td>57.8</td>
</tr>
<tr>
<td>House</td>
<td>$12,900</td>
<td>$28,000</td>
<td>$80,000</td>
<td>$107,049</td>
<td>14.5</td>
</tr>
<tr>
<td>Adelaide</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>$2,000</td>
<td>$12,000</td>
<td>$35,000</td>
<td>$164,000</td>
<td>82.5</td>
</tr>
<tr>
<td>House</td>
<td>$1,200</td>
<td>$20,000</td>
<td>$40,000</td>
<td>$206,277</td>
<td>17.1</td>
</tr>
<tr>
<td>Australian CPI</td>
<td>28.5</td>
<td>61.4</td>
<td>106.9</td>
<td>162.4</td>
<td>7.3</td>
</tr>
</tbody>
</table>

(Standardised to a 230sqm house on a 650 sqm block).
Source: HIA, 2006d, p.2

Note that the 2006 figures put the land component of the total new house package at over 55% in Sydney.
3.6 The Housing Supply Shortfall.

Not surprisingly shortfalls in the land supply are reflected in a housing supply which fails to meet demand:

![Diagram showing housing market balance, 1994 - 2010.](Source: Braddock, 2007, p.10)

Braddock's (2007) calculation of the national housing shortfall is supported by BIS Shrapnel (cited UDIA, 2008, p.7) at an estimated 23,000 dwellings per annum.

The contribution of NSW to the national housing supply shortfall is significant. Braddock's (2007, p.11) placement of each state's housing supply shortfall in terms of production lag in months is particularly telling, with NSW housing production currently a year behind and estimated to be over three years in arrears by 2010:

![Pent-up housing demand by state.](Source: Braddock, 2007, p.11)

The relationship between the supply of houses and the supply of land is complex, and government land releases do not necessarily translate into increased housing production. This
is due to the dependence of completed lot development and housing construction on the private sector. As a result the housing supply is sensitive to a range of economic factors.

The relationship between a range of supply factors and the final production of houses, specifically the situation in NSW, will receive more detailed consideration in Section 4 of this report. However at this stage it is important to note the housing supply shortage is at least in part related to reductions in the land supply - with the land supply obviously acting as an upper limit to the housing supply at some particular level - and is placing continued upward pressure on house prices.

3.7 Planning Systems and Regulatory Compliance Costs.

In addition to the previously noted directly applied costs, there are also a range of indirect cost pressures that result from planning systems, such as:

- Inconsistent building and planning regulations.
- Uncertainties associated with the approval process.
- Excessive time delays and associated holding costs.
- Regulation compliance costs, such as building and local regulations, and the cost of consultants.

These indirect cost pressures impact housing affordability by increasing the costs of new dwelling production and impacting the viability of development and reducing the responsiveness of supply.

While many of these costs are difficult to quantify the HIA (2003, p.18), in its Report on Housing Affordability, cites anecdotal evidence from residential developers that put the cost of delays and inefficiencies in the residential development approval process equivalent to around 10% of the final price of a typical new home. They note that given the industry turnover of new dwellings (in 2003), improvements in the approval system could result in a saving of as much as $2.5 billion nationally (HIA, 2003, p. 18). Delays in the approval process adversely impact housing affordability by affecting the production cost and viability of residential developments. The financing of development is subject to substantial interest costs which are of course related to time; an extended delay between a developer's decision to purchase land and the completion of dwellings obviously increases these costs, with an extra year of holding costs being shown to add around $7,000 per-lot in certain developments (UDIA, 2007, p.17).

Figures 28 & 29, from the PCA's (2006b) study, illustrate the extent to which indirect cost pressures add to the cost of new dwelling production - with the "other" costs shown being government related costs, including compliance with building and other local regulations, as well as the cost of hiring consultants. Note that consultancy costs in particular are becoming more extensive due to the complexity of development applications; in many cases councils now mandate that DAs are provided with consultancy reports (PCA, 2006b, pp. 6-7).
Figures 30 & 31, which are for typical 100 lot subdivisions and 50 unit apartment developments respectively, show the wide variations between council development approval times. Such variations contribute to uncertainty, and illustrate the lack of consistency in the process nationally.
The delays and uncertainties associated with the development approval process, as well as the increasing costs of regulatory compliance, are having significant impacts on costs and responsiveness of the new dwelling supply, ultimately contributing to the decrease in housing affordability. As the figures indicate, these indirect cost pressures vary greatly from state to state and often between local government areas; this is in part the result of varying planning and approval processes. Issues relating specifically to the NSW planning and approval process will receive greater consideration in Sections 6 & 7 of this report.

The impact of holding costs upon housing affordability has been recently acknowledged via Prime Minister Rudd’s announcement of the creation of a $500 million Housing Affordability Fund to address holding and infrastructure costs. Part of this strategy includes a $30 million investment in an Electronic Development Applications and On-Line Tracking System (Rudd, 2008a). Both of these measures are positive steps, as is the national recognition of supply-side charges and processes on affordability. However further widespread reform is needed to adequately address the issue. The creation of an On-Line Tracking System will do little to address the underlying problems of the nation’s planning systems, such as conflicting requirements between agencies, lack of resources, poorly conceived land use strategies and the excessive approval delays. Issues such as these play a significant role in restricting the
housing supply and require addressing. In terms of infrastructure costs, the entire $500 million Housing Affordability Fund represents less than 6% of the amount needed to cover the infrastructure contributions for Sydney’s Growth centres alone. However, the aim of the Fund is sound and one notable aspect of the Fund’s structure that may go some way to addressing the need for planning system reform is that local governments will have to apply for infrastructure funding grants through a competitive process, with their proposals outlining how they will streamline the planning process. (Australian Government, 2008b, p.6).

3.8 GST and Other Government Charges

The introduction of the GST has given the states a broad-based tax that is linked to growth. All GST revenue is returned to the states, and this revenue has grown at an average annual rate of 7.9% since the GST’s introduction (Australian Government, 2007, p.9). The effect of the introduction of the GST has been to deliver significant windfall gains to all the states – estimated to be over $4 billion over 2008-2009 (Australian Government, 2008a). According to the HIA (2003, p.11), approximately half of the GST collected in excess of budgetary projections has been collected on new housing and renovations. As such their recommendation is that the state governments apply this additional revenue to the reduction of infrastructure charges associated with new home construction via increasing state funding of infrastructure.

Double taxation (or ‘double-dipping’) - the result of the GST being charged on top of some of the levies and taxes on new residential developments which is then added to the GST paid on a new home and redistributed back to the states by the federal government as revenue – is particularly concerning, and hides the real tax burden from consumers (UDIA NSW, 2007, p.12). In 2003, HIA (p.16) estimates put the cost savings associated with the removal of double taxation on a house and land package in the range of $2,000 - $11,000 depending on location.

As Table 7 indicates, while the NSW Government has removed stamp duty for first home buyers, double dipping still occurs via the imposition of the GST on the remaining stamp duty elements and state and local government infrastructure charges.

<table>
<thead>
<tr>
<th></th>
<th>Current GST Margin Scheme</th>
<th>Broadened GST Margin Scheme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Selling Price</td>
<td>$297,344.00</td>
<td>$297,344.00</td>
</tr>
<tr>
<td>less</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land Acquisition</td>
<td>$58,824.00</td>
<td>$58,824.00</td>
</tr>
<tr>
<td>Stamp Duty</td>
<td></td>
<td>$3,326.00</td>
</tr>
<tr>
<td>State and Local Government Levies and Charges (SIC, S73, S94 etc)</td>
<td>$70,530.00</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$238,520.00</td>
<td>$164,755.00</td>
</tr>
<tr>
<td>GST Payable</td>
<td>$21,683.64</td>
<td>$14,977.73</td>
</tr>
<tr>
<td>GST paid on State and Local Taxes and Levies</td>
<td>$6,705.91</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 7: Broadened GST Margin Scheme. (Source: UDIA NSW, 2008a, p.17)

27 These issues receive more detailed consideration in Sections 6 & 7 of this report, specifically with regard to the situation in NSW.

28 Based upon a total housing production of 180,000 (GCC, 2007) and the current $49,000 contribution requirement (NSW Treasury, 2007) giving a total infrastructure expenditure in excess of $7.8 billion.
The Broadened GST Margin Scheme as outlined by UDIA NSW (2008a, p.17), which holds that raw land and the cost of its conversion should not be taxed, eliminates this double taxation and would enable a saving of over $6,500 in this example. As UDIA NSW (2008a, p.17) notes, the forecast state infrastructure expenditure for Sydney's Growth Centres is approximately $7.8 billion for the next 25 years. Based on an average house price of $650,000 the GST revenue generated will exceed $7 billion. Given the demand-price-supply issues these areas are currently experiencing and their key role in NSW's housing supply there is a strong case for the use of some of these GST revenues for the funding of infrastructure. A more equitable distribution of the GST, including increased state funding of infrastructure, is needed in order to increase housing affordability (UDIA NSW, 2007, p.12).

The GST is one in a wide array of increasingly costly government charges, including the already noted developer infrastructure contributions, on new housing developments:

<table>
<thead>
<tr>
<th>Land Development</th>
<th>Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developer Infrastructure Contributions:</td>
<td>Council Fees and Charges:</td>
</tr>
<tr>
<td>- Major Roads</td>
<td>- Building Permit Levy</td>
</tr>
<tr>
<td>- Drainage</td>
<td>- Training Levy</td>
</tr>
<tr>
<td>- Public Open Space</td>
<td>- Kerb Deposit</td>
</tr>
<tr>
<td>- Sewer and Water Headworks</td>
<td>- Water Corporation</td>
</tr>
<tr>
<td>- Recycled Water</td>
<td>- Development Application Fees</td>
</tr>
<tr>
<td>- Community Facilities</td>
<td>- Long Service Leave Levy</td>
</tr>
<tr>
<td>- Roads and Transport Levy</td>
<td>- Compulsory Home Warranty Insurance</td>
</tr>
<tr>
<td>- Stormwater Retention</td>
<td>GST</td>
</tr>
<tr>
<td>- Land Restoration</td>
<td></td>
</tr>
<tr>
<td>Clearance Fees</td>
<td></td>
</tr>
<tr>
<td>- Water Corporation</td>
<td></td>
</tr>
<tr>
<td>- Council</td>
<td></td>
</tr>
<tr>
<td>- Land Titles Office</td>
<td></td>
</tr>
<tr>
<td>- Electricity</td>
<td></td>
</tr>
<tr>
<td>- Development Assessment Commissioner</td>
<td></td>
</tr>
</tbody>
</table>

Table 8: Fees, Taxes and Charges on New Residential Development.  
(Source: HIA, 2003, p.15)

The HIA report (2003, p.13) estimates that the value of indirect taxes on new housing was over $10 billion in 2002-2003; including around $3 billion in GST, around $6 billion in front-end levies imposed on residential developments by a combination of state and local governments, and around $1 billion in state government stamp duties on new house purchases. By HIA (2003, p.13) estimates, this amounts to an approximate 30% contribution to the land component of new dwellings in Sydney and Melbourne, and approximately 20% in other cities. In terms of new dwellings, the removal of the wholesale sales tax and the imposition of the GST have resulted in an effective indirect tax increase on new dwellings of over 8% (HIA, 2003, p.13).

Many of these indirect taxes and charges are increasing at a much higher rate than inflation. Further, the GST is being applied to land development taxes and charges even though these charges often have little-to-no relation to the consumption of these services by new home purchasers (HIA, 2003, p.14). Citing the example of a new Sydney home with a sale price of $635,000 the HIA points out that the total indirect taxes and charges levied would come to

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29 See Section 4 of this report.  
30 Note that the GST does not apply to the sale of existing homes, however it is applied to the construction and sale of new homes, as well as to renovations to existing homes.
$196,000 - representing an effective indirect tax rate of 31% (HIA, 2003, p.16). The breakdown of taxes and charges is illustrated in Figure 32.

![Figure 32: Taxes and Charges on Sydney Greenfield Development. (Source: HIA, 2003, p.16)]

The following data from HIA (2006b) outlines the total charges applied in NSW and nationally:

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Land Taxes</td>
<td>948</td>
<td>900</td>
<td>929</td>
<td>1,001</td>
<td>1,138</td>
<td>1,355</td>
<td>1,646</td>
<td>1,717</td>
</tr>
<tr>
<td>Municipal Rates</td>
<td>2,012</td>
<td>2,075</td>
<td>2,168</td>
<td>2,266</td>
<td>2,339</td>
<td>2,419</td>
<td>2,531</td>
<td>2,604</td>
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<td>Stamp Duty on Conveyances</td>
<td>1,899</td>
<td>2,406</td>
<td>2,214</td>
<td>3,041</td>
<td>3,623</td>
<td>3,882</td>
<td>3,261</td>
<td>3,237</td>
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<tr>
<td>GST*</td>
<td>-</td>
<td>-</td>
<td>1,029</td>
<td>1,213</td>
<td>1,448</td>
<td>1,599</td>
<td>1,729</td>
<td>1,851</td>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Taxes</td>
<td>1,925</td>
<td>1,817</td>
<td>2,103</td>
<td>2,172</td>
<td>2,553</td>
<td>3,059</td>
<td>3,583</td>
<td>3,613</td>
</tr>
<tr>
<td>Municipal Rates</td>
<td>5,796</td>
<td>6,072</td>
<td>6,447</td>
<td>6,800</td>
<td>7,205</td>
<td>7,715</td>
<td>8,200</td>
<td>8,982</td>
</tr>
<tr>
<td>Stamp Duty on Conveyances</td>
<td>4,560</td>
<td>5,538</td>
<td>5,281</td>
<td>7,302</td>
<td>8,788</td>
<td>10,470</td>
<td>9,565</td>
<td>10,945</td>
</tr>
<tr>
<td>GST*</td>
<td>-</td>
<td>-</td>
<td>3,270</td>
<td>3,914</td>
<td>4,510</td>
<td>5,050</td>
<td>5,670</td>
<td>5,782</td>
</tr>
</tbody>
</table>

Source: ABS Taxation Revenue 2005-06 and HIA Estimates (see note below)
*Note: GST revenue calculated on 10% of the value of work done on new housing and renovations

Table 9: Federal, State and Local Government Taxes on Housing. (Source: HIA, 2006b)

After the GST, revenue from housing taxes are the largest source of tax receipts for the states - they received over $10 billion in stamp duties and over $3 billion in land taxes and stamp duties combined in the 2005 - 2006 period.

In their 2006 study, the PCA (2006b) put the magnitude of these types of charges into context as percentages of total residential development costs - as shown in Figures 33 & 34. The study also found significant increases in these charges since in the five years 2000 - 2005, with increases of up to 200% in Sydney's key North West development area.
The general trend towards an increased reliance on property taxes as a source of revenue is clear in all states and territories:
Government-imposed charges, such as infrastructure levies, stamp duties and double charging of the GST are significant contributors to the cost of producing new houses and, as such, are contributing to Australia’s steady decline in housing affordability. Given the minimum realistic margins for developer profitability it can be seen that these charges are effectively new house buyer charges. When viewed in this context the charges must be seen as increasingly inequitable and inappropriate.

The effective use of double taxation via the imposition of the GST on certain charges is particularly concerning and needs to be removed. As suggested by UDIA NSW (2008a), the collection of GST on new houses is a potential source of infrastructure funds, notably in the Growth Centres. The use of the GST to fund infrastructure has the potential to significantly reduce new house prices and capture the windfall gains that have resulted from the GST’s introduction.

There are a number of supply-side factors that have contributed to the decline in housing affordability. The most significant are the increased cost of land and the increase in infrastructure costs applied to new dwelling production. Policies of urban consolidation and the associated restriction of land releases affects the ability of the land supply to respond to demand, resulting in substantially increased land prices. The increasing percentage of land as a component of new house and land package prices indicates the importance of an adequately responsive land supply in ensuring housing affordability. The current under-supply of developed housing lots suggests there will be a continuing decline in housing affordability in the short to medium-term. The transfer of infrastructure funding from government funded debt, recovered over time via broad-based taxes, to capitalised up-front developer charges has resulted in the cost of a broad range of infrastructure being added to the cost of a new home and an attendant increase in house prices. Added to this are the increasing costs of various forms of regulatory compliance, as well as the time and risk costs associated with the approval process and double-dipping of the GST.

When combined, these land price, infrastructure, taxation and regulatory compliance cost increases amount to a substantial increase in the cost of producing a new home which are in turn borne by new home buyers. The price of houses in urban fringe areas acts as an effective floor to established house prices, with increases in the price of these homes reducing general housing affordability, particularly for first home buyers who are left without the option of a modest entry into the housing market via the traditionally affordable option of an urban fringe dwelling.

The affordability impacts of regulatory-induced supply-side restraints are not limited to Australia. The U.S. Department of Housing and Urban Development (2005, p.3), for example, has been arguing strongly for more than 15 years that regulatory barriers have significant negative affects on the ability of the U.S. housing market to meet national housing needs, impede the production of affordable housing by increasing the cost of development and inflate prices by constraining the general housing supply. It is significant to note that the general issues raised in the U.S. report, specifically, the cost increases induced via regulatory intervention, are broadly similar to those that have been raised in Australia.

Given the national importance of housing affordability (and land supply in general) there is a strong argument for a national review of land supply and infrastructure funding arrangements. Such a review would be able to clearly determine the impacts of these policies and establish
whether there is an economically sound case for the return to earlier infrastructure funding arrangements.
4 Infrastructure Costs, Land Supply and House Prices: The Situation in NSW

4.1 Land and Dwelling Supply

As previously illustrated, Sydney has experienced a considerable downturn in land supply since the 1990s - see Figure 15. This downturn can be directly linked to the NSW Government’s policy of urban consolidation (UDIA, 2006, p.12).

The impact of land supply restrictions on housing affordability in NSW is implicitly acknowledged by the NSW Government’s recent decision to increase land releases amid ever increasing reports of declining housing affordability. In fact a recent NSW Treasury (2007, p.3) briefing describes an increase in dwelling production via greenfield and brownfield areas as the primary method available to the State Government to influence housing affordability.

The downward trend in greenfield land releases as a percentage of total land releases since the early 1990s is apparent in the NSW Government’s own literature, as are the forecast supply increases from the recently revised benchmarks.

Figure 36 illustrates dwelling supply for Sydney’s greater metropolitan area.

![Figure 36: Dwelling Supply in Greenfield and Existing Areas. (Source: NSW DOP, 2006)](image)

The Metropolitan Development Program (MDP) is the NSW State Government’s key land and housing supply management program, and covers both greenfield and brownfield development. Infrastructure demand management is an integral and acknowledged aspect of government involvement in the process, with the MDP therefore playing a significant role in assisting infrastructure and service provision (NSW DOP, 2007e).

The Figure 37 illustrates the basic processes of greenfield land supply in NSW.

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31 Greenfield development refers to development on previously undeveloped areas. Such areas are typically rural or semi-rural land located near the outer suburbs. Brownfield development refers to the development of previously used land and is typically infill development in existing urban areas, including the rejuvenation of former industrial areas.
Figure 37 also denotes the primary areas of responsibility and current supply levels at the various stages in the supply process. The benchmarks for the first three stages of the land supply process have recently been revised upwards:

- Total MDP stock benchmark is now 112,500 potential dwellings which is sufficient for 15 years supply at current rates of conversion.
- Zoned stock benchmark is now 60,000 potential dwellings which is sufficient for 8 years supply at current rates of conversion.
- Zoned and serviced benchmark is now 55,000 potential dwellings which is sufficient for 7.3 years of supply at current rates of conversion (NSW DOP, 2007e).

According to the MDP, these benchmarks have been revised in order to ensure an adequate supply of land, and to enable land supply to be able to meet any upturn in demand. Sufficient margins in the process are important in this regard, as the process, which is largely sequential, typically takes between 7 to 10 years (NSW DOP, 2007e).

The MDP acknowledges the importance of step three in the process as the link between the stock of land and the actual dwelling production process. It is important to note that this is the point at which the land/dwelling supply becomes dependent upon the private sector. The MDP also refers to the cyclical nature of the housing market, noting that the translation of potential lots into actual lots is highly dependent upon market conditions, which are in turn dependent upon broader macroeconomic factors, such as interest rates (NSW DOP, 2007e). The link between potential dwellings and the actual supply of dwellings is significant; despite strong increases in the production of potential dwellings in the past three to four years - there was an almost 50% increase in total zoned and serviced lots (Sartor, 2007) - there has not been a corresponding increase in actual greenfield lot production. In fact greenfield lot production has actually declined - as illustrated in Figure 38.
A similar trend is indicated in national new dwelling commencements over the period:

Declining dwelling production has significant negative implications for future housing affordability; as Abelson et al (2005, pp.96-103) note, housing stock per capita is a significant long-run determinant of housing prices. Abelson et al’s (2005) modelling, which shows that a capital city price index is representative of general Australian residential prices, predicts that a 1% increase in housing stock per-capita leads to a long-term decrease in real house prices of an average 3.6%. The modelling also shows that house price adjustment occurs more rapidly in periods of real house price growth (a greater than 2% increase in real house prices) than in periods of stagnant or falling real house prices; a one year vs. 1.5 year adjustment to equilibrium.
In their recent report into affordable home ownership the UDIA (2007, p.16) cite several studies that emphasise the potential price rises associated with an underestimation of the available land supply. One study finds that an over estimation of the land supply by as little as 10% could result in a price increase of over 90% by the end of the decade. The report (UDIA, 2007, p.16) notes that supply constraints which may result in overestimation potentially include the overestimation of achievable housing densities, failure to adequately allow for population growth, land use restrictions due to environmental restrictions and rezoning delays.

Given the potential for an increase in dwelling supply to impact house prices, and subsequently housing affordability, the importance of the conversion of potential dwellings (in the form of rezoned developable land) into actual dwelling production is highlighted. However, as HIA Chief Economist Harley Dale (cited in Markson & Chesterton, 2007) recently noted, the issue is no longer simply one of land supply - rather the price of currently available developed land is critically important. According to the HIA-APM Land Monitor (2007b, p.1), the critical shortage of developed lots under $250,000 per-lot is the primary issue, and a significant adjustment to underlying structural costs is needed to free up supply. In NSW it is noted that sales of house and land packages are highly dependant on price points and a strong consumer preference towards larger land parcels remaining in spite of high land costs (HIA-APM, 2007a, p.5). The HIA-APM Land Monitor (2007a, p.1) outlines the issue, with high developed land prices being sustained in the face of falling demand resulting in dismal national sales.

The combination of a restricted land supply and previously high levels of demand have driven land prices up to the point where new house and land packages are reaching, and exceeding, the practical limit for the majority of first home buyers, greatly impacting supply.

4.2 Factors Influencing the Price of Developed Lots

Two key components affect the cost of producing saleable lots - the price of developable land and infrastructure charges. Greatly increased infrastructure charges are impacting the feasibility of new residential development in a period of economic uncertainty. This is particularly the case in the North West and South West Growth Centres (GCs) which are a key component in the MDP land supply (NSW Treasury, 2007). The NW and SW GCs contain the vast majority of the new land release areas for Sydney, constituting around 30 to 40% of the total area available for new homes, with the remaining to be developed in infill areas. Ultimately the GCs are anticipated to provide over 180,000 new homes (GCC, 2007). Given the GCs noted key role in the metropolitan region's land supply it is critical that the dwelling potential of the areas are realised.

