



**Supply sceptics beware:
without more housing, it won't be
affordable**

**Brendan Coates, Fellow, Grattan Institute
Australian Conference of Economists, Canberra
11 July 2018**

Without more housing, it won't be affordable

Housing has become less affordable, especially for low-income earners

Housing construction hasn't kept pace with additional demand

- Population growth jumped, and **dwelling construction did not respond** for almost a decade
- Mismatch between demand and supply ultimately clears through **larger household sizes**
- Even current record housing construction is ***barely* keeping up with population growth**

Planning policy is a problem

- Rising house prices mainly **reflect land values**, not dwellings
- The **zoning premium** in Australia is large
- We're **not building the housing people want**, where they want it

Building more homes would make housing more affordable

- Building an extra 50,000 homes a year for a decade could see house prices 10-15% lower

Other policies alone are unlikely to be enough, or produce collateral impacts

- (Premature) interest rates hikes have economic costs
- Macro-prudential rules have short-lived impact
- Tax reforms would make housing modestly more affordable
- Slower migration would improve housing affordability, but has collateral impacts

Without more housing, it won't be affordable

Housing has become less affordable, particularly for low-income earners

Housing construction hasn't kept pace with additional demand

- Population growth jumped, and **dwelling construction did not respond** for almost a decade
- Mismatch between demand and supply ultimately clears through **larger household sizes**
- Even current record housing construction is **barely keeping up with population growth**

Planning policy is a problem

- Rising house prices mainly **reflect land values**, not dwellings
- The **zoning premium** in Australia is large
- We're **not building the housing people want**, where they want it

Building more homes would make housing more affordable

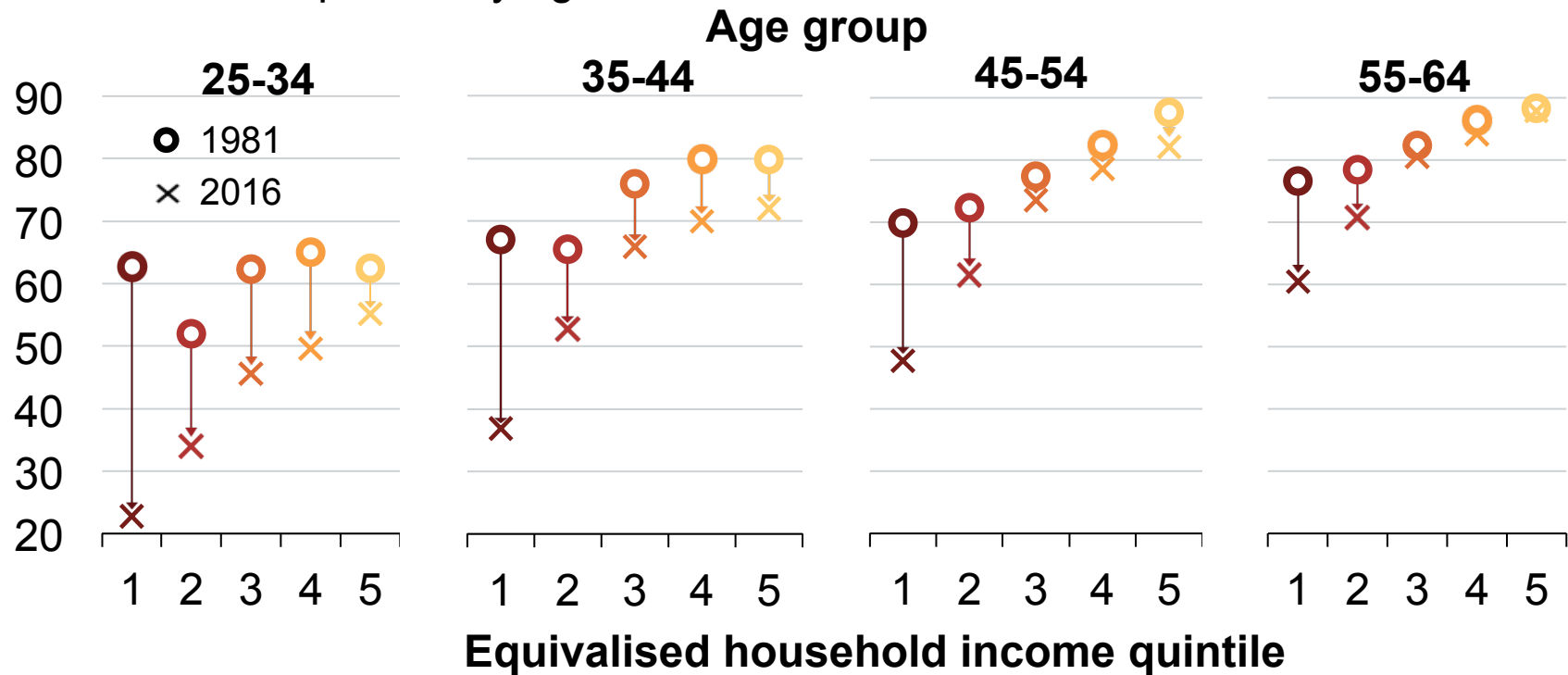
- Building an extra 50,000 homes a year for a decade could see house prices 10-15% lower