4.3 Infrastructure Costs

It is important to recall that the NSW Government's dwelling supply policy framework is entirely dependent upon the private sector and therefore greatly influenced by general macroeconomic conditions, development profitability and the profitability of alternative investment opportunities. While infrastructure charges are theoretically imposed upon developers they are predominantly paid for by the home buyer, particularly in situations of inadequate supply/high demand (UTF, 2008, p.47 & Dollery, 2005, p.6). Developers are largely unable to pass such charges backwards to the developable land owner due to the effective setting of a minimum price by the

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32 The ability of developable land owners to sustain high prices in the context of constrained land supply receives further consideration in Section 4.6 of this report.
market in combination with the reluctance of sellers to accept less than market price and their ability to withdraw their land from the market (UTF, 2008, pp.47-49). Typically such costs are not born by a reduction in developer profit due to the mobility of investment capital (UTF, 2008, p.47); as UDIA NSW (2005, p.16) notes, failure to achieve an appropriate return on investment will result in development becoming uncompetitive with alternatives, such as the stock market, limiting developer’s access to investment funds, lowering dwelling supply and further affecting affordability. This phenomenon is confirmed by the low rates of investment in development in Sydney and NSW in recent years. This suggests that developer profits are in line with normal expectations and have therefore been unable to absorb these extra costs and remain adequately profitable (UTF, 2008, p.47).

Consequently, given the practical borrowing capacity limits of home buyers, particularly in a period of steadily rising interest rates, increased infrastructure charges result in a decreased supply of new dwellings rather than a reduction in developer profit margins (UTF, 2008, pp.47-48). As the Urban Taskforce (2008, p.48) states:

*High government infrastructure charges and costs imposed by a heavily regulated market (through limitations on the supply due to zoning and prescriptive and expensive aesthetic design rules) force up the cost of new housing beyond the reach of potential homebuyers. As a result, homebuyers are unable to pay more, and developers are unable to lower costs to meet the demand.*

In an effort to address housing affordability the NSW Government announced a series of changes to infrastructure levy assessment on 12th October 2007. These changes include the removal of infrastructure charges for the construction of infrastructure, such as schools, hospitals, emergency services and regional open space facilities, with infrastructure charges now only applying to the land component of such assets (NSW DOP, 2007c). Local government infrastructure charges (Section 94 & 94A) will be limited to a key infrastructure category, significantly reducing the range of attributable infrastructure (NSW DOP, 2007b & 2007c). The changes are aimed at reducing the overall infrastructure levies associated with residential developments and are combined with a staged contribution system whereby 25% of state and local government infrastructure charges are recovered in a Rezoning Infrastructure Contribution (RIC) at the time of land sale or DA approval. The remaining 75% is payable upon the release of the subdivision or occupancy certificate in the form of a Serviced Infrastructure Contribution (SIC). Reductions in infrastructure levies in GCs as a result of recent revisions in infrastructure contribution requirements are estimated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Levy per lot – existing approach</th>
<th>Indicative levy per lot – revised approach</th>
<th>Indicative saving</th>
</tr>
</thead>
<tbody>
<tr>
<td>State levies (Growth Centres)</td>
<td>$33,000</td>
<td>$23,000</td>
<td>$10,000 (30%)</td>
</tr>
<tr>
<td>Indicative local levies (Growth Centres Council)</td>
<td>$45,000</td>
<td>$26,000</td>
<td>$19,000 (42%)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$78,000</strong></td>
<td><strong>$49,000</strong></td>
<td><strong>$29,000 (37%)</strong></td>
</tr>
</tbody>
</table>

Table 10: Revised Indicative Developer Contribution Levies. (Source: NSW Treasury, 2007, p.10)

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33 Note that the NSW State Government has recently announced its intention to defer the introduction of the staged contribution system for further consideration (NSW DoP, 2008a, p.14).
The Urban Taskforce (2008, p.49) argues that these changes will have a limited effect at best, with developers still having to pay 25% of the state and local government charges up-front when a development application is granted, which could be years in advance of sales. Rather than having deferred 75% of the infrastructure charges, 75% of the state infrastructure charges have been deferred and 25% of Section 94 costs have been brought forward. According to UTF (2008, p.49) calculations, the effect of these changes is relatively modest. Based on state and local government charges of $23,000 and $30,000\(^\text{34}\) per-lot respectively, the up-front payment would previously have been $23,000 and final payment $30,000 - 44% & 56% respectively. As a result of the recent changes the up-front payment (RIC) now comes to $13,000 and the final payment (SIC) totals $40,000 – a reduction of less than 20% of the total cost (UTF, 2008, p.49).

Infrastructure charges increase the cost of development and impact viability, particularly in the current situation where new house prices are at the limit of borrowing capacity for many new home buyers. Table 11, which is based upon the amended charges, outlines the ongoing lack of development viability in Sydney’s Growth Centres:

<table>
<thead>
<tr>
<th>Expense</th>
<th>Cost per lot (A$1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of undeveloped land from the original owner</td>
<td>$50,000 (which is equivalent to $750,000 per hectare)</td>
</tr>
<tr>
<td>An infrastructure contribution to the State Government</td>
<td>$30,000 (as per the government’s announcement of 30 October 2007)</td>
</tr>
<tr>
<td>A section 94 contribution to pay for facilities provided by local councils</td>
<td>$30,000 (according to the government’s announcement of 30 October 2007)</td>
</tr>
<tr>
<td>Developer charges imposed by utilities such as Sydney Water and Integral Energy and gas supplies</td>
<td>$30,000</td>
</tr>
<tr>
<td>Construction of internal infrastructure within the precinct (e.g., roads, footpaths, power lines, sewage, water, gas and civil engineering)</td>
<td>$40,000</td>
</tr>
<tr>
<td>Holding costs (because it takes around 3 months from buying the undeveloped land to selling a finished serviced block; interest and equity)</td>
<td>$65,000</td>
</tr>
<tr>
<td>Architects, planners, engineers and other consultants</td>
<td>$30,000</td>
</tr>
<tr>
<td>Sales and marketing</td>
<td>$120,000 (4 per cent - 2 per cent for sales commission and 2 per cent marketing costs)</td>
</tr>
<tr>
<td>Contingencies</td>
<td>$10,000</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>$2,500</td>
</tr>
<tr>
<td>GST</td>
<td>$10,000</td>
</tr>
<tr>
<td>Total costs</td>
<td>$302,500</td>
</tr>
</tbody>
</table>

Table 11: Average Per-lot Developer Costs in Sydney’s Growth Centres.  
(Source: UTF, 2008, p. 48)

Given the average market price of $300,000 for such a property the developer would have to be willing to produce at a loss for this development to proceed despite the reduction in charges\(^\text{35}\). While there may be some areas in which such a development would be profitable it becomes a question of modest returns vs. a not insubstantial risk vs. the returns available on

\(^{34}\) Note the UTF figures are based upon the NSW Government’s 12th October announcement.

\(^{35}\) Note that even using the NSW Treasury (2007, p.10) infrastructure figures the viability of the development would still be extremely questionable - given the potential for market fluctuations and the availability of alternative investment opportunities, the rate of return would be marginal.
alternative developments or investments as to whether such developments proceed (UTF, 2008, pp.48-49).

4.3.1 Infrastructure Levies as a Barrier to Competition and Supply

Given the new charges scheme, the up-front payment for a 200 hectare development would be $40 million, the financing costs of which may well be beyond the ability of some developers to bear (UTF, 2008, p.49). Such up-front costs, which are present regardless of whether the proposed changes go ahead, represent large and potentially risky outlays for smaller developers and are a significant barrier to start up developers wishing to enter the market. Reductions in the ability of new developers to enter the market represent a restriction to the competitive production of developed land and new dwellings - production that is vitally important to improving housing affordability in NSW. As UDIA NSW (2005, p.16) states: "A mix of small and large developers in the market is essential to maintain competitiveness and affordability". This is particularly the case given the noted dispersion of land holdings in the Growth Centres, with an over-reliance on the development of large landholdings placing the successful implementation of the Metro Strategy on the goodwill of land holders (UDIA NSW, 2005, p.16). Reliance on large-scale development increases the potential for vendors to maintain high developable land prices in these areas through their ability to affect the viability of larger developments by withholding their land.

A reduction in infrastructure charges and other restrictive requirements would promote increased small-scale development; this has the potential to reduce the artificial maintenance of increased developable land prices by placing landholders into price competition with each other. Land holders who attempt to maintain higher prices by withholding their land would find that smaller developers would simply move their development to an alternative land holder. In contrast larger developments are dependent upon being able to purchase multiple land holdings, increasing the ability of landholders to obtain high land prices. The effects of land holding on land prices have been noted by Gillen & Fisher (2002, pp.55-56).

The UTF (2008, p.49-50), while not arguing in support of increasing the number of small scale developments, also argues for the removal in up-front fees on the basis that they discourage the early development of land. Due to the increased financial risk associated with potentially substantial up-front costs developers will only submit applications for land that has a high likelihood of being successfully marketable in the immediate future. By affecting the risk associated with development up-front payment requirements impact the production of developed land and the housing supply. To this end an argument may be made for the removal of the up-front payment component of infrastructure charges. As the UTF (2008, p.50) notes, the timing of such payments is critical and should ideally fall at the final stage of creating a new subdivision36. UDIA NSW (2005, p.18) goes further, suggesting that all NSW State Government development levies should be delayed for two to three years after the development begins to produce revenue.

Moves towards either of these situations would effectively result in the increased use of government debt to finance infrastructure provision. This would occur insofar as the cost of providing necessary infrastructure constructed prior to the payment of developer contributions would be financed by the government in this interim period. While this is not a return to the intergenerational equity of previous government debt funded infrastructure provision, short-term

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36 At the finalisation of the Linen Plan.
government infrastructure financing has the potential to increase the production of developed land by reducing both barriers to entry to smaller developers, as well as much of the potentially supply-reducing risk associated with larger scale developments and up-front payments. This would also take advantage of the reduced borrowing costs available to government, enabling significant interest cost savings. If borrowing arrangements were such that these savings were passed on in the form of reduced new house prices, affordability could be further improved.

A further suggestion is the use of a percentage levy on the final sale price of the land to the home buyer. Such a system would have a double effect; firstly, it would take into account the ability of a particular market to sustain the charge, thus reducing the possibility of sterilising land development (UTF, 2008. pp.50-51); secondly, it would eliminate the regressive tendencies of infrastructure charges and introduce an element of social redistribution into the infrastructure charge system. This would target housing affordability and go some way towards offsetting the wealth-shift that has occurred during the recent decline in housing affordability. Those housing developments targeted towards more affluent buyers, who would generally either have benefited from the wealth-shift, or earn substantially high incomes so as not to be as adversely affected by the affordability crisis, would carry a larger infrastructure cost burden. Such a system would operate in much the same redistributive manner as the current taxation system, with the added benefit of a potentially increase in the housing supply - further improving affordability.

While infrastructure charges are a useful tool, providing price signals by which development may be efficiently guided - certainly they are potentially more economically efficient than rigid policies such as land release controls - their use to impose the full cost of a wide range of infrastructure onto the cost of a new dwelling is both inequitable and inefficient. To this end it is suggested that there needs to be a separation of the cost-location-signal benefit of infrastructure charges from their broader inefficiencies. This would involve the elimination of a large part of the charge, leaving a component directly related to the additional infrastructure costs to government resulting from a particular development's location and which exceed a base line infrastructure cost figure. The base line figure would reflect the general non-location-specific cost of providing infrastructure associated with population increases. The additional cost would then be the appropriate developer contribution figure - providing a signal to developers and eventually through to new home buyers that would allow the market to influence location decisions, thereby retaining flexibility and eliminating much of the inequity associated with the current system.

Broadly, given the difficulties of equitable cost allocation, there remains a strong case for a return to an infrastructure funding mechanism similar in operation to the earlier intergenerational system while retaining the cost-location-signal benefit of infrastructure charges. Decisions by state and local governments to impose infrastructure levies reflect the increasing burden of infrastructure provision and it should be noted that state and local government expenditure obligations are growing at a much faster rate than their taxation revenues, including GST (HIA, 2008a, p.5). Clearly the return to largely government debt funded infrastructure provision would require significant cooperation between federal, state and local governments making COAG the ideal forum for generating such an arrangement with the significant expansion of the Housing Affordability Fund one possible delivery vehicle, particularly as funds are tied to reform. Given the Prime Minister's recognition of a national housing affordability crisis and the apparent increase in cooperation resulting from Labor dominance at the state and federal levels of government now is an ideal time to achieve such changes.
4.4 Land Supply, Landholder Expectations, Land Costs and Dwelling Supply

As the example in Table 12 illustrates, the recent reductions in infrastructure charges have been more than offset by the effects of government-imposed land supply constraints. The restriction of the developable land supply to limited areas, combined with staged releases, has limited supply in the face of previously high levels of demand and resulted in extremely high expectations amongst developable land vendors, particularly in the GCs. UDIA NSW (2005, p.13) found that vendor’s expectations in the GCs are in the region of $500,000 to $1 million per acre. In comparison current rural-use land sale prices are in the region of $300,000 to $400,000 per acre. However as the following table - which is based upon the earlier infrastructure contribution requirements - indicates, when risk and return factors are taken into account, the maximum residual land value to developers is approximately $210,000 per acre:

<table>
<thead>
<tr>
<th>ASSUMPTIONS</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Dwelling density</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>&amp;/ha</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average lot size</td>
<td>40</td>
<td>sqm</td>
</tr>
<tr>
<td>Infrastructure levy</td>
<td>340,000</td>
<td></td>
</tr>
<tr>
<td>&amp;/lot</td>
<td>400 &amp;/km</td>
<td></td>
</tr>
<tr>
<td>SN contribution</td>
<td>145,000</td>
<td>per lot</td>
</tr>
<tr>
<td>Water Board contrib.</td>
<td>15,000</td>
<td>per lot</td>
</tr>
<tr>
<td>Currents</td>
<td>340,000</td>
<td>per lot</td>
</tr>
<tr>
<td>Sales price</td>
<td>$220,000</td>
<td>per lot</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>FEASIBILITY</th>
<th>Lot</th>
<th>Acre</th>
<th>Hectare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales price</td>
<td>290,000</td>
<td>1,030,000</td>
<td>410,000</td>
</tr>
<tr>
<td>Less GST</td>
<td>7.5%</td>
<td>20,000</td>
<td>121,000</td>
</tr>
<tr>
<td>Net sales revenue</td>
<td>269,000</td>
<td>1,000,000</td>
<td>3,796,250</td>
</tr>
<tr>
<td>Less Development Costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Civil works</td>
<td>40,000</td>
<td>249,000</td>
<td>99,000</td>
</tr>
<tr>
<td>Water Board contributions</td>
<td>15,000</td>
<td>96,000</td>
<td>38,000</td>
</tr>
<tr>
<td>Section 54 contributions</td>
<td>48,000</td>
<td>376,000</td>
<td>150,000</td>
</tr>
<tr>
<td>Infrastructure levy</td>
<td>40,000</td>
<td>249,000</td>
<td>99,000</td>
</tr>
<tr>
<td>Selling expenses</td>
<td>5.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rates, taxes and interest est.</td>
<td>10,000</td>
<td>60,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Subtotal</td>
<td>183,990</td>
<td>991,000</td>
<td>3,452,290</td>
</tr>
<tr>
<td>Development profit</td>
<td>26%</td>
<td>15,000</td>
<td>1,289,500</td>
</tr>
<tr>
<td>Total development costs</td>
<td>214,790</td>
<td>1,289,500</td>
<td>3,221,390</td>
</tr>
<tr>
<td>Residual land value</td>
<td>25,000</td>
<td>110,000</td>
<td>425,000</td>
</tr>
</tbody>
</table>

Table 12: Impact of Levies on Urban Development in Sydney’s Growth Centres.
(Source: UDIA NSW, 2005, p. 15)

The recent reductions in infrastructure charges ($29,000 per lot) has resulted in a residual land value of $384,000 per acre or $64,000 per lot. The reductions bring the value of the land to developers closer to typical rural prices; however they remain far short of vendor expectations. The ability of individual vendors to impact the viability of a development in the GCs is clear, with over half of the proposed residential zoned land consisting of lots less than five acres in size (UDIA NSW, 2005, p.16). Constrained land releases give land vendors considerable market power with any downward pressure on prices coming at the cost of greatly reduced supply. In 2005 vendor expectations were such that UDIA NSW (2005, p.16) suggested that only those developers who had purchased large (>40ha) developable land parcels at earlier prices, which represent less than 30% of the developable area, would be able to produce developed lots at marketable prices.

While vendor expectations appear to be realigning themselves more recently, prices of $1.2m million per hectare ($485,000 per acre) are still being achieved in the GCs and interest rate uncertainty will continue to impact maximum viable developed lot prices by limiting home buyer

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37 Celeris paribus, see UDIA, 2005, pp.15-16, for full details of assumptions.
borrowing capacity. These limited developable land price reductions have come at the cost of a dramatic reduction in supply – see Figure 38.

Greatly increased developable land prices in combination with high vendor expectations as a result of restrictive land release policies are not limited to Sydney. A similar pattern is observable as a result of Melbourne’s 2030 Strategy, with developable land inside the Urban Growth Boundary selling at around $600,000 per hectare, in comparison to similar non-rezoned land outside the boundary, which sells for $150,000 to $200,000 per hectare – prices which are already inflated due to speculation that it would eventually be rezoned as residential (Moran, 2005, p. 3). In the UK this result is also apparent, with land on which residential development is permitted averaging more than two hundred and fifty times the value per-acre as general agricultural land (Demographia, 2007, p.20). The ability to earn substantial profits as the result of rezoning encourages speculation and land holding - in fact planning schemes are sometimes referred to as a speculator’s guide to land buying (Neutze, 1996, p.231). Such speculation is far from a modern practice in Australia, with recorded occurrences in Melbourne in the 1830s (Sandercock cited Paris, 1993, p.134). As Moran (2007, pp.37-38) notes, land value increases beyond those associated with its actual improvement are ‘economic rents’. Such rents are enabled due to the artificial restriction of the developable land supply and do not represent any increase in real worth from an economic perspective, although they are clearly extremely important in terms of the redistribution of wealth. If such economic rents are generated through the process of land use conversion there is a strong argument that they should be collected by government rather than individual landholders (Else-Mitchell cited Neutze, 1996, p.231). As Neutze (1996, p.231) points out, while developer contributions where initially intended for a different purpose there was hope that they would go some way to reducing these gains by reducing the price developer’s were prepared to pay for undeveloped land. However it is now widely accepted that the effect has flowed the opposite direction - into increased house prices (Neutze, 1996, p.231, Dollery, Witherby & Marshall, 2000, p.323 & Moran, 2006b, p.64). This is not surprising as housing is an essential need rather than a substitutable good and, in the last ten or so years of favourable borrowing conditions, the market’s capacity to pay for houses has increased enormously.

It appears as though little thought has been given to the economic and subsequent social impacts of such policies, with policy being made on the assumption that high levels of regulation may be imposed without resulting in significant economic impacts (Demographia, 2007, pp.20-21).

4.5 The Need to Increase Land Release Rates

Even assuming that the recent reductions in infrastructure levies are sufficient to enable developers to meet vendor price expectations for developable land and profitably produce saleable lots, it is still unlikely that the reductions will result in a significant improvement in housing affordability. While the reductions are commendable, developer infrastructure levies, amongst other costs, still contribute significantly to the cost of dwelling production in comparison to previously used funding methods. More importantly, the reductions do not address the issue of increased developable land prices as a key driver of new dwelling prices.

Significant and sustained increases in land releases have the potential to reduce the artificial inflation of developable land prices. As the UDIA (2007, p. 32) notes, vendors who are unable to obtain a satisfactory price for their land from developers are likely to withhold their land from the market and further constrain supply. Similar to developable land holders the ability of
developers to withhold land in the face of market downturns is also enabled by restrictions in the land supply process. As noted by Richards (2008), if developers are, as has been suggested, ‘hoarding’ land due to price falls in the outer suburbs impacting their profits, they are only able to do so due to a lack of competition. In alternate more competitive industries, firms have to accept market price for their product and those who do not will face further losses as other firms enter and supply the market at the lower prices. Therefore if developers and land holders are able to successfully engage in such behaviour it is a reflection of deeper problems in the land supply process.

In order for land release increases to impact developable land prices land holders must be convinced that there will be long-term downward pressure on prices. Increases must be of sufficient magnitude and duration that vendor expectations are affected, otherwise they will simply result in land being withdrawn from the market, further constricting supply and increasing price in the absence of widely available alternatives. House and land prices are notoriously downwardly sticky and it will take extensive and consistent increases in land releases to generate a tangible and sustainable affect.

In terms of the impact of land price increases on housing affordability, the clear solution is the use of land release increases as a tool to realign prices by placing downward pressure on land price growth. The current increase in total MDP stock to 112,500 potential dwellings in 2009 seems extremely unlikely to achieve this effect given that it is largely consistent with the long term MDP growth trend (NSW DOP, 2007, p.15). In fact it is suggested that even if the GCs create only 150,000 dwellings in the next 25 years they would still be required to produce an average 6,000 dwellings pa - 4,000pa in the NW and 2,000pa in the SW in proportion. Such production levels are historically exceptionally high (UDIA, 2005, p.10) and, given current levels of affordability, interest rates and greenfield lot production, it is questionable as to whether even this outcome will be achieved in light of current land release practices.
5 Other State’s Responses to the Housing Supply Shortfall

5.1 The Recent Victorian Response

In a timely reminder of the need to address supply Victorian Premier John Brumby recently announced the creation of urban growth zones to enable the rapid release of 90,000 lots of currently unzoned land in order to provide for Melbourne’s unexpectedly high population growth and address housing affordability (SMH, 4th March 2008). Reductions in planning red tape, such as the use of precinct structure plans developed in consultation with councils, will enable complying development proposals to go ahead without the need for rezoning applications on individual blocks (Whinnet & Schulz, 2008). Premier Brumby (cited SMH, 4th March 2008) estimated the cost savings associated with red tape reduction to be in the order of $10,000 per home and noted that the fundamental outcome of increasing supply will be downward pressure on prices. The Premier also estimated that the changes would reduce the time taken to prepare land for development by more than 12 months (Whinnet & Schulz, 2008). The moves have already been supported by industry groups, such as the HIA, who have also noted the importance of supply on housing affordability. HIA Managing Director Ron Silverberg (cited Whinnet & Schulz, 2008) notes that blocks of land in Sydney are already over three times the price of those in Melbourne and that the current land releases will ensure Melbourne’s housing remains more affordable than Sydney’s. The land releases come in part as a response to recent population growth forecasts for Victoria. These forecasts indicate that Victoria is growing much faster than expected, with Melbourne now tipped to overtake Sydney and become Australia’s largest city by 2028 (Whinnet, 2008).