Other policies alone are unlikely to be enough, or produce collateral impacts

- (Premature) interest rates hikes have economic costs
- Macro-prudential rules have short-lived impact
- Tax reforms would make housing modestly more affordable
- Slower migration would improve housing affordability, but has collateral impacts

Home ownership is falling particularly fast among younger low-income earners

Home ownership rates by age and income, 1981 and 2016



Notes: This graph updates Burke et al 2014 using Census data obtained from the ABS. Limitations in Census calculations of household incomes means that changes in home ownership rates by age and income are indicative and small changes in ownership rates should be ignored. Excludes households with tenancy not stated (for 2016) and incomes not stated. Uses age of household reference person and equivalised household income quintiles.

Source: ABS Census; Burke et al 2014 'Generational change in home purchase opportunity in Australia'; Grattan Institute

There are three hurdles to home ownership

1. Can you save the deposit?

- Saving the deposit is harder than the past

2. Can you afford to service the mortgage?

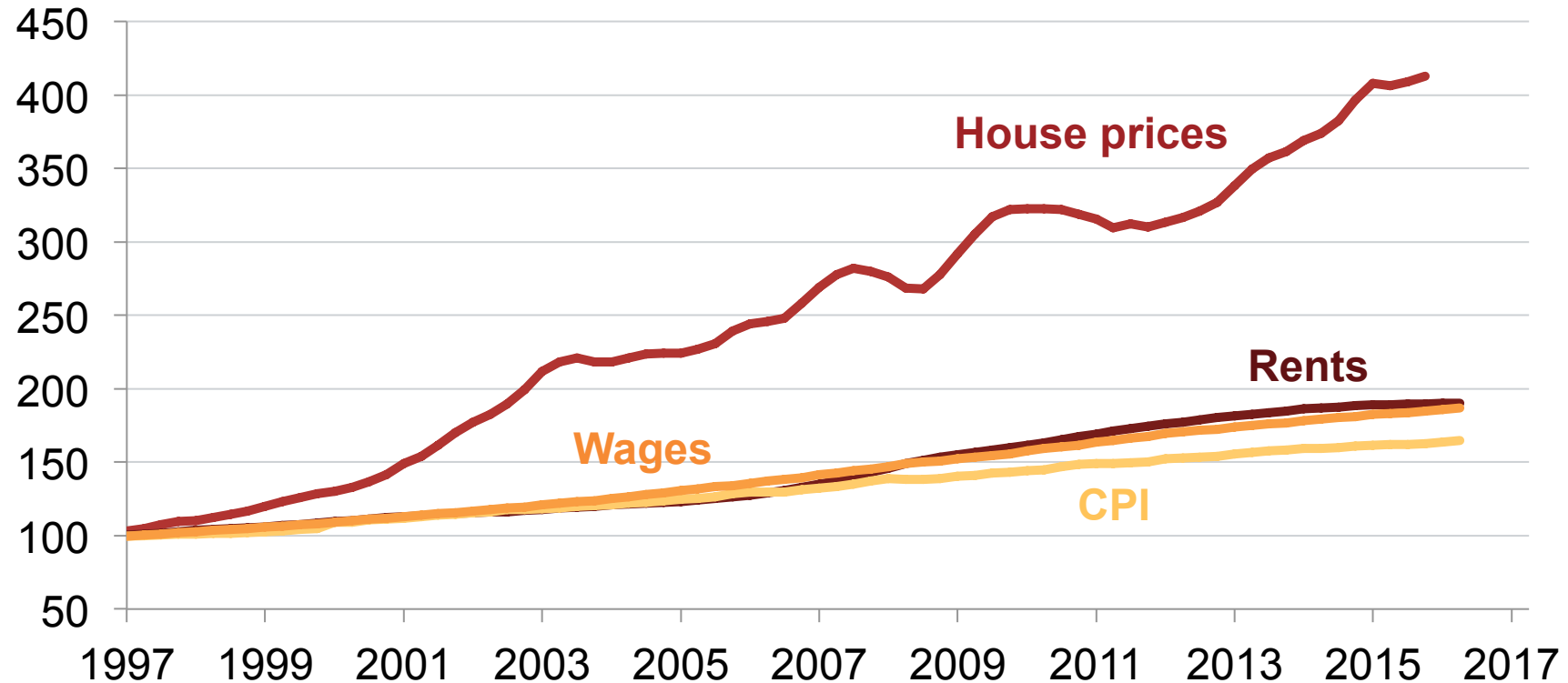
- Mortgage costs are affordable now
- Paying off a loan is likely to be harder with inflation, wages lower in future