As opposition leader Ted Baillieu (cited Whinnet & Schulz, 2008) points out, the success of this policy will depend on the ability of the Victorian Government to provide the necessary infrastructure for the expansion and their ability to maintain adequate land supply in the longer term, the likelihood of which is questioned by Mr Baillieu. The increase in land supply will dramatically reduce the number of years of land supply Victoria holds in advance and if increased land releases are to be sustained they will demand a rethink of the land supply process. Nonetheless, the increases are clearly a positive response to the housing affordability crisis and, as previously noted, streamlining the land supply process has the potential to deliver long-term benefits by making land less costly and supply more responsive to demand.

5.2 The Recent Queensland Response

The Queensland Government’s establishment of an Urban Land Development Authority in order to create a more responsive land supply and improve housing affordability (QLD DoI, 2007) provides a further acknowledgment of the link between housing affordability, the land supply and the development approval process. The Queensland Housing Affordability Strategy (QLD DoI, 2007) states that, while there are broader economic factors that influences prices beyond the Queensland Government’s control, issues of housing affordability may be addressed by improving the responsiveness of supply to demand via such measures as increased land supply, the reduction of holding costs (which, by their estimates, add between $15,000 and $20,000 per dwelling), streamlining of the approval process and standardised transparent infrastructure charges (QLD DoI, 2007).

Recently, Queensland Premier Anna Bligh announced the fast-tracked release of two major residential development areas – Bowen Hills and Northshore Hamilton. According to Premier
Bligh (cited ULDA, 2008) "Queensland's toughest challenge in housing affordability is the lack of supply and these new areas will deliver housing for more than 30,000 Queenslanders".

The increase in land releases announced by the Victorian and Queensland State Governments represent a step towards improved housing affordability and an acknowledgement of the importance of supply in addressing affordability. Equally important is the Queensland Government's acknowledgment of the need to improve the responsiveness of supply to demand. Similarly this report argues that a more responsive and less costly supply is the key to ensuring the ongoing maintenance of housing affordability via the creation of an efficiently functioning housing market.
The Effect of the Planning System on Supply and the Need for Reform.

The planning system is a key element in the supply of new dwellings, with all forms of significant residential development requiring some form of approval. The potential for planning systems to impact on house prices has been acknowledged by the OECD (2005, p.210), with aspects of the planning system, such as restrictive zoning, cumbersome building regulation and administrative time delays, highlighted as being able to impede and restrict supply and potentially resulting in increased house prices. The need to improve the planning system is particularly pressing if the ongoing decline in housing affordability and the current national housing supply shortfall are to be addressed, as this will require a significant increase in housing production. The impact of increases in the land supply on housing affordability will not be fully realised if they are not efficiently converted into completed dwellings and many of the state and territory planning systems are currently struggling to assess the existing quantity of applications in reasonable time frames. As previously noted, the conversion of developable land into completed dwellings ultimately relies upon the private sector, not the government, and the cost of dealing with a complex and lengthy approval process influences both project viability and final dwelling prices. Further, improvements to the planning system have the potential additional benefit of improving dwelling supply responsiveness in the longer term - reducing future disparity between demand and supply, thereby reducing house price volatility.

Australian planning systems generally consist of four key elements:

- Zoning – the definition of approved or prohibited activities or uses on defined areas of land.
- A list of criteria against which permission may be granted to undertake these activities or land uses – Environmental Planning Instruments and Development Control Plans.
- A process by which permission may be applied for – the Development Application.
- A possible right to third party appeal against decisions to grant or not to grant permission (Mant, 2005, p.1).

As a result of the federal system Australia has nine separate regulation-based statutory planning systems and the legislative frameworks encompassing these planning systems are growing increasingly complex (Williams, 2007, p.93). Historically, state governments have delegated the assessment of development to local government; however in recent years increasing tension has arisen over attempts by the states to centralise development considered to be of state-significance. Development regulatory reform is becoming increasingly common, with the predominant outcome being the centralisation of decision-making authority at the expense of local government (Williams, 2007, pp.100-101). Coordination mechanisms for policy at various government levels appear weak, and the complexity and inconsistency of Australia’s planning systems are becoming an increasing concern for the development industry (London & Chen, 2007b, pp.1-2). Such planning system inefficiencies are impacting upon housing affordability by increasing the risks, delays and time costs associated with residential development. At the same time concerns regarding the impact of decision-making centralisation have been raised by a diverse range of groups including those who would traditionally be considered on opposite sides of the debate - local government organisations and developer representative bodies (see UTF, 2008 & McCaffery, 2008a&b amongst others).
The planning system needs to balance the needs of all stakeholders, and emphasis needs to be placed upon the efficiency, accountability, transparency and quality of outcomes. However it is becoming increasingly apparent that the economic impacts of the process are either not being given due consideration or have not been recognised. In its consideration of building regulation the Productivity Commission (2004b, p.30) states that government intervention demands a sound rationale and will ultimately be judged on its ability to address problems and pursue goals at least cost. While there are undoubtedly sufficient market imperfections and externalities associated with residential development to justify a certain degree of government intervention, such intervention needs to be effective, efficient and undertaken with an awareness of the economic impacts it generates. The Productivity Commission (PC, 2004b, p.35) notes that, fundamentally, efficiency entails individuals and groups in society achieving their preferences at the lowest possible cost. In this respect regulatory efficiency is determined on its ability to address market failures and deliver the highest net benefit when compared with the available alternatives. Given the national importance of housing affordability, planning regulation, and indeed all aspects of land use regulation, must be assessed in this context. To what extent does any particular regulation achieve a socially positive outcome, and at what cost? Are the net outcomes positive? And what alternative, non-regulatory, methods might achieve a more efficient outcome?
The NSW Planning System

The Improving the NSW Planning System Summary Paper (NSW DoP, 2007b) provides a useful snapshot of the current position of the NSW planning system:

- 105,000 DAs were determined by local councils in 2005/06.
- The average process time across NSW was 68 days.
- Roughly 95% of DAs were determined by council officers under delegation.
- Roughly 4% were determined by councillors.
- The remaining 1.3% were determined by another body, a panel or committee.
- 45% of DAs were for residential alterations lodged by home owners and 17% for new houses.
- 11% of development decisions were made via a complying development certificate.
- $20 billion worth of DAs were determined under the NSW local development assessment scheme.
- $10 billion worth of DAs were determined under the State development assessment scheme (NSW DoP, 2007b).

The NSW planning system has been widely criticised as being overly complex, unresponsive and under performing. Encouragingly, the main stakeholders agree that reform is needed; however they all have differing ideas as to the best way to improve the system. At the same time those most affected by the impact of the planning system on housing affordability - first home buyers - have little involvement or representation in the reform process. This is concerning, and the impact of the planning system on housing affordability receives limited attention in the current NSW Department of Planning reform papers (2007b & 2007a). Nonetheless the NSW State Government has acknowledged the need for planning system reform via the release of its Improving the NSW Planning System Discussion Paper (NSW DoP, 2007a).

Many of the recommendations contained within the discussion paper reflect elements of the recommendations made by the Development Assessment Forum’s (DAF) Leading Practice Model. In 2005 the federal government initiated DAF (whose membership includes the three levels of government, the development industry and related professional associations) released its 10 proposed leading practices for development assessment:

<table>
<thead>
<tr>
<th>1 Effective policy development</th>
<th>Elected representatives should be responsible for the development of planning policies. This should be achieved through effective consultation with the community, professional officers and relevant experts.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Objective rules and tests</td>
<td>Development assessment requirements and criteria should be written as objective rules and tests that are clearly linked to stated policy intentions. Where such rules and tests are not possible, specific policy objectives and decision guidelines should be provided.</td>
</tr>
<tr>
<td>3 Built-in improvement mechanisms</td>
<td>Each jurisdiction should systematically and actively review its policies and objective rules and tests to ensure that they remain relevant, effective, efficiently administered, and consistent across the jurisdiction.</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
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<tr>
<td>4 Track-based assessment</td>
<td>Development applications should be streamed into an assessment ‘track’ that corresponds with the level of assessment required to make an appropriately informed decision. The criteria and content for each track is standard. Adoption of any track is optional in any jurisdiction, but it should remain consistent with the model if used.</td>
</tr>
<tr>
<td>5 A single point of assessment</td>
<td>Only one body should assess an application, using consistent policy and objective rules and tests. Referrals should be limited only to those agencies with a statutory role relevant to the application. Referral should be for advice only. A referral authority should only be able to give direction where this avoids the need for a separate approval process. Referral agencies should specify their requirements in advance and comply with clear response times.</td>
</tr>
<tr>
<td>6 Notification</td>
<td>Where assessment involves evaluating a proposal against competing policy objectives, opportunities for third-party involvement may be provided.</td>
</tr>
<tr>
<td>7 Private sector involvement</td>
<td>Private sector experts should have a role in development assessment, particularly in: - Undertaking pre-lodgement certification of applications to improve the quality of applications. - Providing expert advice to applicants and decision makers. - Certifying compliance where the objective rules and tests are clear and essentially technical. - Making decisions under delegation.</td>
</tr>
<tr>
<td>8 Professional determination for most applications</td>
<td>Most development applications should be assessed and determined by professional staff or private sector experts. For those that are not, either: - Option A – Local government may delegate DA determination power while retaining the ability to call-in any application for determination by council. - Option B – An expert panel determines the application. Ministers may have call-in powers for applications of state or territory significance provided criteria are documented and known in advance.</td>
</tr>
<tr>
<td>9 Applicant appeals</td>
<td>An applicant should be able to seek a review of a discretionary decision. A review of a decision should only be against the same policies and objective rules and tests as the first assessment.</td>
</tr>
</tbody>
</table>
10 Third-party appeals

Opportunities for third-party appeals should not be provided where applications are wholly assessed against objective rules and tests. Opportunities for third-party appeals may be provided in limited other cases. Where provided a review of a decision should only be against the same policies and objective rules and tests as the first assessment.

(DAF, 2005, pp.2-3)

These practices aim to maximise efficiency and certainty in delivery and are practical recommendations based on the DAF’s belief that a leading practice assessment model should:

- Focus on achieving high quality sustainable outcomes.
- Encourage innovation and variety in development.
- Integrate all legislation, policies and assessments applying to a given site.
- Encourage an appropriate performance-based approach to regulation.
- Promote transparency and accountability in administration.
- Be cost effective.
- Be streamlined, simple and accessible.
- Use standard definitions and terminology.
- Incorporate performance measurement and evaluation.
- Promote continuous improvement.
- Promote sharing of leading practice information.
- Provide clear information about system operation (DAF, 2005, p.7).

The Leading Practice Model has been created as a toolkit and elements of it may be progressively adopted by jurisdictions which will over time result in an increased national harmonisation of planning systems (DAF, 2005, p.2). One of the key (and controversial) aspects of the Leading Practice Model is its implied separation of roles; the model outlines an approval process in which approval is independently and objectively assessed against predetermined criteria in a ‘depoliticised’ method. Elected officials no longer play a role in the assessment of development applications; rather their role in the process is confined to the creation of the assessment criteria. The potential benefits of this model of approval are significant, and have been largely adopted in South Australia, as well as in one LGA in Victoria, with positive results. The South Australian and Victorian examples of assessment panel use will receive further consideration in section 7.1.6 of this report.

While the DAF model provides a useful reference for the improvement of development assessment it should be noted that it is predominantly process-orientated and, as such, its recommendations are largely limited to improving the mechanics of the assessment process rather than the overall values and orientation of the planning system. Further, it is suggested that many of the process issues are related to the different objectives held by the different parties involved in the process (London & Chen, 2007c, p.9). While London & Chen’s (2007c, p.3) observation refers specifically to the development approval process, conflicting motives
between all three levels of government and between varying departments suggest that it is also
an apt description of the broader land and housing supply process. Nonetheless the DAF
model provides a valuable point of reference for the consideration of reforms, and there
appears to be a strong correlation between many of its recommendations and those suggested
by the NSW DoP, which is the primary reason for its inclusion.

The NSW DoP's *Improving the NSW Planning System Discussion Paper* (2007a) has
generated significant debate, and the majority of issues considered in this section are the result
of the discussion paper, the responses to it and the recently released draft amendments.

### 7.1 The NSW Planning System Process

In NSW the Department of Planning is the primary body overseeing land use planning and the
*Environmental Planning and Assessment Act 1979* is the central legislation to the process.
Under the legislation there are three types of statutory plans or Environmental Planning
Instruments (EPIs) - State Environmental Planning Policies (SEPPs), Regional Environmental
Plans (REPs) and Local Environmental Plans (LEPs)\(^{38}\). Current EPIs in operation number 58
SEPPs, 44 REPs, and over 5,500 LEPs. While reform is being undertaken to drastically reduce
the number of separate documents in each of these categories\(^{39}\), the multilayered approach is
being retained which is in contrast to states such as South Australia where a single category of
document is used (Mant, 2005, p.2).

The use of multiple categories increases the complexity of assessment as all levels of controls
must be considered in relation to any application as well as in relation to each other (Mant,
2005, p.2). At the same time there has been a trend towards planners listing matters for
consideration in control documents. These matters have to be addressed, resulting in
assessment reports with tens of matters for consideration from any number of control
documents that apply to the particular area of land. By way of example the *Coastal SEPP*\(^{40}\),
which has been layered over an array of pre-existing state and local government control
documents, has 28 matters for consideration, all of which must be addressed in addition to any
other relevant control documents (Mant, 2005, p.2).

The Act identifies five types of development;

- State Significant Development - identified as being of a scale that is significant to the
state of NSW and is to be assessed by the Minister.
- Local Development - the most common type of development, assessed by council.
- Integrated Development - which requires the consent of the local authority as well as
one or more consents of state agencies with reference to the following Acts:
  - Fisheries Management Act 1944
  - Heritage Act 1977
  - Mine Subsidence Compensation Act 1961
  - Mining Act 1992

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\(^{38}\) Note that there are six types of LEP: Spot Zoning, Rezoning, Reclassification, Precinct, Policy, Comprehensive –LGA
Wide and Surplus Government Land. Unless otherwise stated the type of LEP being referred to is a

\(^{39}\) SEPPs will be reduced to 38 and LEPs will be reduced to less than 200 (NSW DoP, 2008a).

\(^{40}\) Available @
- National Parks and Wildlife Act 1974
- Petroleum (Onshore) Act 1991
- Protection of the Environment Operations Act 1997
- Roads Act 1993 Rural Fires Act 1997
- Water Management Act 2000

- Complying Development - identified in the council's LEP. Complying development does not require development approval due to its minor nature but must be undertaken in accordance with a Complying Development Certificate.
- Exempt Development - as identified in the council's LEP. Exempt development requires neither development approval nor a Complying Development Certificate due to its minor nature.

Currently the vast majority - around two thirds of the total value - of development applications are Local Development and are consequently assessed by councils. The main exemption to this is assessment under Part 3A which applies to state or regionally significant residential, commercial or retail projects whose capital investment value exceeds $50 million.

7.1.1 Land Supply, Rezoning and LEPs

LEPs are the main planning documents for councils and form the basis upon which councils control and assess new development. LEPs provide links to the relevant planning rules that apply in that particular area, such as Development Control Plans (DCPs), which complement the LEP and give more detailed design requirements for specific sites/areas.

As of March 2006 councils are required to produce a LEP for their local area in the form of a standardised instrument or template in an attempt to reduce variation, unnecessary duplication and simplify the planning system thereby freeing up resources to focus on strategic planning. At the same time it is hoped that standardised, area wide LEPs will increase community and developer understanding of the planning system (NSW DoP, 2005b). LEP creation times for a whole council area average around five years, which is largely consistent with NSW DoP's plans. However minor amendments take an average of 196 days, largely the result of the same process being used for amendments as is used to create an entire LGA-wide LEP. There are currently no time guidelines within the Act for the plan making process other than the exhibition period for a LEP and there is limited incentive in the Act for the timely resolution of LEPs (NSW DoP, 2008b). The times taken to produce or modify LEPs are extensive:

![Diagram showing average time taken to prepare an LEP by type](image)

Figure 41: Average Time Taken to Prepare an LEP (by Type). (Source: NSW DoP, 2007b, p.7)
Recently, changes to the LEP creation/amendment process have been proposed with the stated aim of reducing both LEP processing times and the number of SEPPs/REP by 50% (NSW DoP, 2007b, p.14). Under the changes an LEP creation/amendment gateway system will be created:

 Council resolves to change policy

 Gateway
 Justification Report

 Minor amendments

 Significant land use changes

 State significant land use changes

 Legal drafting

 Approved plan

Figure 42: LEP ‘Streaming’ and the Gateway Process.
(Source: NSW DoP, 2007b, p.14)

Councils will prepare a written proposal in plain English, improving community understanding of the LEP, to be presented to the Minister who will then determine:

- Whether the matter should proceed or be resubmitted.
- The required community and state or commonwealth agency consultation.
- Whether a public hearing is required by the Planning Assessment Commission (PAC), other person or body.
- Timeframes for further plan-making steps.
- Whether the council is able to approve its own plan under delegation (NSW DoP, 2008c).

The new approach is intended to provide the following benefits:

- New timeframes for each step of the plan-making process will drive down the current slowcoach LEP process.
- Community consultation will be retained for proposed LEPs and there is likely to be far greater community consultation for major LEPs such as those covering an entire council area.
- There can be a circuit breaker for stalled proposals through a referral to a Planning Assessment Commission (PAC) or Joint Regional Planning Panel (JRPP).
- Speculative and ill-conceived proposals can be weeded out at the start of the LEP process while proposals with a sound strategic basis (such as those supported by long-term regional strategies) can proceed.
- There will be early input from government agencies which will have to service the proposed development" (NSW DoP, 2008d, p.9).

Councils are free to develop their own LEPs under the reforms. However the increased centralisation of approval and the requirement for LEPs to be assessed and approved by the NSW State Government on the basis of their consistency with state and regional planning objectives - in particular those outlined in the regional and metropolitan strategies - illustrates
the degree to which the land supply process is centrally controlled. It is important to note that, as previously described, rezoning is critical to the state’s land supply as it is the method by which government enacts and controls the release of developable land. Additionally recent legislation enabling the standardisation of LEP has effectively enabled direct ministerial control over the form and content of all LEPs via the amendment of the standard instrument. This introduction of standardised instruments has moved the NSW system much closer to the Victorian system which has increasingly focussed on the centralisation of strategic frameworks and statutory plans (Williams, 2007, p.98). The Minister’s decision making authority has been further consolidated via amendments to the Act - specifically the previously noted Part 3A amendment in 2005, and the recent highly controversial changes to infrastructure contributions which centralise the collection and distribution of infrastructure funds via the NSW Treasury.

As argued by UDIA NSW (2008b, pp.9-10) there is a need to acknowledge the significant impact of state agency consultation on the timeliness of plan making. To this end UDIA NSW supports the use of a gateway system, as proposed in the DoP reform report. However they also recommend the use of a 28 day time limit for agency responses with a ‘deemed to concur’ default outcome. This recommendation would emphasise the importance of a timely response, acknowledging both the holding costs and the broader economic costs of land use change delays. Additionally it would reduce much of the risk and uncertainty associated with development that requires land rezoning, further reducing costs and enhancing land supply. Industry group The Urban Taskforce (UTF, 2008, p.22) advocates similar measures. Further, they state that the number of spot rezonings requested is a symptom of an overly prescriptive and rigid zoning system which relies on a dated approach to planning. It is suggested that if zoning took a modern and more flexible approach, focussing on the form, scale and relationship of buildings to the surrounds, it would be more able to respond to changing market circumstances and reduce the need for spot rezonings (ibid, pp.8-9).

It is argued that the current zoning scheme, as laid down in the standard instrument, encourages inefficient development which is disproportionately focussed on the limited areas zoned for commercial activity. As such, the UTF’s recommendation is to reduce the complexity of the zoning process by reducing the number of zones in the standard instrument from 34 to seven form-based zonings (ibid, pp.17-18). Such a recommendation is in keeping with Barker’s (2006, pp.3-15) view that increasing the flexibility of zoning would increase the influence of the market in the determination of development. Additionally it would facilitate the creation of mixed-use neighbourhoods with the potential to reduce car use and increase pedestrian trips - outcomes hoped to be achieved through policies of urban consolidation. These benefits are outlined by the UTF (2008, pp.13-14) in their criticism of the anti-competitive restriction of retail development under the NSW planning system. They note that under the current system supermarkets and shopping malls are one of the most heavily regulated sectors of the economy, resulting in a lack of competition and potentially higher costs to consumers. The restrictions, it is argued, prevent the creation of pedestrian friendly, economically strong, mixed-use communities and eliminate the potential to locate places of employment and retail outlets within close proximity to peoples home (UTF, 2008, pp.13-14). Such restrictions actually work in opposition to many of the stated aims of planned development such as reduced car-depency and localised employment opportunities. At the same time they demonstrate the

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41 Note that it is intended that the new Planning Assessment Committee will assess around 80% of the state significant developments currently determined by the Minister. Joint Regional Planning Panels will assess regionally significant developments worth more than $50 million (NSW DoP, 2008a, p.4).
inefficiency of over-regulating development - demand is best measured by the market than by bureaucratic means otherwise inefficient allocation results.

While the draft legislation changes may result in the faster and more efficient production of LEPs it is questionable as to whether this will prove to be a long-term improvement in terms of housing affordability. Improving the efficiency of the existing planning system clearly has the potential to improve supply however the current reforms appear to be coming at the cost of increased centralisation. This is concerning as, although centralisation can enable rapid responses to housing affordability crises, such as those recently made by the Victorian and Queensland State Governments, it can also serve to isolate routine land supply decisions from market signals.

As the comparison between the German, Swiss and Irish planning systems indicates, the lack of responsiveness of centralised planning systems can play a key role in declining housing affordability. Centralised planning systems generally lack an effective mechanism whereby changes in demand are registered and generate supply-side responses. In less centralised and less restrictive planning systems changes in demand are more able to induce supply through the price mechanism, which in turn acts to dampen price rises. One aspect of the mechanism operates through the obvious effect of price as a signal to the private sector, however local government also receive a 'price' signal - increased revenue generated from growth induces them to make more land available for residential development. In a centralised system however, increased demand no longer induces supply as government planning agencies, removed from market signals, make supply decisions dependent on their own requirements such as the cost of infrastructure provision to government. Such decisions may even be made on the basis of political economy. While the private sector may attempt to produce more dwellings in response to increasing prices, the land supply will not be similarly responsive and the likely outcome will be significant increases in the price of developable land with limited increases in the dwelling supply. As noted in section 4 of this report, there is substantial evidence to suggest that this situation has occurred in recent times throughout NSW and it is particularly noticeable in Sydney's Growth Centres. This has resulted in an increasingly dysfunctional new housing market with attendant implications for housing affordability. Reforms which seek to increase the centralisation of the current planning system only will serve to exacerbate its lack of responsiveness to market signals.

As previously noted, targeted land releases and restrictive zoning - a common practice in centralised planning systems - enables land holders to charge significantly increased prices for land in those areas which have been approved for development. Due to the artificial restriction of developable land rezoning has significant economic implications. Rezoned land (and even land which is considered by the market to have the potential to be rezoned in the short to medium term) has a significantly elevated market price. The generation of these profits is enabled by the restricted supply which reduces competition between landholders. As previously noted by Richards (2008), in the absence of restriction developable land on the urban fringes should be priced similarly to rural-use land. Again this effect is particularly apparent in Sydney's Growth Centres with dramatic increases in the cost of developable land occurring. Without such restrictions land holders would be increasingly placed into competition with each other and would be unable to sustain inflated prices. Increasing urban fringe land supply and decreasing the restrictiveness of planning and land use requirements will reduce the ability for such high profits to be maintained.

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[42] See Section 8 of this report.
Given the possibility of earning such high profits it would be naive in the extreme to suggest that neither land holders nor developers would seek to benefit from rezoning. It should be clear to all that the pursuit of profit underpins our economy and is considered to be rational economic behaviour. The real issue is not the behaviour of landholders or developers in seeking to benefit from windfall economic profits, rather it is the current system of land supply and its ability to distort the land/housing market to such an extent that these types of profits can be made while at the same time remaining unresponsive to market signals.

The creation of specific planning strategies such as the Sydney metropolitan and regional development strategies are useful tools by which the NSW Government may target growth and encourage cost effective development in terms of infrastructure provision. However they are not without cost. Such strategies have the potential to greatly increase the cost of developable land and hence house prices, particularly if not sufficiently generous with their land releases. Plan making in NSW lacks a strategic and outcome-focussed approach and there is an acute need to make plan-making more responsive to demand (UDIA NSW, 2008b, p.9). The same may be said for the entire land and housing supply process. Market signals should play an important role in ensuring the efficient conversion of land with consent authorities taking a positive approach to land use, particularly where there is little or no likelihood of harm. It is argued that the LEP process is unnecessarily constraining with consent authorities attempting to restrict land use changes based upon their own, often misguided, assessment of demand. As noted in the UK’s Barker Review of Land Use and Planning (Barker, 2006, p.29):

> It is not the role of local planning authorities to turn down development where they consider there to be a lack of market demand or need for the proposal. Investors who are risking their capital and whose business it is to assess likely customer demand are better placed than local authorities to determine the nature and scale of demand.

### 7.1.2 Opportunities for Appeal

In NSW there is a 12 month appeal period available via the Land and Environment Court (LEC) during which the refusal of development consent or conditions imposed by the consent authority may be reviewed. However this right of appeal does not relate to decisions of rezoning. The right of appeal in the LEC was questioned by local government resulting in a NSW Attorney General Working Party that upheld the Land and Environment Court’s jurisdiction, albeit with some amendment to the appeals process (Williams, 2007, pp.107-108).

Unfortunately the current right of appeal in the LEC is essentially an assessment of whether council has complied with the DA process. The nature of this appeal process has implications for the approval process. There are considerable costs to councils associated with the contesting and possible loss of these appeals. In 2004/05 the average annual legal expenditure per council was over $280,000 (London & Chen, 2007b, p.15). The NSW DoP (2007) notes that seven councils in NSW have lost more than 60% of their appeals, with one losing over 90%. As Mant (2005, p.3) notes, due to the complexity and inefficiency of the system "(A)pplicants, objectors and councils have to spend excessive amounts on operating the system". The end result is that councils are effectively encouraged, by the costs associated with a successful appeal, to focus upon getting the process exactly right rather than the overall outcomes of the process.
The recently proposed use of planning arbitrators, who will conduct non-adversarial reviews, to review determinations and deemed refusals of development proposals of less than $1 million, has the potential to greatly reduce the legal costs associated with the current appeals process. Ideally the arbitration process will be able to solve disputes at low cost avoiding the need for LEC appeals (NSW DoP, 2008, p.5). However concerns have been raised as to their benefit, with Mant (2008) suggesting that they will only increase complexity by including yet another step in the decision-making process which will encourage more ambit claims. To this end the success of the arbitration panels will depend on their ability to generate timely and appropriate decisions without increasing overall assessment times and cost to councils and applicants.

If such an outcome is not generated an alternative may be the increased use of merit-based hearings in the Land & Environment Court (Mant, 2008). A similar argument was made by Cr Genia McCaffery, President of the Local Government and Shires Associations (LGSA), at the LGSA Leaders Forum. McCaffery (2008b) argued that the introduction of a merit-based third-party appeal system such as those currently used in Victoria, South Australia, Queensland and Tasmania would reduce the need for councils to prepare extensive and exhaustive reports in order to eliminate the possibility of legal action, therefore simplifying and expediting council’s DA processes. Clearly the establishment of such an appeal system would have to be carefully considered to ensure it did not simply become a further impediment to the approval process. However if combined with the increased de-politicisation of the approval process – via the use of independent assessment panels – such a system would help to streamline the approval process and move council focus towards outcomes rather than procedure.

A merit-based appeal process may also be a worthwhile addition to land rezoning. In situations where the viability of a development is dependant upon rezoning the situation has been made increasingly complex by the need to refer the LEP to the state government LEP Review Panel, which has a stated opposition to spot rezoning (NSW DoP, 2006, p.3). There is no opportunity to appeal such zoning decisions and this greatly increases the risk involved when considering development that involves land rezoning. A similar merit-based appeal process to that suggested above for developments of a substantial size that require rezoning would be a worthwhile addition, reducing the need for developer’s to resort to Part 3A assessments. However it must be noted that the need for this type of appeal process would be greatly reduced if a more positive approach to spot rezoning was taken by the LEP Review Panel, or a more responsive planning system was in place.

7.1.3 Development Approvals

As noted, LEPs provide the overall guidelines by which development applications are assessed with the majority being for matters involving single house developments, of which 45% were for modifications lodged by the home owner. Despite this, average assessment times are well in excess of the statutory 40 day assessment time. Figure 43 indicates some of the causes for delays in DA processing as identified by local government.
Figure 43: Causes of Delays in DA Processing as Identified by Local Government.
(Source: NSW DoP, 2007b, p.6)

The graph indicates several potential areas for substantial improvement with the three most prominent being the standard of DA submissions, complexity and information requirements and integrated and concurrence delays. Addressing the sources of these types of delays has the potential to significantly improve the assessment process and should be a key focus of any reform.

7.1.4 Track-Based Assessment

A significant reform currently proposed for the development approval process is the use of track-based assessment whereby the level of development approval required is tailored to the size and complexity of the respective development. This reform is hoped to improve the efficiency of the approval process by ensuring applications receive the appropriate level of consideration relative to their complexity.

Figure 44 indicates the assessment levels proposed.

Figure 44: Tailoring the Required Sign-off Level to Development Size & Complexity.
(Source: NSW DoP, 2007b, p.16)

State significant projects would be assessed either by the Minister or the Planning Assessment Commission (PAC), with the intention that the majority of projects currently assessed by the
Minister (including all current Part 3A applications) would be assessed by the PAC while projects deemed to be of critical significance to the state would continue to be assessed by the minister. The PAC would be appointed by the state government on the basis of relevant skills for a particular application and would have a permanent chair. (NSW DoP, 2007a, pp.54-55).

Regionally significant projects, such as projects by state agencies with a capital investment value of greater than $5 million or other developments exceeding $50 million, would be assessed by the JRPP. The JRPP would be resourced and partly staffed by the host council. The remaining members would be appointed by the chair of the PAC from a list approved by the minister. Should the relevant council not have adequate resources to undertake the assessment via a JRPP then approval will be determined by the PAC (NSW DoP, 2007a, p.55).

Local applications would continue to be assessed by councils with an increased use of assessment panels in an advisory role (NSW DoP, 2007a, p.55).

Complying development (the range of which would be greatly increased) would be certified by councils or by accredited private certifiers and would apply to minor and routine development. The use of the complying development assessment track will not be based on a specific project value, rather it will be based upon the type of development and its ability to conform to a series of specific codes. For example, proposed codes include development such as:

- Single Storey New House, Lot Size >600m2.

The values at which regional and complying development levels are set is proving to be particularly controversial. Industry bodies suggest the upper limit for council involvement in development assessment should be set as low as $1 million in their alternative model - which includes an independent assessment panel operating between council and regional levels - to assess applications between $1 - $30 million (UDIA NSW, 2008b, pp.3-8). Alternatively, local government associations, such as the Local Government Managers Association (LGMA) and the LGSA, oppose the establishment of Regional Panels arguing that they will increase, rather than reduce, the complexity of the system and are an unnecessary addition (McCaffery, 2008b & LGMA, 2008).

The most recent draft legislation has set the level for assessment by Joint Regional Planning Panels at a minimum of $50 million for regionally significant development (NSW DoP, 2008d, p.4). With regard to the assessment of major and regional development, both the LGSA and UDIA NSW support the use of the PAC in order to increase the transparency of major development assessment. However the LGSA goes further suggesting that the PAC should be overseen by Parliament (McCaffery, 2008b). Similar concerns regarding the accountability of the PAC have been raised by the UTF (2008, p.6) who state that industry would have little confidence in an unaccountable bureaucratic institution. Concerns regarding the increasing centralisation of the planning system have been widespread and the potential for the NSW State Government to focus on its own economic objectives at the cost of environmental and social outcomes has been noted as a contentious issue (London & Chen, 2007, p.6). The PAC, which is anticipated to assess around 80% of the state significant development proposals currently assessed by the Minister (NSW DoP, 2008, p.10), may go some way to addressing these concerns, however the in-practice result of the PAC, and the JRPPs for that matter, will remain unclear until they have been put into use.
Given the role of the Minister in appointing the PAC chairs, and the role of the PAC chair in appointing the majority of JRPP members from a list approved by the Minister, concerns regarding the increased centralisation of assessment appear well founded. Also notable is the shift in the range and quantity of development whose approval has been moved beyond local control towards the department. This will further increase the effective centralisation of the planning system. Ultimately, increased independence and accountability may be needed in order for such panels to function as methods of independent assessment rather than as extensions of ministerial authority.

The proposed increased use of Complying Development Certificates (CDCs) has the potential to substantially reduce development approval delays for a large percentage of applications. Over 60% of development applications were for the relatively simple matters of residential alterations and new houses (NSW DoP, 2007b, p.4). As NSW Minister for Planning Frank Sartor (cited UDIA, 2007, p.33) recently pointed out, NSW determines over twice the number of development applications per annum than Victoria. This is despite the fact that Victoria is currently producing several thousand more dwellings than NSW (ABS, 2008b). According to UDIA NSW (2007, p.15) this reflects the assessment of too many minor matters. Preliminary estimates by the NSW DoP (2007b, p.17) indicate that for 2006-2007 more than 95% of all applications had a value of less than $1 million. The NSW DoP’s recommendation mirrors that of UDIA NSW - they suggest a target of 50% complying development within four years in order to free planning resources from assessing relatively minor matters to deal with more complex proposals.

When CDCs were introduced in 1997 it was intended that work previously requiring only a building application would be covered by this system. However this has not been the case. Prior to the changes over 60% of all developments only required a building application whereas currently only 11% of development decisions are accounted for by CDCs (NSW DoP, 2007b, p.6). However, as both the current (2007) and earlier (2003) reform reports note, despite the generally low state-wide use of complying development a number of rural and regional councils have achieved complying development ratios of 30-50% under current controls (DIPNR, 2003a, p.15 & NSW DoP, 2007b, p.17). Significantly, those councils which have high rates of complying development have found it to be an effective method of dealing with routine development which reduces congestion in the broader approval process and, importantly, does not result in diminished development quality. Additionally, due to the deregulation of complying development fees, charges can be matched to the level of assessment appropriate to the development (DIPNR, 2003a, p.15). This is consistent with the economic principles of efficiency and equity.

The greatly increased use of private certifiers resulting from the proposed increase use of complying development has been raised as a matter of concern on two fronts. Firstly, in terms of conflicts of interest, and secondly, in terms of the potential to reduce legitimate public participation in development decisions - with a resultant impact on the amenity and character of residential areas (McCaffery, 2008a). In NSW there have previously been considerable concerns regarding safety and quality in buildings approved by private certifiers resulting in an inquiry and subsequent amendments to the Act (Williams, 2007, p.104). Issues regarding conflicts of interest and accreditation are acknowledged in the DoP’s reform paper and some measures have been suggested to address these issues (NSW DoP, 2007b, p.20). However the proposed restriction to the number of applications to which a certifier may be appointed in order to reduce conflicts of interest (NSW DoP, 2007b, p.15) may be seen as an unfair
restriction of trade that may result in unintended anti-competitive behaviour such as fostering the creation of developer/certifier cartels (Ku-ring-gai Council, 2008, p.12).

It has also been suggested that previous increases in the use of private certifiers actually increased the complexity of the approval process. As a result of splitting the development assessment process in two, and the issue of private certifier conflicts of interest, councils have been forced to increase the complexity and completeness of designs at the approval stage in order to ensure the safety and amenity of neighbours and the community in general - increasing the cost of an application before applicants know if their developments are acceptable (McCaffery, 2008b & Mant, 2008, p.2).

An alternative solution is that private certifier’s certificates should be made to council who will then issue a detailed construction consent. In this way council relies on the private certifier’s compliance advice, encouraging councils to accept first stage DAs with minimal detail, speeding up the process and reducing some of the need to increase complying and exempt developments (McCaffery, 2008b & Mant, 2008, pp.2-3). The use of private certifiers in this manner would resolve conflict of interest issues as well as making use of market competition rather than regulation to ensure certifier performance. Certifiers with good records and who are trusted by government will be more likely to achieve faster consent; as a result they will have an advantage in the market and consumers will be encouraged to seek out their services. In contrast the current system encourages consumers to use certifiers who cut corners and then relies on regulation to control this form of behaviour. The alternative system has the potential to retain the efficiency gains associated with outsourced certification as well as enabling government to accept staged development applications, streamlining the DA process (Mant, 2008, p.3). The incorporation of this method into the approval process merits consideration and may prove beneficial in the acceptance of a wider range of complying development by local government. A possible application would be the use of this ‘split’ complying development approval for more significant development, such as multi storey houses or small unit developments, while the standard complying development approval process is used for more minor development.

7.1.5 Assessment Panels

The suggested increased use of Independent Hearing and Assessment Panels (IHAPS) in an advisory role by the NSW DoP (2007b, p.15) has been given some support by local government organisations. While the successful use of such panels by some NSW councils43, such as Sutherland, Fairfield and Liverpool, is acknowledged, the need for these panels to be a non-compulsory, advisory-only role has been emphasised (McCaffery, 2008b). However UDIA NSW (2008, p.3), amongst other industry groups, advocates the compulsory use of IHAPS and this method of assessment is advocated in the DAF model. As previously noted, UDIA NSW proposes their use in the assessment of all developments of a value between $1 million and $30 million that are not considered to be of regional or state significance. One potential benefit of the use of IHAPS is the separation of political influence from the approval process, thereby reducing opportunities for issues of political donations and inappropriate influence to enter the approval arena (NSW UDIA, 2008, p.5). Alternatively, however, it may be argued that IHAPS have the potential to increase the opportunities for corruption by removing the public accountability from the approval process. However these concerns could be addressed via

appropriate regulation, monitoring and disclosure requirements as the following examples of their use in Victoria and South Australian illustrate.

7.1.6 Assessment Panel Use in Other States

While the Victorian planning system is also in need of reform\textsuperscript{44}, it does provide one notable example of assessment panel use; the Surf Coast Shire has used a planning panel for the assessment of development applications for 12 years to good effect, as noted by Jennifer Cunic (2006), the Victorian Executive Director of the PCA.

The Surf Coast Shire is among the fastest growing regional municipalities in Victoria, with average growth of over 3\% pa for past 15 years (SCS, 2008b). The Shire covers an area that ranges from rugged coastline to native forest and rural plains. As such, it has a wide range of physical and topographical features which impact on urban development and land use management, resulting in distinctive communities with varying development expectations (SCS, 2007). Despite this complexity, the use of assessment panels has been largely successful, with applicants and objectors confirming they had received an open and independent hearing that made clear the reasoning behind decisions (DoITRDLG, 2005). The process received a federal government award in 1998 for Leading Practice in Local Government and has recently been recommended as an example for other Victorian local governments to follow by the Victorian PCA in a submission to the Victorian State Government (DoITRDLG, 2005 & Cunic, 2006).

Under the Shire’s model an assessment panel - the Planning Committee - is a decision making body that is delegated by council to make decisions on planning permit applications where council officers have recommended a refusal or where there are objections to a proposal (SCS, 2008a). Specifically in cases where:

1. Objections have been received to an application.
2. A council officer is recommending refusal of the application.
3. An application of major significance or sensitivity has been referred by the responsible authority (SCS, 2005).

The Planning Committee consists of five community members with full voting rights and one council officer with the right to debate but not to vote on matters before the committee. Committee members are appointed for three year terms on the basis of geographical representation, appropriate experience and expertise, and communication and conflict resolution skills. In considering planning applications the Committee must consider the Shire’s Planning Scheme & Guidelines, as well as state and council policies. The Committee also considers issues such as any objections and submissions it has received, any decisions or comments from referral authorities, any significant environmental, social or economic impacts, any plan, policy code, or guideline that has been adopted by the planning authority but does not yet form part of the planning scheme and any other matters considered relevant\textsuperscript{45}. Conflicts of interest are managed via member’s declaration of a ‘Register of Interests’ and members may not act in any case where they have an interest, other than presenting an application or objection as a normal submitter (SCS, 2005).

\textsuperscript{44} See \textit{Cutting the Red Tape in Planning; 15 recommended actions for a better Victorian planning system.}
\textsuperscript{45} As per Section 60(1) of the Victorian Planning and Environment Act.
Under circumstances where a development is contentious to the wider community or where a
decision may influence policy development there is provision for an application to be either
called-in by council or referred to council by the Committee (SCS, 2008a). As noted in the
Committee’s Terms of Reference: "Provision for a planning application to be referred to, or
called-in by, Council is an essential part of the community-based committee system. It
acknowledges that certain applications are best dealt with by the full Council rather than the
Committee, due to the level of community interest generated by an application or an issue of
policy is raised that should be handled by Council" (SCS, 2005). Such a call-in would require
the agreement of a minimum of five (out of nine) Councillors.

It would be considered normal for an application to either be referred or called in under the
following circumstances:

- The Planning Committee has a tied vote.
- Receipt of a significant number of objections highlighting wide community concern.
- Proposal seeks a significant variance from the performance standard which may have
future decision making and policy implications.
- There is conflicting policy or a policy vacuum which may have future decision making
and policy implications (SCS, 2005).

The importance of only using the call-in procedure for legitimate reasons is noted with abuse of
the procedure having the potential to eliminate the advantages of the committee system (SCS,
2005). This is a particularly notable statement given the fact that extensive over-use of the call-
in procedure would essentially result in an assessment system similar to that currently used by
the vast majority of NSW, and indeed Australian, councils. Also noted is the importance of open
and clear lines of communication between the Committee and council in order to maintain the
success of the Committee and confidence of council in the process. As a result, information,
such as statistics regarding the number of applications reviewed, decisions upheld, Committee
minutes with regard to planning issues that have arisen, etc, is to be made available, and
annual meetings with opportunities for feedback undertaken (SCS, 2005).

The system adopted by the Surf Coast Shire does much to address many of the concerns
raised by NSW local government and their representative bodies in response to the increased
use of panel development application assessment. Concerns, such as those raised by then
President of the Australian Local Government Association, Mike Montgomery (2004 & ALGA,
2004), that the DAF model’s separation of roles is unworkable as no planning policy could be
sufficiently robust as to eliminate the possibility of inappropriate development being approved,
and that, as a result, elected councillors must be able to act on the community’s behalf are
addressed under this model via the call-in power. The argument that assessment panels
remove the power of democratically elected officials to act in the interest of the community
(ALGA, 2004) is similarly addressed.

However it may be argued that such arguments carries little weight regardless - the criteria by
which developments are assessed are determined by democratically elected officials and their
removal from the assessment process would allow greater effort to be devoted to the
development of these criteria. Further, the involvement of councillors in the creation,
interpretation, and application of development rules is contrary to the doctrine of the separation
of powers under which the larger Australian political system operates.
The doctrine of separation of powers exists in order to maintain individual liberty and prevent the arbitrary rule that can result when one individual or group has the power to both create and pass judgement over laws. Essentially the doctrine is a theory of government whose objectives are the protection of liberty and the facilitation of good government via appropriate specialisation (Carney, 1993). To this end Australia uses a tripartite separation of powers to a varying extent at the state and federal levels. A simple example makes the issue clear; in Australia laws are enacted through parliament, however the application of these laws takes place through the court system. Were politicians are able to both enact and pass judgement over laws, as is effectively the case with regard to development approval, concerns for the integrity and reliability of the legal system would be blatantly apparent. As Cunich (2006) noted in her submission to the Victorian Government on planning reform, it would not be considered appropriate for the Attorney-General to sit on judgement bodies or law-interpreting tribunals, yet the same principle is being violated when elected local government officials interpret the planning policies they enact.

While it may seem overly grandiose to compare the activities of local government planning approval to one of the principles behind the structure of modern democracy, the principle of appropriate separation of power is as valid at this level of government as at any other. To some extent then it is not unreasonable to suggest that the inclusion of councillors in all aspects of the planning process is fundamentally less democratic than the situation created under a panel system such as that used by the Surf Coast Shire. Further, the model’s success provides a strong argument for its broader adoption - as Cunich (2006) has called for: “The system has depoliticised planning decisions and reduced inefficiencies. There is no reason why other Victorian local government authorities shouldn’t follow the Surf Coast Shire example. Local government should move on from being bogged down in individual planning cases and focus on the big picture of what they are trying to achieve”.

Peter Verwer (cited Robinson, 2008 p.36), ex Chair of the Development Assessment Forum and current CEO of the PCA, makes a similar point with regard to the South Australian use of the panel system: “The South Australian experience proves that this is a democratic approach...it doesn’t undermine communities at all”. He adds that he considers it to be far more democratic than the system it replaced. To date South Australia is the state that has gone the furthest down this path, with the Development (Panels) Assessment Act 2006 (which came into force in February 2007) requiring councils to delegate DA assessment decisions either to council staff, a seven member council Development Assessment Panel (DAP), or a regional development assessment panel.

The South Australian DAPs perform a statutory role mandated under the Development Act 1993 and play an essential part in the governance of the development assessment process. The panels make decisions on development applications brought before it but do not act as a policy making body (Williams, 2007, p.43). Amendments to the Act, such as those made in July 2001, recognise the need for council’s to be able to use more of their available resources to undertake strategic, rather than day-to-day, planning decisions (Campana cited LGASA, 2006, p.3). An amendment on 24th February 2007 requires that all council DAPs are to be operational under the provisions of the Development (Panels) Assessment Act 2006 by that date. Under the Act councils must delegate their development consent authority to the DAP which consists of seven members unless an exemption has been sought from the minister (LGASA, 2006, p.10). Membership consists of one presiding member, who must not be a council member or officer, up to three council members or officers and at least three non-council members. The appointment of members is subject to relevant experience and council officers who are
appointed must not have been involved in the preparation of reports or the assessment of any matter that the DAP is considering (ibid, p.8).