3. Are you comfortable with the level of risk you're taking on?

- What if interest rates rise?
- Few new buyers are taking out high LVR loans

(Quality-adjusted) rents have grown in line with wages

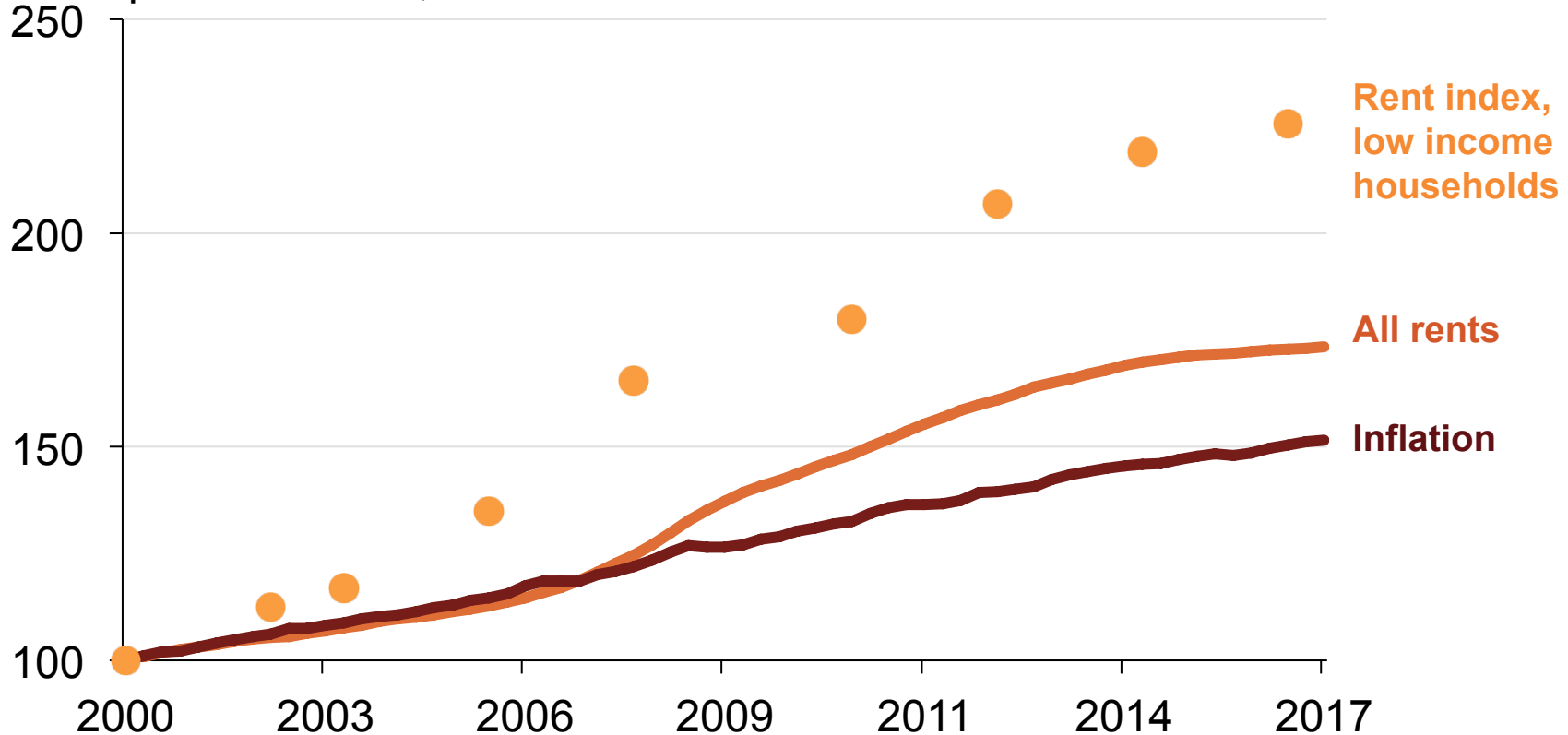
Nominal, index, 1997 = 100



Notes: Nominal house price growth; All Groups CPI; Wage price index (excluding bonuses; private and public)
Source: ABS 6401.0 Consumer Price Index, Australia; ABS 6345.0 Wage Price Index; OECD Affordable Housing Database

Rents have risen fastest for low-income households, well above inflation

Rent prices and CPI, indexed to December 2000



Source: Productivity Commission (2018), *Reforms to Human Services: Social Housing in Australia*, Figure 6.1

Without more housing, it won't be affordable

Housing has become less affordable, particularly for low-income earners

Housing construction hasn't kept pace with additional demand

- Population growth jumped, and **dwelling construction did not respond** for almost a decade
- Mismatch between demand and supply ultimately clears through **larger household sizes**
- Even current record housing construction is ***barely* keeping up with population growth**

Planning policy is a problem

- Rising house prices mainly **reflect land values**, not dwellings
- The **zoning premium** in Australia is large
- We're **not building the housing people want**, where they want it

Building more homes would make housing more affordable

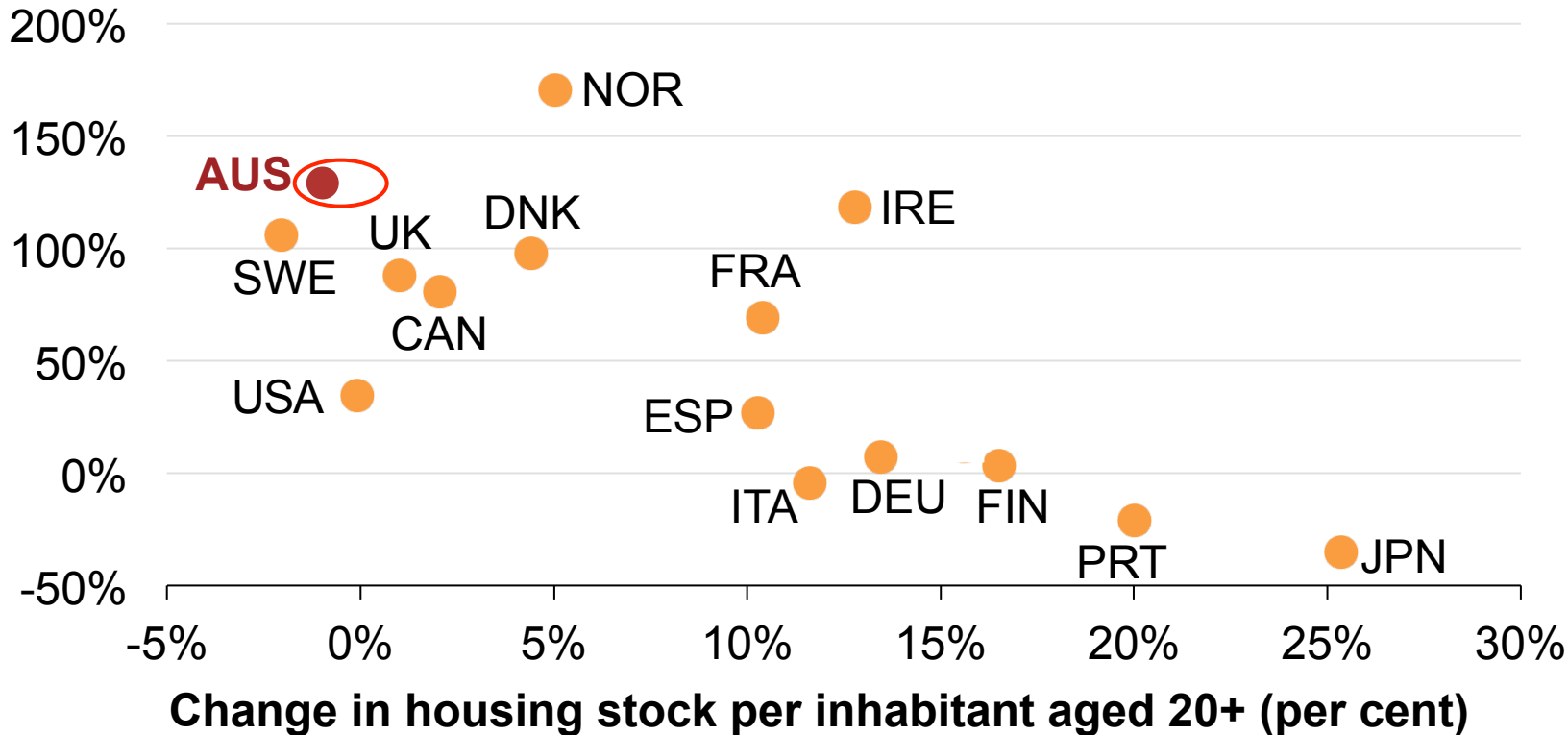
- Building an extra 50,000 homes a year for a decade could see house prices 10-15% lower