Issues of influence and conflicts of interest are also to be considered in the selection of panel members, which is undertaken by Council, and the maximum term of appointment must not exceed two years. Specific grounds for removal of members are outlined with regard to issues such as misconduct and independent members have an additional duty to disclose their financial interests (ibid, pp.11-16). Decisions on applications are made via a vote with the presiding member having a second or casting vote in the event of an equal vote. Similar to the Surf Coast system there is an emphasis on public openness with meetings to take place in a place open to the public. DAPs must also have a Council-appointed public officer whose duties include ensuring complaints regarding the panel or member conduct are properly investigated (ibid, pp.16-18). Council members who are not DAP members are free to act as community representatives either in a support or stand in role (ibid, p.21).

As noted by Brian Moulds (cited Robinson, 2008, p.36) one of the engineers of the South Australian policy change, part of the reason that South Australia has been quicker than other states to move to this system, is that independent assessment bodies are not new to the state: “The South Australian planning system for a long, long time has some of these elements in it”. Mr Moulds (ibid, p.36) points out that judging each case via a politicised assessment process takes too long, creates too much uncertainty and impacts on the ability to get development policy right: “Assessing development applications against policy should be a judicial process, not a political one”.

The model has already received praise from PCA Executive Director for South Australia, Nathan Paine, who notes anecdotal evidence of a 10-20% improvement in assessment times. At the same time Mr Paine also admits that the move to the new system has had some issues, with desirable developments being rejected due to deficiencies in the local plan (Developer, 2008). However it must be noted that the highlighting of such issues is in some ways one of the positive aspects of the use of the panel system; it places an emphasis upon the need for consistent plans and frees the resources to do so. Planners also seem to see the merit in the changes, as SA ranking the highest of all Australian states in terms of its streamlining of planning assessment in the Planning Institute of Australia’s 2007 Planning Report Card (PIA, 2007). The South Australian system’s use of DAPs makes it the closest adherent to the DAF model’s Leading Practice Principles and it will be interesting to see the results of the recently announced State Planning and Development Review46.

It must be said that South Australia seems to have a far more positive attitude towards planning reform than other states, with Urban Development and Planning Minister Paul Holloway (2007) stating that the South Australian Government’s aim is to make the state the most competitive place in Australasia in which to do business. Achieving this goal will be aided by gaining a competitive advantage over other states via greater efficiency and effectiveness, and by creating the most effective planning and development system. Notably, Minister Holloway (2007) acknowledges the critical importance of planning reform in establishing the state’s economic competitiveness. Similarly, local government representative body, the Local Government Association of South Australia, appears to be far more open and positive towards development reform than other such organisations. The Association (LGASA, 2008, p. 9) supports the removal of 50-70% of development applications from the current planning system

via codification of standards for types of development similar to those considered to be exempt/complying in NSW.

Assessment panels have the ability to depoliticise the development approval process by improving the consistency of decisions and reducing delays. Importantly, as the Victorian and South Australian examples of panel use indicate, they can achieve this without compromising the quality of outcomes. At the same time they free council resources to focus upon more strategic planning activities and the creation of higher quality planning documents. It is questionable as to whether the involvement of councillors in both the creation of planning requirements and the assessment of development applications is as democratic as is suggested by its proponents, and it appears to be at odds with principles of good governance.

The recently proposed draft legislation by the NSW Department of Planning (2008d, p.10) will make provision for NSW councils to appoint IHAPs in an independent advisory role. This is a positive step; however it is strongly recommended that further progress in the use of development assessment panels needs to be made.

7.2 NSW Development Approval Times

The UDIA (2007, p.33) notes the widespread failure of Sydney Metropolitan Councils to determine development applications within the 40 days prescribed under Environmental Planning and Assessment Act 1979; the mean time for development groups one, two and three (which cover most types of urban renewal activity) was 74 days in 2004/05. The highest mean was well in excess of 100 days. Further, they argue that these figures are somewhat misleading with respect to the time taken for large project approval, as the majority of the applications recorded would be for relatively minor developments such as home modifications. According to the UDIA (2007, p.33), major proposals, which represent significant amounts of investment and risk, are much more likely to be subject to extended approval delays. This is a significant point. As noted in the Department of Infrastructure, Planning and Natural Resources (DIPNR, 2003a) report on development assessment improvement, the removal of the need to assess large numbers of relatively minor developments – detached houses, swimming pools, additions, etc – will free up resources, allowing councils to allocate more resources to complex applications, improving assessment quality and reducing assessment time. Given current levels of community dissatisfaction with council approval processes, improvements in the speed and consistency of the assessment of relatively minor development would be to the benefit of many councils; the effectiveness of these types of approvals has a substantial effect on the community’s perception of their council (ibid, p.18).

Unfortunately, reforms undertaken since the writing of the DIPNR (2003a) report have failed to adequately reduce the number of minor applications being assessed, a fact acknowledge by the NSW DoP’s recently announced complying development target. While not a key area of consideration in the DIPNR (2003a) report, the steady increase in approval times and costs are at least noted, with Department of Local Government (cited DIPNR, 2003a, p.18) data showing a steady increase from an average approval time of 22 days in 1997/98 to 84 days in 2003 - a level which has not yet been significantly reduced. As a result of the slower approval process and the need for greater documentation Masterton Homes estimated the additional development approval cost at just under $10,000 per dwelling in 2003 (ibid, p.18). This growth

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47 Note that there has been modest improvement in these statistics in the 2005-2006 period, see NSW DLG, 2007 for further details.
in approval times and associated costs illustrates the increasing impact of the approval process on new house prices and housing affordability.

Holding costs (the interest and other costs associated with delays caused by the approval protest) can add significantly to the cost of new dwellings. While they can often be hard to quantify, particularly if forgone alternative investments are considered (opportunity costs), industry body reports such as the NSW Urban Taskforce (2007) indicate their ongoing growth. Holding costs are now estimated to be in the region of 15-20% of total project value, resulting in increased development costs of up to $4 billion annually in NSW alone. As much as $40,000 of the cost of a $350,000 family home is the result of uncertainty in the DA process and associated holding costs. As the DIPNR (2003a, p.18) reform report notes, these increases were the largely unintended consequences of earlier (1998) reforms. While the reforms were intended to streamline the development process they resulted in increased council assessment of dwellings due to their new status as ‘development’. Community expectations of consistent and clear standards for new housing were effectively overridden by expectations of the protection of the character of existing neighbourhoods. While not articulated in the report, the implications for housing affordability are clear - the approval process has become slower and more costly, uncertainty in the process has increased, and common standards are unclear (ibid, p.18) resulting in increased costs and reduced supply of new dwellings. These outcomes should serve as a warning to the Department of Planning with regard to current reforms.

7.2.1 Targeted Development Approval Times

While the NSW Department of Planning (2007b, p.15) is targeting a general reduction in average DA processing times – from 68 to 48 days – it has also suggested that time lines for development approvals be ordered to more accurately reflect the complexity of applications. The following times have been suggested:

- 10 days for a complying development certificate.
- 20 days for DAs not requiring exhibition.
- 40 days for small-scale development.
- 60 days for medium-scale development.
- 90 days for development equivalent to designated development (NSW DoP, 2007b, p.15).

In principle targeted development approval times - which provide benchmarks that reflect the relative scale and importance of development - have the potential to improve the efficiency of the approval process. It is clear that prescribing a 40 day approval period to both a small residential extension and a multi-unit residential project is inappropriate. By targeting assessment times to development size and complexity the time limits will provide an appropriate resource allocation signal, increasing the efficiency of assessment. Minor development will receive limited consideration and complex/sizeable development significantly more.

Such changes also have the potential to reduce the number of appeals faced by local governments by clearly prioritising the appropriate time for the assessment of an application relative to its complexity. At the same time council’s ability to ‘stop the clock’ on a DA – allowing them to stall an application without it being counted towards the 40 day statutory assessment period – has been removed (NSW DoP, 2008a). However the effectiveness of the changes will largely depend on their ability to remove the work load associated with the assessment of minor development in order to free resources for the assessment of more complex matters. As
councils are not being provided with increased resources as a result of the reform, their ability to meet these new targets and maintain assessment quality will largely depend on the ratio of the gains to losses engendered by the changes. Such outcomes will only become clear with time; however there is much to suggest that the increased use of complying and exempt development and independent assessment panels will aid this process.

7.3 State Government Agency Consultation

The need for state government agency referrals is a significant cause of delay to development approvals (NSW DoP, 2007b, p.6). Under the current multilayered structure of the NSW planning system the consent process often requires the referral of applications to multiple state agencies due to concurrences, integrated developments and various other consent requirements.

Both industry groups, such as UDIA (2007, p.33), and local governments (see Figure 43) note the increased delays associated with referrals to various government agencies who often have competing agendas. The NSW DoP (2007b, p.15) has acknowledged the need to reduce such referrals by increasing the amount of information available in the relevant guidelines and standard conditions, and has also acknowledged the need to reduce agency reply times where referral is necessary. However the reform paper has little suggestion in terms of improving this situation and development applications are increasingly determined on the basis of single issues, such as natural vegetation preservations or bush fire risk, as a result of the effective veto power granted to Departments by the current legislation (UDIA NSW, 2008b, pp.7-8).

Conflict between various state and local government sectors, as well as inter and intra governmental policy conflicts, represent a significant concern for the development industry (London & Chen, 2007b, p.2). Anecdotal evidence suggests that dealings with certain departments can be particularly difficult and, critically, UDIA NSW (2008b, pp.7-8) points out the importance of considering development applications in their broader context of the potential community benefits and positive economic externalities associated with them. Such concerns are mirrored in the UK’s Barker report (Barker, 2006, 3-15). These types of inefficient, cost-inducing delays should be a key target of reform.

The UDIA NSW’s (2008b, pp.7-8) suggested solution to this issue is twofold; firstly that integrated development assessment and concurrence requirements should be amended so that consent authority in these circumstances resides with the minister and may be delegated accordingly; secondly it is recommended that councils are indemnified against prosecution in circumstances were DA determinations have been made in good faith in the absence of timely advise from government departments. Limiting council exposure to this liability risk would reduce the delays associated with council’s unwillingness to make a development decision in the absence of advice from relevant Departments, increasing the efficiency of local decision making. It is recommended that this step be taken in conjunction with timeframe requirements that result in a ‘deemed to comply’ default position if the relevant government departments fail to respond within given time frames (UDIA NSW, 2008, pp.7-8).

The final recommendations have merit, however the lack of coordination between various state agencies and local government development regulations would be better addressed via a coordinating body - which could act as a bridge between state and local government (Bengston, Fletcher & Nelson, cited London & Chen, 2007b, p.2), rather than further
centralisation of consent. The creation of a Concurrence Authority tasked with the facilitation of obtaining concurrences is therefore recommended.

The Concurrence Authority would improve interaction between the NSW Department of Planning, various NSW State Agencies, and local government by unifying a currently inconsistent and disorganised series of intergovernmental relationships. In this regard the Concurrence Authority would play a key role in both streamlining the NSW development process by speeding up the approval process, providing clarity and improving applicant submission standards and through the facilitation of informed reform initiatives. In this sense such an authority may be considered a temporary addition to the planning system, providing a short to mid-term benefit with a view to informing further reform to eliminate such conflicts.

7.4 Complexity and Delays as an Incentive to Bypass the Planning System

London & Chen (2007a), in their analysis of three development case studies from different NSW local government areas, note that inconsistencies between state, regional and local planning instruments and policies resulted in an increased potential for conflict. The regulatory environment, rather than acting as a mechanism to reduce conflict and provide clear direction, has increased complexity and the potential for conflict, while at the same time limiting any clear direction as to how to resolve such conflicts as they arise. The issue is further complicated by inconsistencies in the prescriptive and non-prescriptive nature of planning instruments. They note that "(T)he capacity to produce a development application that satisfies both what is prescribed by the instrument as well as the subjectivity of those assessing the application is thus inevitably made more complex by the lack of clear definition by the instruments on what sustainable urban development means and on how to resolve conflicts as they arrive" (London & Chen, 2007a). This results in applicants being greatly influenced by the need to minimise conflicts and difficulties associated with development applications. The need to convince those from whom they are seeking approval encourages a climate of self-interest and opportunism with applicants seeking out whatever strategies necessary to save time and gain approval. At the same time assessors, faced with the reality of time and resource constraints, admit to having to make subjective assessments. The lack of regulatory clarity and consistency and the subsequent tendency towards subjectivity enables an applicant’s ability to persuade an approval authority to become an important ingredient in the application process (ibid). London & Chen (2007a) find that the ability to achieve certain objectives in the development approval process appears to be through the use of persuasive tactics and knowing the best ways ‘to jump through the hoops’. They note that this situation has developed to such an extent that new roles in the industry have developed that essentially amount to professional persuaders. This raises serious questions regarding the outcomes and efficiency of the planning system, and implies a great amount of ‘wasted’ effort in achieving development approvals; the cost of which is ultimately passed on to dwellings in the case of residential development.

Although it is not the subject of London & Chen’s (2007a) study, given the results of their analysis it is not surprising to find that the complexity of the planning system provides both the opportunity and incentive for inappropriate manipulation of the system, and subsequent potential for corruption. As noted, the system is increasingly difficult to understand, and this complexity encourages both applicants and objectors to attempt to influence decisions by undue means (Mant, 2005, p.3). These issues are greatly exacerbated by artificially inflated prices and the possibility of windfall profits and economic rents generated by a restricted land supply. The potential profit associated with development, in a period of restricted land supply and combined with a complex, restrictive, and a non-transparent approval process, create a
strong incentive for the use of inappropriate influence. Further, the complexity and cost associated with the development approval process in such an environment creates a barrier to entry that limits the ability of new entrants to compete away such profits.

The corruption risks generated by restrictive land supply and the development approval process at the local level also exist at the state level as the economic incentives remain. While the issue of corruption is far from new to development -- with recorded instances as early as the 1830s in Melbourne (Sandercock cited Paris, 1993, p.134) - it has become increasingly apparent of late, with the ongoing case at Wollongong council and the scrutiny of political contributions to the NSW State Government. As Moran (2006a, p.6) states: "When vast profits can be made by a politically directed and essentially arbitrary recategorisation there are grave dangers of political corruption". While this is not to suggest that corruption is an inevitable result, nor is the intention to bring into question the honesty of those involved in the development process, it illustrates that the current planning system, through its restrictive complexity and inconsistencies, results in an ongoing incentive for such behaviour.

7.5 Planning Requirements and Prices

Beyond the cost increases associated with the approval process it must also be pointed out that various design and planning requirements similarly contribute to increased house prices. This may occur, for example, by enforcing maximum floor area ratios, maximum building heights, setbacks, drainage and fire offsets, parking requirements, and a wide variety of general building design requirements. This is not to suggest that such requirements are necessarily without merit (and it is well beyond the scope of this report to undertake an empirical analysis of the individual costs and benefits of all such regulations); however it is important to make clear that all such regulation results in both costs and benefits. Further, it is questionable as to whether these costs are being adequately considered, if at all, in the implementation of such regulations. It must be noted that, particularly in the context of a constrained land supply, such regulation, especially land use regulation, may greatly affect the yield of a development and subsequently the final cost of new dwellings.

7.5.1 Land Use Restrictions

The following case study provides an example of the impact of increased land use requirements on the productive yield of an already constrained land supply.

Both figures 45 & 46 are of the same site with similar average lot sizes.

Figure 45 is an approved layout that meets all current requirements for the area. The total yield is 72 lots.

Figure 46 shows the yield available from the land area without any of the constraints that have been progressively imposed upon land development over recent years - such as creek and fire setbacks and slopes greater than 15%. The total yield is 101 lots.

The removal of constraints results in a 40% increase in lot yield. Assuming an average lot price of $150,000\(^{46}\), a 40% increase in lot yield has the potential to reduce the average lot price by

\(^{46}\) Note that actual lots were being advertised between $130,000 to $190,000 in the first development stage at time of writing.
over $40,000 while still maintaining a similar return to the developer\textsuperscript{49}. This represents a significant reduction in the cost of a developed lot which forms an increasingly large component of the total house and land price – well over 40% in many cases (HIA-APM, 2007b, p.2).

This is not to suggest that these particular requirements are without merit and should necessarily be removed, although in this particular case it must be noted that the area in question has been previously subdivided – see Figure 47. This occurred in the early 1920s and although this actual area of land remained largely undeveloped the surrounding lands were developed, and remain in this early form without the modern planning requirements\textsuperscript{50} (LMC, 2008 & Lakemac, 2008). Houses built in these areas would not have been subjected to the extensive developer contribution levies of the current period or the artificially increased land prices that have resulted from the current land release and planning restrictions.

\textbf{Figure 45: Lot Yield Under Current Land Use Requirements.}

\textsuperscript{49} Obviously this could also result in the maintenance of the existing per-lot price and an increased return to the developer when viewed as an individual case. However when viewed from a state-wide perspective it is clear that a general increase in supply will place downward pressure on lot prices.

\textsuperscript{50} Where not subdivided further – a process enabled by the larger block sizes of the time.
Figure 46: Lot Yield Under Without Current Land Use Requirements.

Figure 47: Lot Yield Under as Per 1920s Development Plan.
The purpose of this case study is to illustrate the significant impact of land use requirements upon the yield and subsequent cost of developed land. Given the current situation of constrained land supply and artificially inflated land prices the impact of such restrictions are magnified, as is their impact on housing affordability. It does not appear as though the economic impact of such requirements are being given adequate consideration, nor are these impacts clear to those who ultimately pay for them – new home buyers.

There are undoubtedly many circumstances under which the benefits of land-use requirements exceed their costs and the purpose of this case study is not to argue for their unqualified removal. Rather, it is to argue for a greater understanding and consideration of these costs in order that design requirements are made as efficiently as possible. In fact the land use requirements in this particular example may be completely justified in terms of their costs and benefits - although this seems somewhat unlikely given the use of surrounding land in the previously acceptable standards\(^{51}\). The impact of land use requirements are particularly important when the land supply is constrained and, if such requirements are not being made with regard to their economic impacts, an excessive burden is being placed on home buyers.

Careful consideration of the economic impacts of such requirements and increased transparency of their contribution to new house prices would be a constructive step towards reducing Australia’s housing affordability crisis.

7.5.2 Design Requirements

Design requirements also impact the production cost and supply of new dwellings.

An illustrative example is the supply of new apartments in Sydney’s inner and outer rings. According to the Urban Taskforce (2008, pp.18-20) the supply of new apartments in these areas is being artificially restricted by amenity-focused design requirements. The costs, created by 2002 State Environmental Planning Policy No. 65 – Design Quality of Residential Flat Development (SEPP 65) and the Residential Flat Design Code (RFDC), are pushing the final selling price of residential flats beyond both the borrowing power of potential buyers and levels competitive with houses in the same region.

A case study examined by the Urban Taskforce (2008, p.87) of a five storey residential tower with eight apartments per level and basement car parking indicates that the additional costs imposed by design requirements equate to a total of $880,000 or $22,000 per apartment\(^{52}\).

Table 13 lists the breakdown of these costs.

\(^{51}\) It is acknowledged that standards of ‘acceptability’ with regard to land use may have changed over the interim period.

\(^{52}\) The UTF acknowledges that many of these features would normally be included in 'high end' apartment developments. Consequently these design requirements actually have a greater impact developments built for the lower and middle sectors of the market.
<table>
<thead>
<tr>
<th>Expense</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>External walls</td>
<td>$75,000</td>
</tr>
<tr>
<td>Glazed lobby walls</td>
<td>$10,000</td>
</tr>
<tr>
<td>Glass to additional façade</td>
<td>$15,000</td>
</tr>
<tr>
<td>Additional slab areas</td>
<td>$55,000</td>
</tr>
<tr>
<td>Additional balustrade privacy screen</td>
<td>$20,000</td>
</tr>
<tr>
<td>Ground floor lobby and roof</td>
<td>$100,000</td>
</tr>
<tr>
<td>Loss of profit from 10% of sellable area*</td>
<td>$450,000</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>$75,000</td>
</tr>
<tr>
<td><strong>Total costs</strong></td>
<td><strong>$880,000</strong></td>
</tr>
</tbody>
</table>

* There was a loss of floor space ratio by complying with SEPP 65. The loss of sellable space would be 20% for each 100m² building. When we apply a sales rate of $17,500 per m², there is a loss of $450,000 for the building. The additional construction costs not incurred would be $250,000, leaving a net loss of profit of $450,000.

Table 13: Cost Imposed by SEPP 65 on a Five Storey Residential Tower With Basement Car Parking and Eight Apartments Per Level. (Source: UTF, 2008, p.87)

Also noted are the further cost increases associated with the mandating of underground car parking, as opposed to above ground, which increases costs by $17,500 per space. Given that it is fairly typical for such apartments to be required to provide one and a half spaces for each two bedroom apartment, the additional cost per apartment is around $26,000 bringing the total additional costs to $48,000 per apartment. The Table 14 illustrates the typical cost of producing such an apartment.

<table>
<thead>
<tr>
<th>Expense</th>
<th>Cost per apartment (80-95m²)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase of land</td>
<td>$40,000</td>
</tr>
<tr>
<td>Government charges</td>
<td>$15,000</td>
</tr>
<tr>
<td>Construction (including car parking)</td>
<td>$200,000</td>
</tr>
<tr>
<td>Holding costs (because it takes around 24 months from buying the land to selling a finished serviced block)</td>
<td>$54,000</td>
</tr>
<tr>
<td>Architects, planners, engineers and other consultants</td>
<td>$10,000</td>
</tr>
<tr>
<td>Sales and marketing [4 per cent]</td>
<td>$16,000</td>
</tr>
<tr>
<td>Contingencies</td>
<td>$16,000</td>
</tr>
<tr>
<td>GST</td>
<td>$27,200</td>
</tr>
<tr>
<td><strong>Total costs</strong></td>
<td><strong>$422,200</strong></td>
</tr>
</tbody>
</table>

Table 14: Typical Developer Costs for a Two Bedroom Apartment in Sydney’s Middle to Outer Rings. (Source: UTF, 2008, p.86)

Removing the SEPP 65 generated costs has the potential to reduce the final price of the apartment to $384,200, bringing it into line with consumer demand:

<table>
<thead>
<tr>
<th>Local government area</th>
<th>Price homeowners are willing to pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burwood</td>
<td>$400,000</td>
</tr>
<tr>
<td>Auburn</td>
<td>$400,000</td>
</tr>
<tr>
<td>Bankstown</td>
<td>$420,000</td>
</tr>
<tr>
<td>Parramatta</td>
<td>$390,000</td>
</tr>
<tr>
<td>Liverpool</td>
<td>$375,000</td>
</tr>
<tr>
<td>Fairfield</td>
<td>$365,000</td>
</tr>
</tbody>
</table>

Table 15: Consumer Demand for an ‘Affordable’ Two Bedroom Apartment in Key Local Government Areas of Sydney (GST Exclusive). (Source: UTF, 2008, p.85)
The reductions would result in the project being viable, increasing supply and putting downward pressure on prices and rents.

As the UTF (2008, p.19) note, it seems as though little thought was given as to how SEPP 65 would impact apartment costs or supply, nor does there appear to have been much consideration given as to how to minimise these impacts. While the effect of these requirements undoubtedly add to the amenity of the apartments this increased amenity comes at the cost of increased price, a reduction in consumer choice, viability, supply, and ultimately a reduction in housing affordability.