Other policies alone are unlikely to be enough, or produce collateral impacts

- (Premature) interest rates hikes have economic costs
- Macro-prudential rules have short-lived impact
- Tax reforms would make housing modestly more affordable
- Slower migration would improve housing affordability, but has collateral impacts

In countries that built more housing, prices grew more slowly

Change in real house prices, 1990-2015,

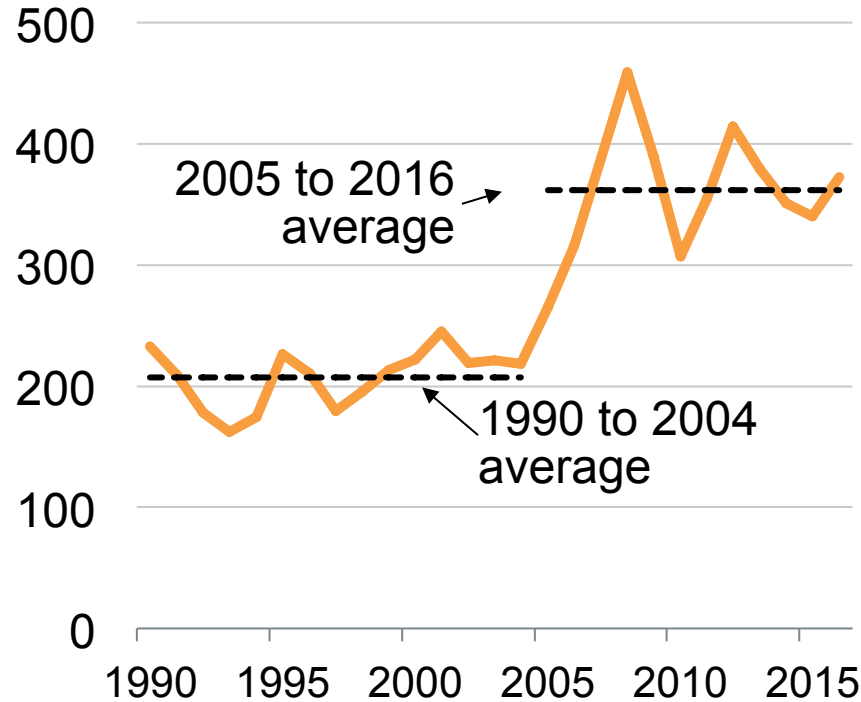


Note: Australia data to 2015. Includes all dwellings

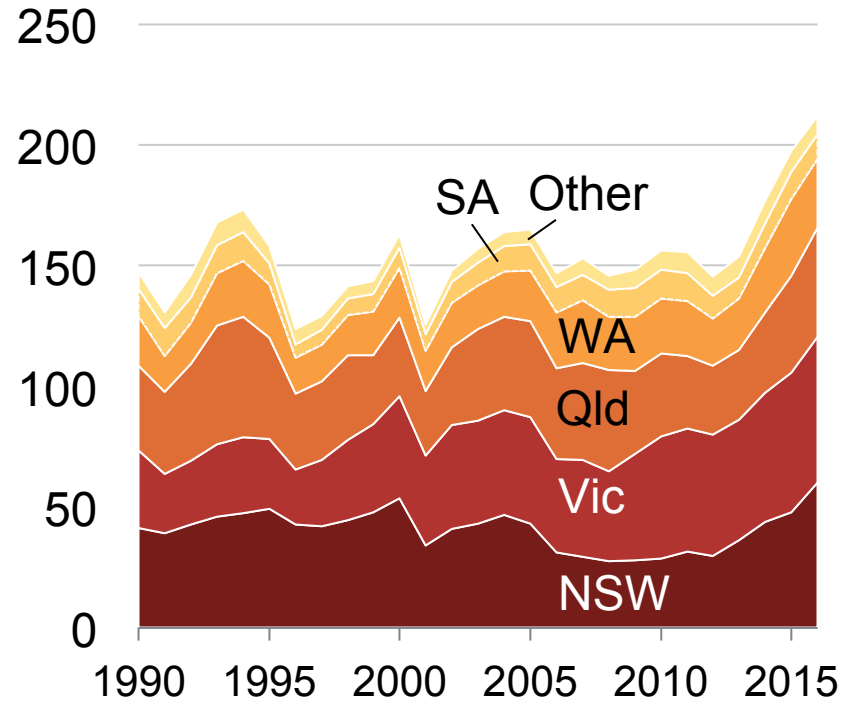
Source: OECD, Social and Affordable Housing, Pathways Foundation