While this study specifically illustrates the impact of SEPP 65 and RFDC requirements on lower to middle level apartments it also provides an indication of how regulation may have unintended or unanticipated effects upon housing affordability. These impacts demand greater consideration during the formation of policy. While there are undoubtedly benefits associated with land use and development regulation there are, as the preceding example demonstrates, substantial costs. This is to be expected and is not necessarily to be seen as an argument against these types of regulations per se; rather it is an argument for a greater consideration of economic impacts in the creation of such legislation.

Regulation does not take place in a vacuum and the creation of efficient regulation demands an understanding of the outcomes it will generate in any particular market. It is highly questionable as to whether economic outcomes are being adequately accounted for in the generation of land use and development regulation. Further, given that much of the justification for the regulation of development and ‘active’ planning is framed in terms of making efficient use of infrastructure, the creation of liveable communities and development that reflects community expectations, it must be noted that the outcomes of the current, and highly regulated, NSW planning system are often less than ideal. The Western Suburbs of Sydney are, for example, essentially the result of the current planning system and yet are ultimately lacking in good urban design elements and with limited public amenity (Mant, 2005, p.5). Despite this they are subject to large infrastructure charges, price-increasing land supply constraints and a wide variety of planning requirements and, on balance, are far from affordable for low to middle income households. In part this argument is acknowledged by the NSW DoP (2007a, p.49), who admit that it is questionable as to whether the last two decades of increasingly comprehensive and prescriptive planning controls have resulted in a commensurate improvement in outcomes that justify the additional regulatory burden.

To this end it is recommended that an independent review of current land use planning and development regulations is undertaken in order for their efficiency and effectiveness to be assessed in relation to their imposed costs. The outcome of such a review would be the clear illustration of costs associated with such measures in order that they may be considered along with their benefits when policy decisions are being made.
International Planning Examples

There is a clear need to make land supply and development approval processes responsive to demand - as noted by Barker (2006) in her report on the United Kingdom's planning system. The introduction of competitive elements into the provision of land and planning systems has the potential to greatly improve housing affordability and provide the long-term benefit of a highly responsive housing supply.

Evans & Hartwich's (2005) consideration of the German and Swiss land use systems provide informative examples of how the introduction of competitive elements into the planning system has the potential to improve the responsiveness of the housing supply and development in general. Similarly their consideration of the Irish planning system, and its ineffective response to Ireland's housing affordability crisis, illustrates the problem of responsiveness in a centralised planning system.

8.1 Germany

Like Australia, Germany has a federal political structure which has resulted in a particularly complex land use planning system with a hierarchy of different plans and the majority of planning decisions taking place at the local level (Evans & Hartwich, 2005, pp.14-21). However the German system contains several elements that work in favour of development.

Firstly, the right of land ownership and use is constitutionally enshrined and is therefore not a matter of being assigned by local law or regulation. Once an area has been assigned a particular planning character permission to build is not a matter for discretion and the right to build will be enforced by a court if local authorities deny permission. Consequently the rights of the property owner are quite strong. Secondly, there is a set of criteria which must be considered in the construction of land use plans which include issues such as the population's housing needs and the support of population and economic growth. Finally, and most importantly, the federal tax structure is such that local municipality's ability to generate revenue is predominantly limited to a share of local income tax and state government grants which are directly linked to the size of local income tax revenue and the number of local residents respectively. As a result councils are economically discouraged from pursuing policies which limit growth and actively encouraged to develop pro-settlement and business policies (ibid, pp.18-19). Planning has, in effect, become part of the council's fiscal policy, with local politicians encouraging growth in order to increase their ability to fund new facilities and attract more residents. These financial incentives have led to competition between municipalities with cheap land releases being used to attract new residents, typically young families, to green low-density areas which are inline with consumer preferences (as is also the case in Australia). This system of competition has resulted in extremely green and pleasant development, such as in the Ruhr Valley (formerly a heavy industrial and coal mining area), with a high levels of resident satisfaction and quality of life (ibid, pp.19-20).

The constitutional right to use one's own property combined with local government's positive attitude towards development provide a high degree of outcome certainty for developers, which Australia lacks. Even if a site is a difficult development an eventual go ahead is largely assured, and developers often work closely with municipal planners to achieve successful outcomes. At the same time the increased competitiveness of outer suburbs has placed pressure on older inner suburbs to revitalise, encouraging creative brownfield use (ibid, pp.23-24).
Through the introduction of competitive incentives, albeit government regulated, the German planning system has resulted in flexible land release which has acted to restrain both the growth and volatility of house prices. Local councils are free to control local development while at the same time receiving clear economic incentives to streamline land use changes and encourage growth. This enables local solutions to local problems while at the same time producing stable house prices and a flexible land supply (ibid, pp.26-27).

8.2 Switzerland

With over 2,900 largely autonomous municipalities Switzerland is one of the most decentralised countries in the world and, like Germany, uses a system of tax-based incentives (ibid, p.28). As is largely the case in Australia, land use planning becomes more detailed and specific as it moves down the tiers of government with municipalities using a canton (essentially equivalent to Australia’s states) guiding plan in much the same principle as Australia’s regional strategies and LEPs. However, unlike Australia, the needs of the broader population and the economy are specifically mentioned in a federal land use Act, with the rights of the property owner clearly spelt out as the result of constitutional protection from the state. Again, as in the case of Germany, the uncertainties of the NSW planning system are absent, with the zoning system such that if a building fits into the use plan a building permit must be issued53 (ibid, pp.28-32).

As in the case of Germany, it is the taxation system that arguably has the largest impact on the regulation of development. The various cantons and municipalities are largely autonomous in terms of their ability to set taxes and often compete with one another for tax payers, with taxes on income, property, and profits forming around half their budgets. Residents of one high tax area therefore have an incentive to move to an alternative municipality that offers a lower tax rate. The result of this method of funding and inter-regional competition is that local decision-makers act to ensure their regions are attractive to new residents and developers are (relatively) free to provide housing that meets Swiss consumer preferences. Swiss preferences, it should be noted, are not dissimilar to those expressed by Australian home buyers - quiet, spacious and low density (ibid, pp.34-36).

The effect of placing revenue-raising capacity with the same level of government as that which is responsible for related expenditure54 results in planning and development decisions based upon un-skewed cost-benefit analysis, where governments have a direct incentive to facilitate growth. By contrast the Australian system, which largely separates revenue and expenditure, removes the influence of the economic benefits associated with growth from the entire land use and development approval process. In the Swiss system planning is not seen as a way to control and limit development rather it is seen as a tool whereby a region may be strategically developed to benefit both its current and future residents (ibid, pp.34-36).

OECD (cited Warren, 2006, p.171) data confirms the increased tax autonomy of both the German and Swiss local levels of government. In terms of percentages of total tax revenues Australian local government has the ability to generate 3%, Germany over twice as much at 7%, and Switzerland over five times greater at 16.2%. At the same time local government expenditure accounts for a significantly larger proportion of total government expenditure in

53 It must be noted that there is some small level of uncertainty remaining in the process, largely as the result of legal ambiguities (Evans & Hartwich, 2005, p.32).
54 A principle which is consistent with a number of benchmarks listed by Warren (2006, pp.xii-xiv) in his report on Australia's intergovernmental fiscal arrangements.
Germany and Switzerland than in Australia - 14%, 22%, and 6% respectively (Warren, 2006, p.54).

In his review of Australia's intergovernmental fiscal arrangements Warren (2006, pp.6-12) outlines the potential economic benefits of decentralisation in general. He notes that many of the benefits of the federal system are dependent upon sub-national governments having taxation power powers sufficient to fulfil their expenditure responsibilities, which in turn should be determined on the basis of subsidiarity.

Increasing the economic connection between local government and development, as is the case in Switzerland and Germany, would increase the role of the market as a signal in housing provision and land use in general, increasing the responsiveness of supply to demand. As shown by the Swiss and Germany examples this has the potential to eliminate artificial house and land price growth and reduce price volatility.

8.3 Ireland

Ireland's response to their nation's decline in housing affordability provides a warning of the potential downsells of a poorly thought out response that is particularly relevant to Australia. Ireland's housing affordability decline was precipitated by the combination of an extended economic boom, low interest rates, strong population growth, household composition changes, and housing price-growth-induced speculative demand. Circumstances not identical but not so different to those in Australia, with speculative investment exacerbating a genuine need for an increased housing supply and strong price growth encouraging land holding as a result of a slow planning system unable to meet demand (Evans & Hartwich, pp.47-49). Eventually the central government realised the shortage of supply and moved to encourage increases through their influence over local government, who largely rely on the central government for their funding. At the same time developers, anticipating a price peak, increased their output. The result being the rapid and widespread construction of small poorly constructed flats and new estates of semi-detached or terraced houses. These developments had little social amenity and often functioned as dormitory suburbs for existing cities (ibid, p.50). While the increased supply did help to stabilise prices it did so an uneven fashion and with long-term consequences.

Firstly, it must be noted that, as would be the case in Australia, these types of housing do not meet Irish consumer preferences which are for large, detached houses with gardens. Secondly, by addressing demand at only the bottom end of the market the increased supply stabilised low-end house prices but did little to affect the price of older, more spacious house. Such houses, as noted, meet Irish consumer preferences so while the increased supply of low-end houses brought their price growth into line with inflation trade-up demand to older houses has remained extremely strong. As a result, there is a dramatically widening gap between the price of small new houses and large old houses. In the long-term these cheap estates may well become a liability and the problem of housing affordability will still not have been successfully addressed; the quick-fix solution has in effect stored up problems for the future (ibid, p.51).

Evans & Hartwich (2005, pp.51-52) note four main reasons for the inadequate response which bear a striking resemblance to Australia's situation - a build up of unaddressed demand, pressure on planners and politicians to deliver new housing quickly, a lack of existing public amenity, and pecuniary incentives to hold property.
Like the Australian planning system, Ireland uses a zoning system whereby areas are split into the types of development that are considered appropriate i.e. commercial, residential, etc. Similarly to in Australia, despite this relatively inflexible system, there is far less certainty of outcome than in Switzerland and Germany as the systems lack legal certainty (ibid, 2005, p.46). Notably, the Irish planning system lacks a structure of revenue incentives that encourages growth, and there is no competition between councils. This required the stimuli for development to come from the central government which did not react until prices had already risen dramatically. By this time, the demand for action was strong and the central government responded purely in terms of numbers, a methodology which was passed onto local planners. Developers reacted to this situation as rational, profit-motivated actors would be expected to - by producing high quantities of cheap to construct dwellings that they could sell at historically high prices. This situation largely stemmed from the inability of Ireland’s planning system to respond, or even to register, market signals. With no economic incentives, local governments had no reason to respond rapidly to rising demand and the central government had reason to respond to the issue only once prices had increased to such a point that political pressure was mounting and the crisis threatened to affect national economic development (ibid, pp.52-53).

As Evans & Hartwich (2005, p.54) state:

A system that does not provide local incentives and ultimately has to rely on central governments to push through large-scale housing developments will never be flexible enough to deal with demand at an early stage, and is more likely to fail to deliver the kind of housing people actually want. A flexible housing supply and a healthy housing market are much easier to realise in a system in which planning is not only a formally decentralised system, but also a system in which the costs and benefits of planning are considered at the same level.

The Irish planning/land use system and housing affordability crisis is clearly an informative and relevant example. Australia’s highly regulated system has striking similarities to that of Ireland’s and similar criticisms of its inability to react to, or even register, increasing demand are appropriate. A centralised and highly regulated system is unlikely to be able to rapidly respond to changes in demand. This is particularly relevant to Australia, where strong economic conditions have combined with banking deregulation and financial innovation to enable greatly increased borrowing capacity. In fact Moran (2006b, p.84) suggests that the Australian planning system, via its emphasis on land-use restriction, actually undermines existing incentives for local government to provide for those seeking to enter the housing market. This occurs as a result of the link between rate revenues, land values and land-use restrictions. A similar argument may also be made with regard to the state governments. Further, Ireland’s response the rapid creation of (relatively) low-cost, low quality housing as an attempt to facilitate a short-term correction to the issue only goes to further reinforce the inability of a highly regulated system to adequately address the housing affordability issues. When seen in this context, the recently announced large scale land releases in Victoria and Queensland, while clearly moving in the correct direction, will prove to be at best a short-term solution if they are not followed by ongoing increases in land release rates and supply process reforms.

The ability of the German and Swiss planning systems to accommodate demand, maintain housing affordability and produce high-amenity, liveable communities is telling, and has resulted in a responsive housing supply that produces ‘quality’ outcomes. While the Australian affordability situation could undoubtedly be improved by eliminating the vast majority of land use and development restrictions, the quality of the outcomes would be questionable at best.
To this end the German and Swiss examples demonstrate how the need for housing affordability can be achieved along with attractive residential development - due to competitive pressure, development must be of an attractive nature else the area will not attract the necessary growth, and hence revenue. By contrast, in Australia's current housing affordability situation, houses on small blocks in low-amenity neighbourhoods, far from urban centres, are able to command severely unaffordable prices.
9 Reforming the NSW Planning System

As the NSW Department of Planning (2007b, p.7) reform report notes, the NSW planning system has become overly focussed on processes rather than outcomes. There are an increasing number of issues that councils are forced to address, as well as contradictions between various planning instruments. Applications often have to address issues of little relevance and the flexibility to develop locally based controls, while potentially useful if undertaken within the appropriate framework, has resulted in an overly complex system with widespread inconsistencies and contradictions. The most recently proposed changes contained within the draft legislation are clearly moves towards streamlining the existing process. In this respect they may be seen as generally beneficial although, as is generally the case with reform, their practical effects will not be clear until some time after their adoption and it should be noted that early attempts at reform appear to have contributed to the current problems.

Unfortunately it is all too easy for the process of reform to be derailed by political expediency and point scoring. While much of the recent reform process has been targeted at local government practices the reality is that these practices have developed under a system implemented by their respective state governments and, ultimately, the federal government. The recent changes to infrastructure funding in NSW in particular appear to have been undertaken in a largely adversarial and politically motivated manner. While infrastructure charges clearly need to be addressed, infrastructure must still be provided; restricting the ability of local government to generate funding for infrastructure through developer contributions without enabling them to source alternative funding\textsuperscript{56} will simply result in a reduction in the quality and/or quantity of infrastructure provided - a less than ideal outcome.

Attempts to centralise approval power within the Minister's office seem unlikely to result in a more efficient, transparent and accountable process, with concerns being raised in this regard by both industry and local government bodies. Rather it is suggested that, as per the NSW DoP's (2007b) own reform paper, the development approval process should be reformed in such a way as to place the appropriate responsibility with the appropriate level of authority, creating an environment in which the timely and efficient assessment of development is the defining goal of the entire process.

An adversarial relationship between state and local government will not produce the necessary outcome - an efficient planning process that works well for both levels of government, developers, individual applicants, and improves housing affordability. Moves towards centralising consent in the minister's department will do little to increase the responsiveness of supply or the transparency of the process. While it may increase the ability of the minister to unblock particular 'logjams', as Mant (2005, pp.4-5) refers to them, it is the entire process that ultimately needs to made more efficient and effective. In order for development policy to be successfully reformed the coordination of activity at all levels of government is required (Innes, Nelson & Duncan, cited London & Chen, 2007d, p.1). Conflict between and within government organisations and policies is an increasing concern for the property industry (London & Chen, 2007b, p.2).

\textsuperscript{56} Note that in NSW the State Government has recently announced restrictions to council's infrastructure contributions while at the same time capping rate increases at a reduced level. For a broader understanding of local government cost and funding see the 2003 Report of the House of Representatives Standing Committee on Economics, Finance and Public Administration – Rates and Taxes: A Fair Share for Responsible Local Government.
9.1 NSW Planning System Reform Recommendations

Mant's (2008) summary of the NSW planning reform proposals is largely consistent with the changes in the draft legislation:

![Diagram of the decision-making process for NSW planning reform.]

Figure 48: DA Decision Making Process—NSW Government Reform Proposal.
(Source: Mant, 2008)

The increased complexity of this system is clear. As an alternative, Mant (2008) suggests the model outlined in Figure 49.
It is suggested that this alternative model represents a more effective model as it reduces the centralisation of the planning system with the associated potential of a more responsive supply.

However a number of significant amendments are needed:

- **The increased use of complying and exempt development codes needs to be accepted as does the use of staged assessment times.**
- IHAPS to move from an advisory to an approval role in a manner similar to that of the Surf Coast Shire with Council retaining the call in power in acknowledgement of the difficulties associated with the creation of comprehensive plans. This will aid in the depoliticisation of the approval process and increase the availability of council resources for the creation of plans and the assessment of called-in or referred projects.
- **The inclusion of the potential economic (and housing affordability) impacts in the creation of all levels of planning schemes and regulations** – this is inline with the Barker report’s (2006, p.6) recommendation of ensuring the economic benefits of development are fully taken into account in plan and decision making.
- A Concurrence Authority to be developed with the aim of improving interaction between state agencies and local government in the assessment of applications and with the longer term aim of improving planning consistency and interaction between the two levels of government.
- **The creation of a State Planning Resource centre accessible by all councils that will aid them in the creation of LEPs, DCPs and assessment criteria as well as facilitating increased interaction and understanding between the State and local government planning departments.** The centre would play an important role in assisting councils in the assessment of larger developments.
- **The current system of land/housing supply would benefit from the increased coordination provided by a state-based housing and land supply body such as the Ministerial Council for Land and Housing Supply in Western Australia or a more**
broadly focussed version of Queensland’s Urban Land Development Authority. Their role would be to work in association with the national body recommended below.

As noted in the Productivity Commission’s (2004a, p.xxii) report into first home ownership, while there is limited scope for government to improve housing affordability in the short-term, governments have an important role to play in the facilitation of efficient housing outcomes; particularly in terms of addressing structural factors that unnecessarily reduce the responsiveness of supply to increases in demand.

9.2 National Planning System Reform Recommendations.

At a broader level it can be seen that the introduction of economic and competitive incentives has the potential to create a highly effective and responsive planning system. Such a recommendation was made in the Institute of Public Affairs’ (cited Moran, 2006a, pp.7-8) submission to the NSW IPART investigation into regulatory burdens. In Germany for example, competitive elements have been introduced via the taxation system; thereby providing local government with a development/growth incentive. The effectiveness of the German and Swiss planning systems contrasts dramatically with that of Ireland’s and Australia’s. The inability of the two centrally-planned and over-regulated systems to respond to market signals is a strong argument for broader reform of Australian land supply/use regulation.

Importantly, the link between growth and local government revenue generation needs to be strengthened – this is inline with the Barker (2006, p.14) report’s recommendation to improve incentives. Increased local government independence in rate setting would be a move in this direction, as would a linkage between growth and elements of state funding. The structure and application of these incentives is complex and will require significant consideration; however the connection is vital to improving the responsiveness of housing supply to demand.

To this end the following recommendations are made:

- An increased role for local government in COAG in order to facilitate increased interaction between all levels of government and initiate change.
- A non-adversarial inquiry into land use by COAG in order to determine the current condition of land and housing supply, the appropriate level of supply increases in order to achieve significant improvements in new house prices and the development of a standardised measurement methodology. As per the PCA’s (2007b, p.8) suggestion, this would include:
  - The differences between theoretical and actual land releases including the role of the private sector in lot production.
  - Differentiation between land releases based upon the classification of supply i.e. zoned, unzoned, serviced etc.
  - Underlying demand factors.
  - Factors which affect demand.
  - Forecasting of key price points based upon the interaction of supply and demand.

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56 The PC was specifically referring to affordability for first home buyers; however it may be argued that the same applies to housing affordability in the broader context.
Such an inquiry would represent an interim step towards the increased decentralisation of supply and incentivised funding arrangements, and would enable an increased understanding of the dynamics of the nation’s housing markets. While this type of analysis is typically undertaken by the individual states and territories, it should be recognised that this analysis is heavily influenced by their respective fiscal requirements. Transferring this analysis into the national arena will reduce this bias and create a greater awareness of the impact of the fiscal funding imbalance on housing affordability. Ideally this would lead to the creation of a national body incorporating representatives from all three levels of government. The body would forecast land supply requirements and research the intergovernmental fiscal and policy arrangements with a view towards the generation of reform recommendations and improved affordability.

The following recommendation is made:

- The creation of an independent National Land and Housing Supply Committee incorporating representatives from all levels of government to forecast ongoing land and housing supply requirements. The body will conduct research into the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations. The National Housing Supply Research Council could potentially fulfil this role however it would need to have increased interaction with the states and local government and increased political independence.
10 The Need for Appropriate Policy Responses

The Victorian response to increased housing demand resulting from increased population growth shows an understanding of fundamental economic principles - increased demand must be met by increased supply if prices are to remain stable, and must be met by an even greater increase in supply if prices are to be reduced. Issues that coincide with the growth of our cities, such as the costs of infrastructure provision, urban consolidation, sprawl, changing urban landscapes, and the preservation of existing suburbs or 'ways of life', must be addressed with the appropriate policies. Addressing these issues by attempting to heavily constrain land supply and development cannot be effective as these policies do not address the fundamental need to produce more houses to meet population growth. Indeed, as Moran (2006b, p. 43) points out, planning centred on the restriction of the land supply is actually generating and exacerbating such issues - despite the fact that it is purported to be the solution. The resulting increase in conflicts and other problems are then seen as a justification for even more comprehensive planning.

While policies targeting urban consolidation and more efficient development in terms of the provision of infrastructure may well have merit, they must be formulated in such a way as to influence land and housing supply but not overly restrict it. If supply cannot match demand then prices will increase and affordability will decline; this result is inevitable. If housing affordability, particularly in terms of new house prices, is to be improved one of three things must happen: Our existing cities must be allowed to grow and change. New cities must be created, most likely through the expansion of existing regional centres. Or demand must be eliminated via the reduction of population growth. While urban growth can and should be influenced, these fundamental realities must also be recognised.

While existing residents of our major cities bemoan the impact of urban consolidation on their leafy suburbs and the unsightly 'sprawl' of McMansion and low-amenity areas that have developed in the newly created outer suburbs, the irony is that these outcomes are the result of attempting to control growth through inappropriately targeted and constructed policies. Cities cannot be expected to not expand, not become more congested and accommodate an increasing population all at the same time. If preserving the aesthetic and character of our existing cities is deemed of utmost importance then these cities must be prepared to expand in size or forego growth. It is ironic that in a time when rural towns are dying as a lack of growth with essential services such as doctors not able to be retained, our major centres are struggling to control and limit the growth that rural towns are desperately in need of.

The result of increased infrastructure charges and excessive restrictions in land supply is house and land prices that have been pushed to the practical limit for the majority of first home buyers. Prime Minister Rudd's (2008b) recent announcement of a $500 million Housing Affordability Fund is both an acknowledgment of the impact of infrastructure charges on housing affordability and a critical first step in addressing the problem. However the Fund's budget is miniscule relative to the size of the issue and its long-term affect will be limited if it is not accompanied by substantial reform to infrastructure charges and their funding. As noted by Prime Minister Rudd (2008b), infrastructure charges in their current form are pushing the dream of home ownership out of reach for many and, in a step towards addressing the need for planning system reform, local government will have to apply for infrastructure funding grants.

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57 See footnote 22 regarding the use of the term sprawl in the Australian context.
through a competitive process, with their proposals outlining how they will streamline the planning process (Australian Government, 2008b, p.6).

Greenfield dwelling production plays a key role in total dwelling production and hence housing affordability. Limited increases in land supply, given the current market conditions, are unlikely to result in a realised increase in dwelling production. In the face of sluggish demand the transformation of any increase in developable land releases into completed dwellings is dependent on the viability of development which is itself influenced by macroeconomic factors on the demand side and the costs of producing saleable lots on the supply-side. In NSW the limitation of developable land releases to designated areas, notably the Metropolitan Strategy’s GCs, has enabled developable land prices to be sustained at artificially high levels. Given the extended and ongoing reduction in housing affordability, the recent modifications to infrastructure contributions by the NSW State Government, while commendable, are unlikely to be able to significantly increase dwelling production without a commensurate decrease in developable land costs. In order to achieve an effective increase in housing affordability there must be a significant increase in dwelling production; this will require large scale increases in the greenfield land supply as well as further reductions in infrastructure charges.

The need to address land supply restrictions has been acknowledged by the federal government, with modifications to land release policies requiring all government agencies to show why surplus land should not be released for the benefit of local communities. Such land releases will be evaluated against the following criteria:

- Whether it increases the supply of housing without adversely effecting neighbouring property prices;
- Whether it improves the amenity of local suburbs; and
- Whether it will create new jobs (Australian Government, 2008b, p.7).

The effectiveness of this land release policy remains to be seen, however the issue of adverse price impacts on surrounding properties is significant and also needs consideration. Increases in land supply must be accompanied by improvements in the rezoning and approval processes if they are to increase the sensitivity of housing supply to demand, which is essential to increase housing affordability given the downwardly sticky nature of house prices. The recent initiatives of the NSW State Government are clearly movements in this direction; however more needs to be done.

Demand-side initiatives will be largely ineffective in the current housing market; supply is constrained and increasing consumer purchasing power, while politically appealing, will at best induce limited supply increases while further increasing prices. If there is a bad apple crop resulting in not enough apples to go around giving apple buyers more money will not solve the problem - what is needed is more apples.

As ANZ Chief Economist Saul Eslake (2008) points out: “...policies which work only on the demand side of the housing market are doomed to fail. Anything which puts additional cash in the hands of buyers (such as grants or stamp duty concessions) or renters (such as cash assistance) with a view to enabling them to rent or buy more expensive houses results merely in more expensive houses. Instead policy needs to focus on increasing the supply of housing – particularly low cost housing – and reducing the time taken to bring land and housing to the market”. A similar argument has been made by the RBA’s head of economic analysis Anthony Richards (cited SMH, March 27th 2008), who states that addressing supply-side issues is the
key to improving housing affordability, and that attention should be focussed on land use policies and increasing the efficiency of land and housing supply.

The newly expanded National Rental Affordability Scheme, which will fund tax incentives to encourage investors to build up to 100,000 new ‘affordable’ rental properties (Rudd, 2008a), at least targets the construction of new rental properties. However efforts to address affordability would be better spent addressing the underlying supply issues in the housing market, particularly when rental affordability is still substantially better than affordability for first home buyers. Declining rental vacancy rates and affordability are a reflection of the general housing supply shortfall and pressure for rental returns to realign with greatly inflated house prices in light of the current relatively low rates of capital gain. There would be little need to subsidise affordable rental properties if housing prices were not artificially inflated and supply artificially constrained. The rental ‘crisis’ is a symptom of a generally dysfunctional housing market and would be more efficiently and effectively addressed, particularly in the long-term, via the correction of the supply-side faults in the broader housing market. To this end it can be seen that the National Rental Affordability Scheme is an attempt to mitigate the effects of a dysfunctional market rather than to address underlying market faults, and must therefore be considered a short-term solution at best.

While increases in the housing supply have the potential to place downward pressure on house prices, as Eslake (2008) points out, house prices do not generally fall due to the fact that housing is a necessary good rather than a pure investment – we all have to live somewhere therefore we do not see people attempting to ‘short’ the property market. Rather when the market reaches a certain price level, relative to would-be buyer’s purchasing power, we tend to see a reduction in the number of transactions rather than a general fall in prices. Unless unemployment or interest rates rise high enough to force existing owners to become sellers we are unlikely to see a reduction in price in the short to medium-term (Eslake, 2008). However any realistic increase in the housing supply would be unable to achieve significant downward movement in house prices in the short-term due to the limited size of any increase relative to the size of the total housing stock. Regardless, significant and widespread decreases in current house prices are neither desirable nor achievable for a number of reasons; firstly, as will be outlined later, housing is related to consumption via the wealth-effect and a substantial price correction would have destabilising impacts on the economy; secondly it would place undue economic hardship upon existing homeowners - most notably those who have recently entered the property market and have already been the victims of restricted supply and intergenerational inequities. As BIS Shrapnel’s Chief Economist Frank Gelber (2008) stated in his address to the Melbourne Institute in March: “(T)he damage has been done. What we need to do is limit further damage”.

Given the relative downward stickiness of house prices, the difficulties associated with substantially increasing the housing supply in the short-term, and the social and economic hardships associated with a strong price correction, the best course of action appears to be targeting a reduction in long-term house price growth. The most effective way of achieving this, and the most beneficial in the long-term, is through improving the flexibility and cost of the housing supply via land supply, infrastructure funding and planning regulation reform - thereby increasing the responsiveness of supply to market signals and reducing the price at which new houses may be brought to the market. Such a conclusion represents a strong argument for immediate commencement of significant reform to all aspects of land and housing supply regulation. In an address to the Melbourne Institute’s Public Economic Forum Briddick (2007, p.19) draws a similar conclusion - housing affordability will continue to deteriorate as supply
fails to meet demand. Interest rate effects on the market and developer charges will continue to act as a restraint on dwelling supply and policy must address supply-side constraints if it is to be successful. Given that the housing supply ultimately involves the interaction of all three levels of government there is a pressing need for a whole-of-government approach to reform.
11 The Economic Effects of Declining Housing Affordability

Beyond the immediate and obvious impact on those seeking to enter the housing market, diminished housing affordability also has a number of significant social and economic impacts. Dramatic increases in house prices are associated with increased household debt, diminishing rates of home ownership and increasing rates of mortgage default. The substantial shift in national wealth engendered by the rapid increase in prices is dividing the effects of monetary policy, increasing Australia’s sensitivity to economic conditions and may be affecting productivity. Increased land and house prices affect Australia’s international competitiveness, internal migration decisions and worker availability. Increased housing costs also feed into inflation by affecting rents and worker wage claims. Declining housing affordability has wide-reaching implications for the nation and the changes it has engendered emphasise the fundamental role of housing in the nation’s economy and the need for a functional housing market.

11.1 The Housing Industry and Employment

The most direct connection between housing and the economy may be seen in the strong correlation (with a 6 to 12 month lag) between building approvals and employment levels nationally:

![Building Approvals and Employment Growth - Australia, 1990 – 2007](image1)

(Source: HIA, 2006a)

The correlation is also clear in NSW:

![Building Approvals and Employment Growth - NSW, 1990 – 2007](image2)

(Source: HIA, 2006a)
As previously noted, the housing industry is a key contributor to the national economy, as well as a strong indicator of the nation's economic condition. Beyond its direct contribution to the economy, which including renovations was over $56 billion in 04/05 (HIA, 2006c), the industry has a very strong multiplier effect which generates substantial more spending and employment in related industries (HIA, 2006c).

11.2 Household Debt and Mortgage Default

Access to credit has greatly increased in association with increased house prices and, as previously noted, has played an important role in declining affordability:

![Figure 52: Household Credit as a Percentage of Nominal GDP – Australia*.](source: Battellino, 2007)

This has come about largely as the result of financial deregulation and subsequent innovation combined with low interest and inflation rates and strong economic growth (Battellino, 2007). The result has been a significant increase in leveraged purchasing power and a commensurate increase in housing debt - particularly with respect to income:

![Figure 53: Housing Debt to Average Weekly Earnings.](source: Oster, 2005, p.3)

This is not necessarily to say that financial deregulation has created or enabled what may be considered 'excessive' demand. As Richards (2008) notes for a large part of the population it
seems to be the case that housing has become a "superior good" - that people are actively choosing to spend more of their income on housing as their income increases. In this sense, earlier financial regulation and high interest rates may have actually been preventing households from spending as much on housing as they would have preferred. The effect of financial deregulation may then have been to enable households to spend on housing at their preferred level. However, the effects of financial market deregulation on house prices and housing expenditure must also be considered with respect to a highly regulated and constrained housing supply. In this respect it may be seen that increased purchasing power may be funding 'rational' increased expenditure and speculative investment on the basis of anticipated capital gains. While the willingness to take on increasing levels of debt in the anticipation of capital gains, or in the fear of being unable to afford future high prices, may be rational within the context of the particular market, in the context of the national economy these are clearly not the 'rational' outcomes of a functional housing market. House price increases are being driven by increased demand capacity in the face of a constrained and increasingly costly supply, not by increases in use-value or utility, or on the basis of return fundamentals.

This is particularly concerning with regard to new house prices on the urban fringes, which have traditionally played a substantial role in providing an affordable entry into the housing market for first home buyers. Were it simply the case that house prices in inner city suburbs had greatly increased while prices in the outer and newly formed suburbs had remained affordable then the cause for concern would be greatly diminished. However, when entry level house prices become unaffordable, it is clear that there are problems in the housing market.

Increased house prices and associated debt levels are reflected in the shrinking percentage of households which have paid off their mortgages and increasing default rates. A recent Reserve Bank of Australia (RBA, 2007a, p.41) review indicates that there has been an 8% increase in the number of households with a mortgage compared to a decade ago and there has also been a steady increase in the number of households with overdue mortgage payments:

![Graph showing housing loan arrears by state.](image)

Figure 54: Housing Loan Arrears by State. (90+ Days past due, per cent of outstandings, based on prime full-doc loans securitised by all lenders.) (Source RBA, 2007b, p.8)

The 2006 Census (ABS, 2007d) confirms this trend showing a fall in the percentage of people who have paid off their mortgages - 48% to 44% in the period 1996 to 2006.

Defaults are also rising, with the Supreme Court of New South Wales annual report showing an increase of over 3,000 lender applications for property repossession court orders from 2004 to 2006 - a 150% increase (NSW Supreme Court, 2006). Given the steady succession of interest
rate rises since 2006 it seems unlikely this trend will dissipate, and a similar trend has been reported in Victoria (Klan, 2007). While these applications do not necessarily lead to a forced sale - as lenders may choose not to enforce the orders - they also do not capture the complete picture of mortgage defaults. Australia’s largest private debt collector - Prushka - states that around three quarters of sales forced by lending institutions were done with borrower consent and were therefore not recorded in these statistics (Klan, 2007). While analysis of home loan defaults is difficult due to the lack of publicly available data, and it should be acknowledged that the increase in defaults may be in some part attributable to the increased use of low doc and 100% of value loans, this upward trend is, at least in part, an indication of the burden of reduced housing affordability.

These figures are not surprising given the widely confirmed increases in housing stress, and are an indication not only of the impact of declining affordability on individual households but also of the increased potential for changes in economic conditions to produce widespread defaults and on-flow impacts.

11.3 Household Savings and the Wealth-Effect.

Housing has both a consumptive and an asset (or investment) component. As a consumption good we need to ‘consume’ some degree of housing, be it in terms of buying a home or paying rent, in order to fulfill our shelter needs. In this sense it can be seen that, in aggregate, we are better off if the cost of housing is lower as it enables us to increase our consumption of alternative goods (Richards, 2008). At the same time however, changes in the price of houses as an asset affect national wealth distribution. As Richards (2008) notes, those who own rental properties will benefit from increasing house prices relative to renters as will owner occupiers relative to those who have not yet purchased their own homes. In this sense it can be seen that there are intergenerational aspects to house prices increases. Older Australians, who are more financially established, are generally more likely to be in positions that benefit, while younger Australians are generally more likely to be in positions that do not. Equally, as home ownership and the ownership of rental property rises with income, lower income households are more likely to suffer than higher income households.

Given that housing is typically the primary asset for most Australian households (Thomson & Tang, 2004, p.3) and that Australians tend to hold a greater share of their wealth in dwelling assets than other western nations (Treasury, 2002, p.18) house price growth has a significant impact upon household wealth in Australia. In turn this is impacting saving decisions, with household saving has been in decline for the past 25 years or more:

![Figure 55: Household Savings as a Ratio of Household Disposable Income.](Source: ABS, 2007e)
Hiebert (2006, p.1) notes that there is an apparent trend in nations such as the US, UK, Canada and Australia for increases in wealth to act as a substitute for traditional personal saving. Section one of Figure 56 shows the correlation between US, UK, Canadian and Australian household savings rates:

![Graph showing the evolution of household savings rates in selected OECD countries as a percentage of disposable income, 1965 - 2005.](image)

**Figure 56: The Evolution of Household Savings Rates in Selected OECD Countries as a Percentage of Disposable Income, 1965 - 2005. (Source: Hiebert, 2006, p.1)**

The correlation is particularly interesting as the countries have had relatively similar experiences over time with regard to asset price increases and the likely similarity of attitudes towards home ownership and renting. Hiebert (2006, p.2) notes that a number of U.S. based studies suggest that capital gains, either on equity holdings or residential real estate, appear to play an important role in the fall of household saving. That is to say that the wealth-effect appears to hold and has a direct effect on declining aggregate household saving.

![Graph showing household saving rates and real asset price dynamics, 1972 - 2002.](image)

**Figure 57: Household Saving Rates and Real Asset Price Dynamics, 1972 - 2002.**

Source: Hiebert, 2006, p.2

Similar to Richards (2008), Hiebert (2006) notes the divided wealth-effect that results from housing having both consumption and investment components. While increasing house prices benefit existing owners, thereby increasing consumption via increased housing asset wealth, this is to some degree offset by an explicit increase in housing costs for future home buyers and the implicit increase in rents.

In this respect we can again see the divided impact of increasing house prices - the increased wealth and consumption of home owners who purchased prior to the recent strong price increases and the increased housing expenditure of those who did not. Hiebert (2006, p.19)
concludes that in Australia, as in the US, UK and Canada, ‘active’ saving (setting aside a portion of current income) has been increasingly supplanted by ‘passive’ saving (asset valuation gains, notably house price increases) as a means of wealth accumulation. The wealth-effect also implies that any correction in house prices must be undertaken in a controlled and considered manner in order to avoid significant economic consequences - any substantial reduction in house prices will decrease consumption via the wealth-effect, slowing the economy.

Given the significant diversion between real house prices and fundamentals, such as real rental returns, a substantial price correction would be needed to achieve realignment:

![Real House Prices and Fundamentals](image)

**Figure 58: Real House Prices and Fundamentals.**
(Source: Richards, 2008)

In their study of house price adjustments and aggregate consumption Thomson & Tang (2004, pp.25-26) found that in order for house prices to align with rental return fundamentals the ratio of house prices to rental income would need to fall somewhere in the region of 21% to 47.5%. This would result in a drop in annual household consumption of between 4% and 10.6%. Clearly this would result in a dramatic economic downturn and emphasises the need for a gradual and considered response to housing affordability. Fortunately, given the size of the existing housing stock relative to any realistic rate of increase, any increased flexibility in supply is unlikely to affect a dramatic short-term correction. Similarly, large-scale short-term responses, such as the measures taken in Ireland, raise their own questions of divided effects. For example, producing large volumes of small and relatively inexpensive attached dwellings in the outer west of Sydney will have relatively limited impact on house prices in inner Sydney suburbs (as the dwellings are limited substitutes) yet would place significant downward pressure on houses in surrounding areas. Such an outcome would subject those who have already purchased in such areas to a disproportionate reduction in their house’s value – placing them under increased financial stress as they struggle to pay off a mortgage much larger than those who have benefited from the supply-induced price reduction, yet they will be unable to sell their house for its purchase price. Additionally, as in the case of Ireland, such a solution would be unlikely to meet consumer preferences and would ultimately create more problems in the future.
11.4 Productivity, Competition and Migration.

The economic implications of increased housing asset prices in the context of a constrained housing supply merit further consideration. Moran (2006a, pp.44-45) estimates that, in terms of aggregate estimated real wealth per capita, the removal of the component associated with artificially (regulatory) induced house price increases results in a reduction of Treasury estimations of per capita real wealth from $305,000 to around $200,000. This has several implications. Firstly, artificially high estimates of aggregate household wealth are likely to encourage government over-confidence with consequences for the distribution of income and wealth (Moran, 2006a, pp.44-45) and, it may be argued, attendant implications for both the appropriateness and effectiveness of policy. Secondly, the artificially increased wealth of around two thirds of home owners, who either owe relatively little or have paid off their mortgages, is likely to encourage a greater than prudent level of consumption with an attendant reduction in saving (the wealth-effect illustrated by Hiebert (2006)) and hence a changed allocation between national expenditure on consumption and investment (Moran, 2006a, pp.45-47).

While the difficulty of determining the amount of diversion is significant, a correlation between housing wealth increases, increases in the share of foreign savings, and reductions in the rate of investment growth is apparent (Moran, 2006a, pp.45-47). Moran (2006a, p.48) postulates that the effective diversion of household saving into increasingly costly houses and land may have been a significant contributor to the post 2003 Australian productivity downturn by reducing overall investment levels. Substantial further investigation would be required to confirm and quantify such an impact. However the importance of domestic saving in the financing of productive investment has been noted by RBA Governor Glen Stevens (2008), while Prime Minister Rudd (2008b) recently noted the effect of declining investment on productivity; "...one of the reasons for declining productivity growth has been a failure to invest in human capital, technology and infrastructure..."

Notably, the link between public infrastructure and productivity growth has been empirically demonstrated (ACG, 2003, pp.6-11), and there is some evidence indicating that business investment is reduced during periods of significant house price growth, with business capital falling significantly as a percentage of net private sector wealth during the 2000-2003 period:

![Graph](image)

Figure 59: Contributions to Growth in Nominal Australian Net Private Sector Wealth at Market Value(a), 1986 – 2006. (Source: Treasury, 2007)

As noted by Moran (2007) in Land Regulations, Housing Prices and Productivity, land is more abundant in Australia than in almost other country on earth, and Australia’s relative abundance
of land available for urbanisation, like our rural and mineral wealth, should be a component of Australia’s national comparative advantage. However land use in Australia is subject to heavy regulation and restriction, creating an artificially restricted supply, and driving up prices as a result (Moran, 2007, pp.35-39). Such increased land costs impact businesses as well as home buyers, with increases in land costs being passed onto general prices through the costs of doing business. This is particularly the case in land intensive industries, with Moran (2007, pp.35-39) finding hotel costs, for example, have significantly increased. The same effect is also notable in shop costs - particularly in light of planning location requirements that are designed to prevent competition between centres (Moran, 2007, pp.35-39).

At the same time restrictive land use and supply policies have implications for labour market dynamics - with a U.S. study showing that employment growth is lower in areas of constrained housing supply (Saks, 2005, p.21). The study indicates that land use restriction has a significant negative effect on metropolitan employment, particularly in the long-run, and may also be associated with changing population distributions (associated with internal migration), increased inequality and the changing availability of worker skills (Saks, 2005, pp.21-22). Such skill shortages are a reflection of the inability of certain types of workers, such as nurses58, police and emergency service personnel, being unable to afford to live in high cost urban areas. Business may then be affected both by the inability to attract and maintain workers and the potential of increased house prices to induce increased wage costs (Ambrose, 2005). Glaeser, Gyourko and Saks (2006, p.72) also note the link between wage inflation and the housing market, finding that a responsive housing supply translates increased labour demand into increased supply, while an unresponsive housing supply generates wage increases.

In fact high house prices are increasingly affecting the availability of workers in professions that would not traditionally be thought of as having difficulty affording housing. For example, the University of California is now building houses to sell at discounted prices in order to house associate professors (Coleman cited Moran, 2006b, p.51). It is interesting to note that housing affordability effects on these types of workers have appeared in a state well known for its land rationing and regulatory restraints (Demographia, 2008, p.23 & Glaeser, Gyourko & Saks, 2004, p.5). Housing affordability effects on the movements of higher-educated ‘creative’ workers have significant implications for regional economic development - a U.S. study (Florida cited Berry, 2003, p.418) stresses the importance of attracting and retaining these types of workers, who account for around 30% of the U.S. economy. Critically, the study indicates that investment and growth actually follows rather than leads these types of workers.

Another international report (Demographia, 2007, p.21) also notes that internal migration in the U.S. appears to be responding to housing prices, with an increasing number of UK residents contemplating leaving the country, citing the high cost of living as their principle reason for doing so. Demographia (2008, p.25) explains housing affordability incentives to move in terms of a ‘relocation bonus’; households can potentially make a considerable saving by moving from an unaffordable market to a more affordable. For example, a household moving from Sydney to Ballarat would stand to save in excess of $900,000 in purchase and mortgage costs for a median priced home. While there are many other factors and costs involved in relocation decisions it does not seem unreasonable to suggest that substantially increased housing costs are likely to have some degree of influence on migration decisions.

58 See Ambrose, 2005 for details difficulties retaining nurses in the UK.
These types of migratory and economic effects are becoming increasingly apparent in Australia. The latest Herald/Nielsen (cited Creagh & Nixon, 2008) report shows that around one in five Sydney residents are considering leaving the city and of those just under 40% cited the cost of living as their reason for considering leaving. The results of the poll indicate the importance of housing affordability to the economic competitiveness of NSW, with the Centre for International Economics (cited Creagh & Nixon, 2008) finding that the state's employment growth lags well behind the national average in all skill fields. At the same time, essential worker housing grant schemes, such as those used in London, have been recently proposed for Sydney (Creagh, 2008) and recent figures show housing is now unaffordable in over 80% of capital city LGA's for key public sector workers; nurses, teachers, police officers, fire fighters and ambulance officers59 (BankWest, 2008, pp1-2).

More broadly, the findings of the U.S. studies (Saks, 2005 & Glaeser, Gyourko & Saks, 2005) suggest some significant implications for Australia in terms of its international competitiveness. The relatively high price of housing and land in Australia has the potential to act as a disincentive to migration and a competitive disadvantage to business, both in terms of the ability to attract new workers and by adding to business costs.

11.5 Inflation and Monetary Policy.

The decline in Australian housing affordability has significant implications for government policy. The economic division between those who have benefited from house price increases and those who have not has resulted in a situation in which the effect of policy, most notably monetary policy as enacted by the RBA, has an increasingly uneven effect on different segments of the Australian population.

Monetary policy controls inflation via its effects on aggregate demand, with home loan rates forming an important transmission channel (Stevens, 2008). Housing debt interest rates payments have increased from 4.5% of total disposable household income to 9.4% during the ten years from September 1997 (RBA, 2008b). In a parliamentary research note Kryger (2006) finds that due to the decrease in housing affordability home buyers have become increasingly sensitive to interest rate rises. Kryger (2006) shows that in June 1986 at a time of 15.5% interest rates the average house buying household spent around 22% of its disposable income on new home loan repayments. The result of a 1% rise in interest rates would have been an additional 1.3% of disposable income needed to make repayments. In June 2006 a 1% increase in interest rates would result in an average household needing to spend an additional 2.4% of its disposable income on its loan repayments. Worriedly, Kryger (2006) points out that housing affordability was lower at the time of publishing than in 1989, when the variable interest rate hit a high of 17%.

Increased interest rate sensitivity results in the effects of an interest rate change on the financial position of Australian households being greatly divided. Changes in interest rates are unlikely to affect households with incomes well in excess of the levels needed to service their home loans and meet their normal consumption needs to the same degree as those heavily indebted households whose incomes are stretched to meet the costs of living - consider the resultant loan payment increases in terms of a percentage of total household income for the different households. More significant however is the reduced impact of interest rate changes.

59 The BankWest study determines housing affordability on the basis of a ratio of key worker earnings to house prices of 5 or less.
on the consumption levels of those who have benefited from house prices increases and now have little or no housing related debt. This sector of the population is unlikely to have their aggregate consumption curtailed by interest rate changes to the same degree as the group who owes significant amounts of housing debt and did not buy before price increases. Recall that, by and large, this group has already had their propensity to consume increased via the wealth-effect. The result of these differences is that monetary policy comes at the cost of an increasingly uneven burden on different segments of the community, with one segment greatly affected by interest rate changes and the other much less so.

This has significant implications for the social legitimacy of monetary policy and its practical effectiveness in so far as monetary policy increasingly needs to heavily impact the more sensitive sectors of the community in order to generate the desired reduction in aggregate spending. If, for example, recent rate rises fail to adequately address underlying inflation, would the RBA and the Australian public be prepared to accept the potential widespread increase in loan defaults and the associated economic and social impacts that may result from a further series of rate rises?

Increased household indebtedness and interest rate sensitivity also imply greater costs to households, and potentially financial institutions, in the advent of ‘adverse shocks’ (Kent, Ossolinski & Willard, 2007, p.155), which may originate internally or externally. This will particularly be the case if borrowers have underestimated the potential risks associated with high levels of debt as a result of an extended period of favourable economic conditions (Kent, Ossolinski & Willard, 2007, p.155). As a result, the sensitivity of the Australian economy to international events is increased. While this is not necessarily undesirable per se, if much of this debt is associated with unnecessarily inflated asset prices then it is clearly an undesirable outcome.

Increased sensitivity to external events could present itself in a number of possible scenarios. For example, a global economic slowdown, initiated by a U.S. recession, may slow the Australian economy thereby increasing unemployment, particularly in those states which are not directly benefiting from the resources boom. This will directly affect the ability of households to service their greatly expanded debt. In fact RBA Governor Glen Stevens (cited HoR, 2007, p.13) has pointed out the effect of greater household debt in exacerbating the effects of an adverse shock to income levels. This danger is similarly noted by Ellis (2006), who suggests that the effects of a macroeconomic downturn may be exacerbated by the responses of highly leveraged households. Alternatively, a global credit-tightening, such as is currently occurring, may continue to push interest rates beyond RBA rate rises, impacting the ability of households to service their debt via increased payment obligations. An attendant effect may then be an excessive reduction in consumer spending, again in those states not directly enjoying the benefits of the resources boom. Another possible scenario would be the need for the RBA to counter inflationary pressures driven by increased international demand for certain key commodities, such as EME demand for oil. In this case, due to the increased household debt associated with artificially inflated house prices, the RBA may be forced to heavily affect certain sectors of the community in order to counter externally originating inflationary pressures. Australia’s sensitivity to international events is further reinforced as a result of the reduction in the domestic savings rate, and the attendant increase in the use of foreign investment capital.

Note that this is not to suggest that the effects of monetary policy are ‘normally’ evenly distributed, rather that these impacts are now highly uneven and, in the light of the artificially high house prices, unnecessarily so.

Given the current measures of housing stress and increasing default rates it is argued that a substantial increase in defaults can be reasonably expected.
Increased interest rate sensitivity is also noted by NAB Chief Economist Alan Oster (2005, pp.16-17), whose analysis suggests that the one of the main impacts of interest rate changes on consumer spending decisions is transmitted via their impacts on house prices. This suggests that the wealth-effect is tied not only to increases in wealth but also to the rate of growth. Oster (2005, p.17) notes that there appears to be a large elasticity between house price growth and consumption - a 10% reduction in the rate of growth of house prices resulting in an approximate 1% reduction in consumption expenditure\(^{62}\). This effect suggests that for those who already own, or largely own, their own home interest rates will need to rise sufficiently to affect the price growth of existing houses in order to reduce their consumption. This suggests an even greater uneveness in the impact of monetary policy; in order to affect the household spending of around two thirds of home owners, interest rates will need to be increased sufficiently to slow house price growth, yet the remaining significantly indebted home owners have become increasingly sensitive to interest rate changes, with small changes in interest rates resulting in a significant increase in their home loan repayments.

Clearly it is to be expected that those who have paid off their homes will be less affected by interest rate changes than those with substantial housing debt - or any other debt for that matter. However the greatly increased economic divide between those who have benefited from house price increases and those who have not is magnifying the uneveness of these impacts. Arguably then, there is currently a strong case for housing supply reform in order to aid in the management of inflation. The previously noted nation-wide under supply of new houses (in the order of 15%) continues to place upward pressure on house prices despite increased interest rates. Reform has the potential to address this price pressure by enabling a more responsive and less costly housing supply. Reductions in house price growth will then reduce consumption, easing inflationary pressures, and hence the impetus for further rate rises.

Distortions in the housing market are also resulting in other unexpected outcomes from monetary policy. As a result of their effect on the cost and responsiveness of new dwelling production, land supply regulation and government charges are effectively translating interest rate increases into housing supply reductions in a time of a national supply shortfall. Currently in NSW there is a perverse situation whereby the increase in interest rates may actually be placing upward pressure on house prices via their effect on the greenfield dwelling supply. This is particularly the case in markets such as Sydney where new house and land packages are approaching the upper limit for buyers. In such markets, interest rate increases are reducing the purchasing capacity of buyers below the point at which new house and land packages may be profitably brought to the market.

Braddick (2007, p.7) confirms the difficulties of increasing the dwelling supply in a period of rising interest rates by illustrating the sensitivity of building approvals to interest rates – see Figure 60.

\(^{62}\) One possible explanation for this effect is through a reduction in equity withdrawal capacity (Berry & Dalton, 2004, p.88).
This sensitivity can be seen in the dramatic downturn in building approvals in every state across Australia except for Tasmania in response to the recent interest rate rises. Total building approvals dropped by over 30% in NSW and 16% nationally in December 2007, seasonally adjusted (ABS, 2008b). As HIA Chief Economist Harley Dale (HIA, 2008b) points out, this reduction in dwelling supply will only further exacerbate house price issues particularly in light of an already inadequate supply. The downturn is a blow to hopes for a much needed increase in dwelling supply, and comes at the end of continued decline in building approvals nation-wide - as indicated by the latest ABS (2008d) data in Figure 61.

NSW’s downturn in building approvals has been one of the most consistent and pronounced and, although there has been a slight increase in private dwelling commencements in the past nine months, overall levels are well below those needed to meet underlying demand:
Housing affordability will continue to deteriorate as supply fails to meet demand. Interest rate effects, in combination with increased prices that are the result of supply-side restrictions and cost increases, will continue to act as a restraint on dwelling supply.

Equally then interest rate rises are indirectly contributing to rising rents by reducing the new dwelling supply in a time of un-met underlying demand and in a rental market made tight by a lack of supply. Rising rents in turn contribute to CPI inflation (Stevens, 2008). Again there is a perverse outcome, with strong house prices increases allowing rents to remain low as residential property investor’s focussed on capital gains rather than rental returns. The slowing of the property market then influenced investors to increase rents in order to realign them with acceptable rates of return in the absence of capital gains (Stevens, 2008). The same market distortions which resulted in rents falling well below fundamentally aligned rates are now responsible for their rapid increase. These price increases are contributing to inflation yet, at the same time, the method of inflationary control is feeding back into rents by reducing the supply of new dwellings.

The increased costs of housing also affect inflation when they result in increased wages claims. This effect is particularly noticeable in areas of high housing costs as housing is a non-substitutable commodity (Ambrose, 2005). Given that wage growth is a key inflationary pressure, and that the potential for anticipatory wage claims in response to increased costs of living associated with increased housing costs has been noted by the RBA (Stevens, 2006), the impact of housing costs on wage growth warrants further investigation and represents another argument for housing supply reform.

The fact that combined house/land and land prices are not included in key inflationary measures is problematic. While there are a number of complex arguments regarding asset price inflation and monetary policy, to the extent that housing is a consumption good, an argument can be made that the exclusion of house and land price inflation has resulted in the underestimation of the inflationary trend and hence overly loose monetary policy. Such an argument further illustrates the complexity of the relationship between the housing market distortions and monetary policy.

These arguments are not intended to present declining housing affordability as a case against the use of monetary policy, rather to argue the opposite - that Australia’s declining housing affordability are affecting both the operational outcomes and the social/political acceptability of monetary policy and needs addressing. The excessive restriction of the land and housing supply has created a structural imbalance in the housing market which impacts the effectiveness of policy, creating perverse outcomes. This imbalance must be addressed if the housing market is to function correctly.

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63 For example, housing construction costs are included in CPI, however final house & land or land prices are not. See A Guide to the Consumer Price Index: 15th Series (ABS, 2005) for further details.
12 Conclusion

Home ownership has great social and economic significance in Australia. Our rates of home ownership have traditionally been some of the highest in the world with owning your own home is commonly referred to as the ‘Great Australian Dream’. However there has been a steady decline in housing affordability in Australia in the past two decades, as income and house price growth have diverged, and an extended period of interest rate increases has greatly increased the cost of borrowing. The downward trend in housing affordability is now widely publicly acknowledged and is confirmed by a large number of industry, academic and government reports.

Increases in demand, in the form of increased borrowing capacity, have been enabled by low interest rates and favourable economic conditions, and have played a significant role in increasing house prices, particularly in ‘desirable’ locations. While the impact of increased leveraged purchasing power is not to be underestimated, greatly increased demand for houses in desirable locations does not adequately explain the strong increase in new house prices, particularly in areas such as the urban fringes - where supply should be far more responsive and dampen price rises. If house prices in inner and seaside suburbs were unaffordable while those in the outer metropolitan areas remained affordable there would not be a housing affordability crisis. However this is not the case and housing affordability is predicted to continue to decline due to further interest raises and restricted supply. The recent HIA-CBA First Home Buyer Affordability Index figures confirm these predictions, indicating a 3.5 % fall in affordability in the March 2008 quarter.

Nationally, the housing market is in a state of under-supply, with production failing to meet underlying demand and the rental market is extraordinarily tight. These shortfalls will continue to place upward pressure on the costs of housing and indicate the significant role of supply in addressing the current housing affordability situation.

On the supply-side of the housing market there are a number of factors which have contributed to declining housing affordability by increase cost of producing new dwellings and reducing the responsiveness of supply. These include the transfer of infrastructure costs into developer levies, the restriction of the supply of developable land and attendant price increases, restrictive and costly regulations and the complexity and inconsistencies of the development approval process.

The governmental push towards urban consolidation in order to reduce infrastructure costs has greatly impacted the supply process. Federal fiscal restraint and the fiscal imbalance between all three levels of government has resulted in state and local governments dramatically increasing the infrastructure charges associated with residential development. Land releases have been constrained in order to direct development into areas of low infrastructure provision cost to government. Steadily increasing house prices, funded by increased leveraged purchasing power, in combination with limited land releases, have resulted in extremely high vendor expectations for rural land in areas tabled for rezoning, constituting a significant increase in the cost of new dwelling production. These increases have combined with the effect of numerous regulatory burdens, and the delays and difficulties associated with the development approval process, to greatly increase the price at which new houses can be brought to the market.
The effects of supply-side restrictions have been greatly magnified by the combination of strong economic conditions and the greatly increased availability of credit via banking deregulation and financial innovation. Increased leveraged purchasing power has enabled buyers to continue to meet these increasing costs, creating an effective rising lower limit for all house prices. The culmination of this process is the current situation, where new house prices have reached the limit of new home buyer’s capacity to borrow, particularly in the current uncertain economic conditions, and supply is heavily restrained.

The increase in house prices and infrastructure charges, which are often used to fund infrastructure not directly attributable to a particular development, represent significant shifts in both general and intergenerational equity, with older and wealthier Australians more likely to have benefited from the price increases, and younger or lower income earners less likely to have benefited. Similarly those who have yet to enter, or have recently entered, the housing market have experienced a substantial reduction in their future earnings as a result of the increased cost of a necessary consumption good.

The decline in affordability has resulted in increased levels of housing debt and reduced levels of young and first home buyers attempting to enter into home ownership. NSW is notable in terms of its low affordability, with Sydney being one of the most unaffordable property markets in Australian and internationally.

At the same time the decrease in housing affordability has broader economic implications. It has greatly increased the interest rate sensitivity of those paying off mortgages, which is particularly concerning in the face of continued interest rate rises, and has significant implications for the continued social and political acceptance of anti-inflationary monetary policy. Such policy is further affected by consumption increasing wealth-effects associated with increasing house prices. The displacement of traditional forms of saving into housing affects the availability of domestic investment capital and has potential implications for national productivity. All of these issues are made more concerning by the fact that house prices have been inflated beyond fundamentals by artificial restrictions and the relatively easy availability of credit in a period of favourable economic conditions. As a result both government and individual decisions are being made on the basis of inaccurate wealth estimations.

In sum, it is apparent that there is a structural fault in the supply-side of the Australian housing market. The housing supply is excessively restricted through a combination of land release, land use and development regulation. The current system is unable to adequately respond to changes in demand and, in fact, seems largely incapable of acknowledging market signals until a crisis point is reached, by which time housing affordability has become a political issue. It is hard to ignore the similarities between the Australian and Irish housing affordability situations and to this end it is clear that substantial change to Australia’s land and housing supply system is needed. Given Australia’s financial deregulation and exposure to the world economy, it is unrealistic to suggest that, even if the current situation was addressed via short-term increases in supply and the creation of virtual dormitory cities as per Ireland’s example, there would be anything to prevent a re-occurrence of a similar situation in the future. If Australia is to create effective and efficient land and housing markets we need to create a system of supply that does not greatly increase the cost of producing new dwellings via regulatory burdens, restrictions and the imposition of inequitable charges, and is capable of registering and responding to changing demand.
While the limited ability of the new dwelling supply to increase the existing stock is acknowledged, the reduction of restrictions will greatly enhance its responsiveness to demand, while at the same time reducing the cost at which new dwellings may be brought to the market. It is noted that Australia's residential construction industry is internationally competitive and forms little barrier to supply increases. Increasing the supply of reduced cost dwellings will have a positive impact on affordability, particularly for those Australians attempting to enter the market, who will again have an affordable option on the urban fringes. Such increases will also act to eliminate any 'rising floor' effects on general house prices. While broad governmental changes are required to best achieve this outcome in the long-term, in the short to medium-term this goal will be most effectively achieved via improvements to the current system.

In NSW it is clear that substantial changes are needed. Land releases need to be broadly increased for a number of reasons. Firstly, in order to meet underlying demand. Secondly, in order to put downward pressure on the housing market. Finally, and most importantly, in order to realign urban fringe land prices and eliminate the economic rents associated with land holding and speculation. The current infrastructure funding system is inequitable and continues to contribute to declining housing affordability. Up-front charges for a broad array of long-lived infrastructure is akin to making new car buyers pay the registration of their new vehicle for its entire life at the time of purchase. The practice is clearly inequitable and unreasonable - even more so when some of these infrastructure charges are almost unrelated to the particular development. An alternative method of infrastructure funding needs to be considered in order to address the inequity and new house price increases generated by current arrangements. The NSW planning system needs even greater reform than is currently suggested. The issue of state agency concurrences, in particular, needs to be addressed, and the economic costs of the all aspects of the planning system need to receive greater consideration in order to ensure that any changes made are effective and result in efficient outcomes.
13 Summary of Key Recommendations

The following recommendations represent a series of reforms targeted at reducing restrictions, the costs of production and improving the supply of affordable new dwellings to the market.

Infrastructure Funding

The impact of infrastructure charges on new house prices needs to be addressed and an alternative more equitable method of infrastructure funding considered. There are a number of potential methods available, each with varying levels of cost reduction and government involvement:

- The current federal Housing Affordability Fund could be expanded into a national working capital pool that would be used by developers to fund residential development infrastructure contributions at a minimal interest rate and repaid at such time as the development begins to produce revenue. The funds needed to create the working capital pool could be diverted from the budget surplus generated from the current mineral resources boom. Such short-term government infrastructure financing has the potential to increase the production of developed land by reducing both barriers to entry to smaller developers and much of the potentially supply-reducing risk associated with larger scale developments and up-front payments. At the same time there would be the additional cost benefit associated with the reduced borrowing rate available to government, which could also be passed on in the form of reduced new house prices. Access to the Fund would be conditional on an agreed reduction in final land/dwelling price.

- An alternate suggestion is made by the Urban Taskforce (2008, p.50-51) involving the use of a percentage levy on the final sale price of the land to the home buyer to determine infrastructure contribution costs. Such a system takes into account the ability of a particular market to sustain charges, reducing the possibility of sterilising land development. It would also introduce an element of social redistribution into the infrastructure charges system and remove the regressive tendencies of these types of charges. This would target housing affordability increases and go some way towards offsetting the wealth-shifts that have occurred during the recent decline in housing affordability. Those housing developments targeted towards more affluent buyers, who would generally either have benefited from the wealth-shift or earn substantially high incomes so as not to be as adversely affected by the affordability crisis, would pay higher absolute infrastructure costs. Such a system would also potentially result in an increased housing supply, particularly in areas such as Sydney’s outer ring where new house prices have currently reached the limit of buyer’s borrowing capacity and are resulting in reduced production.

- There is a strong case for a return to an infrastructure funding mechanism similar in operation to the earlier system while retaining the cost-location-signal benefit of infrastructure charges. This would entail federal government debt funding of infrastructure provision either via existing funding transfer mechanisms or alternatively through the creation of an Infrastructure Capital Fund or through the expansion of the Housing Affordability Fund. In order to retain the cost-location-signal benefit of infrastructure charges full government debt funding would be applicable to areas were development is economically desirable. In areas where development will result in extra costs to government in terms of providing necessary infrastructure the extra cost will be
met by developers in a similar manner to existing charges. In this way developer levies will operate as efficient location signals while the house price and intergenerational effects of infrastructure charges will be addressed.

- The removal of GST ‘double-dipping’ on infrastructure charges. As per the UDIA NSW (2006a) Broadened GST Margin Scheme this recommendation also applies to other state and local charges as well as the cost of raw land. The states have benefited significantly from the introduction of the GST and its application on these supply elements is unnecessarily increasing the costs of dwelling production at the expense of first home buyers.

- The increased use of GST revenue received by the states from new housing to fund associated infrastructure costs. This would reduce the cost of producing new houses by capturing the windfall profits gained by the states from the introduction of the GST.

The Land Supply

Land releases need to be substantially increased in order to address the artificial inflation of developable land prices. While strategic land releases may have benefits in terms of reducing the cost to government of infrastructure provision, this goal would be more efficiently achieved through well constructed pricing signals. The restriction of land releases through formulated land release strategies impacts upon new house prices by creating an artificial restriction, pushing up prices, encouraging rent seeking, land holding and speculative behaviour. Substantial increases in land release rates must be factored into land release strategies in order to address these issues. It is inadequate to target land release rates to ‘meet’ predicted demand. The process is slow, targets are rarely met and downward pressure will not be placed on raw land prices. The following recommendations are made:

- A non-adversarial inquiry into land use by COAG in order to determine the current condition of land and housing supply and the appropriate level of supply increases in order to achieve significant improvements in new house prices. This is an interim step in the creation of a National Land and Housing Supply Committee.

- The creation of an independent National Land and Housing Supply Committee incorporating representatives from all levels of government to forecast ongoing land and housing supply requirements. The body will conduct research into the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations. The National Housing Supply Research Council could potentially fulfil this role however it would need to have increased interaction with the states and local government and increased political independence.

- In NSW the land and housing supply would benefit from the increased coordination provided by a state-based Land and Housing Supply Authority such as the Ministerial Council for Land and Housing Supply in Western Australia or a more broadly focussed version of Queensland’s Urban Land Development Authority. This body would work in association with the recommendations of the National Land and Housing Supply Committee.
The Planning System\textsuperscript{64}

- The creation of a Concurrence Authority tasked with the facilitation of obtaining concurrences. The Concurrence Authority would improve interaction between the NSW Department of Planning, various state agencies, and local government, thereby unifying a currently inconsistent and disorganised series of intergovernmental relationships. In this regard the Authority would play a key role in both streamlining the NSW development process by speeding up the approval process, providing clarity and improving applicant submission standards, and through the creation of informed reform initiatives.

- Increased use of complying and exempt development codes.

- Use of Independent Hearing and Assessment Panels (IHAPS) moved from an advisor to an approval role in an attempt to depoliticise the approval process. Councils to retain a call in power for problematic developments.

- The use of targeted assessment times to replace the current 40 day blanket ruling.

- The creation of a State Planning Resource Centre to assist under resourced councils in the creation of planning documents and the assessment of complex developments.

- The use of an independent Planning Assessment Commission for state and regionally significant approvals, with the Commission able to refer decisions to the Minister were deemed necessary. The Minister to retain approval authority over critical infrastructure projects.

- A move towards the merit-based appeals rather than the current predominantly process-based method in the Land and Environment Court should the proposed arbitration scheme prove unsuccessful.

Planning and Design Requirements

Planning and design requirements need to be made with a greater understanding of their economic impacts. Policy and regulatory decisions are currently being made with little regard or understanding of their cost to consumers. This requires the inclusion of economic impacts into regulatory and policy decisions in much the same way as other outcomes are considered. It is therefore recommended that:

- Potential economic and housing affordability impacts are given greater consideration in the creation of all levels of planning schemes and regulations to ensure the efficiency of plan and decision making with regard to both costs and benefits.

\textsuperscript{64} Note these recommendations apply specifically to the NSW planning system however the aim of creating an efficient and responsive planning system applies to all states and territories.
Research into these impacts to be undertaken by the National Land and Housing Supply Committee.

The General Land and Housing Supply Process

Looking more broadly, a stronger link between the economic benefits of growth and the entire planning system needs to be established. Centralised planning systems are largely unresponsive to market signals, responding only when issues such as housing affordability become political. This results in inadequate, inappropriate and untimely solutions. International examples, such as Germany and Switzerland, suggest that moves towards decentralising the planning process and strengthening the link between growth and local government revenue capacity have the potential to create a highly responsive land and housing supply system. Such systems are shown to generate quality outcomes in terms of amenity and consumer preferences. However it is acknowledged that this is a substantial goal requiring significant cooperation between all levels of government. To this end the following initial recommendations are made:

- An increased role for local government in COAG in order to facilitate increased interaction between all levels of government and initiate change.

- The creation of an independent National Land and Housing Supply Committee. Incorporating representatives from all levels of government the Committee will undertake research into the effects on housing affordability of intergovernmental fiscal and policy arrangements and make reform recommendations.
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