Population growth jumped, but construction did not

Population increase per year, '000

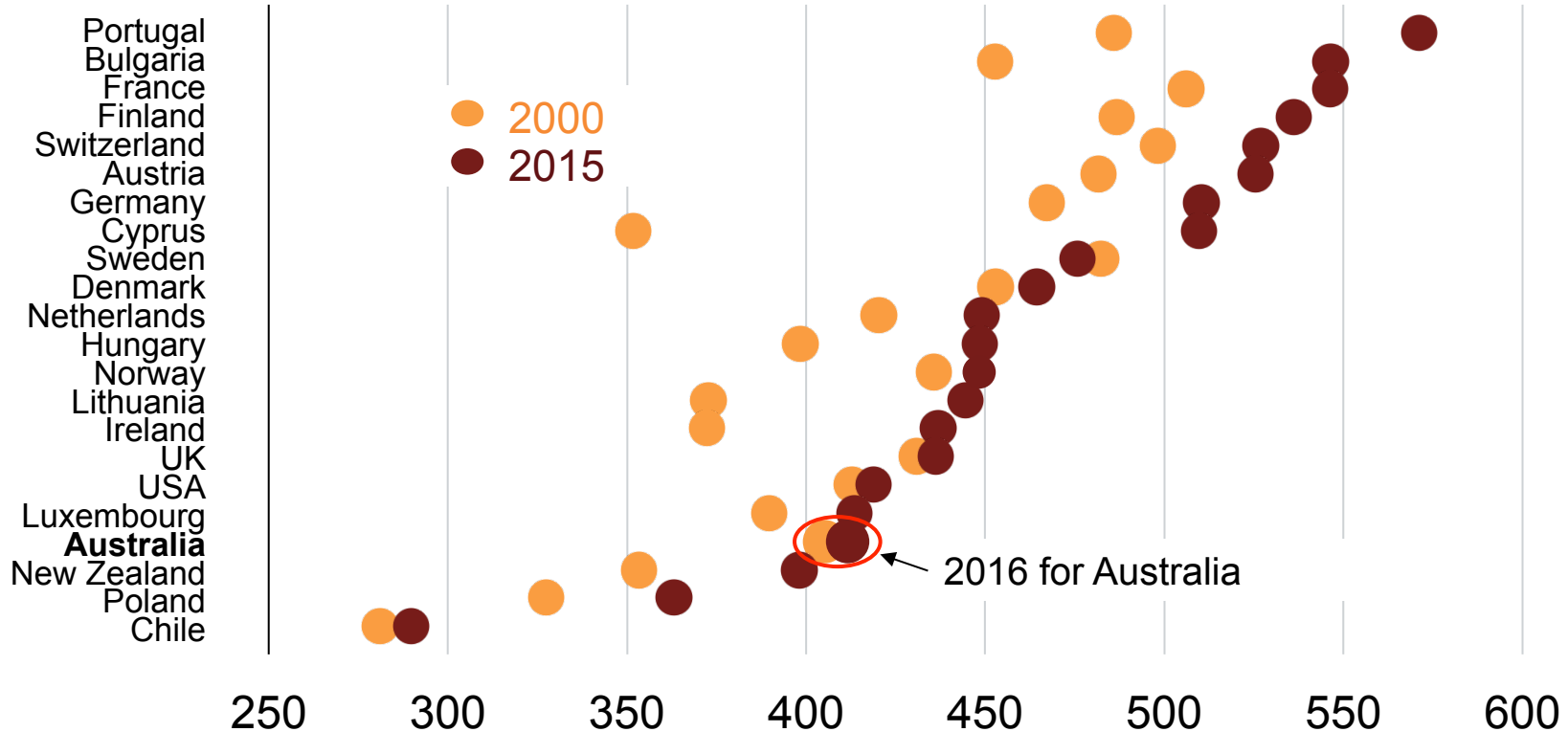


Dwellings completed per year, '000



For its population, Australia has relatively little housing stock (and it hasn't grown)

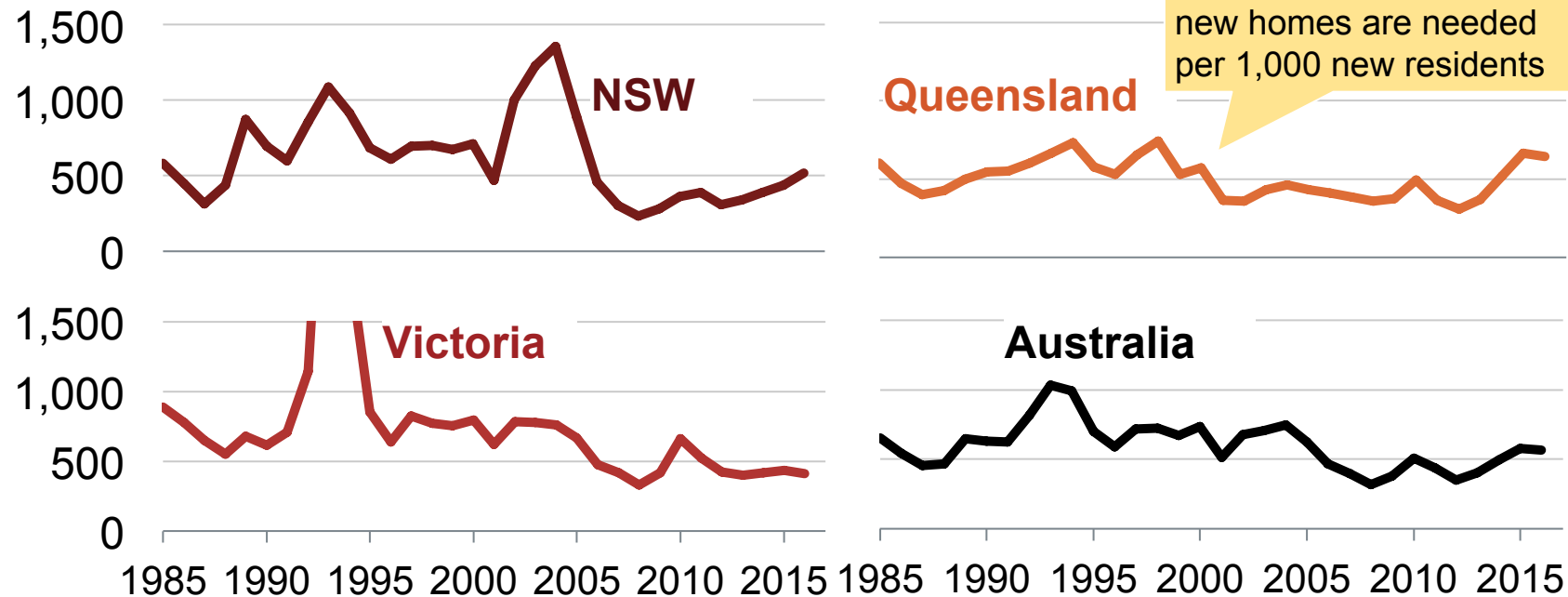
Dwelling stock per 1,000 people



Note: Figures are for total dwellings, not just private dwellings, and include unoccupied dwellings. Figures for Australia updated to 2016 using ABS Census.
Source: OECD Affordable housing database; ABS Census; ABS Demographic Statistics

Housing construction lagged population growth for much of the 2000s, but picked up recently

Dwelling completions per additional thousand people

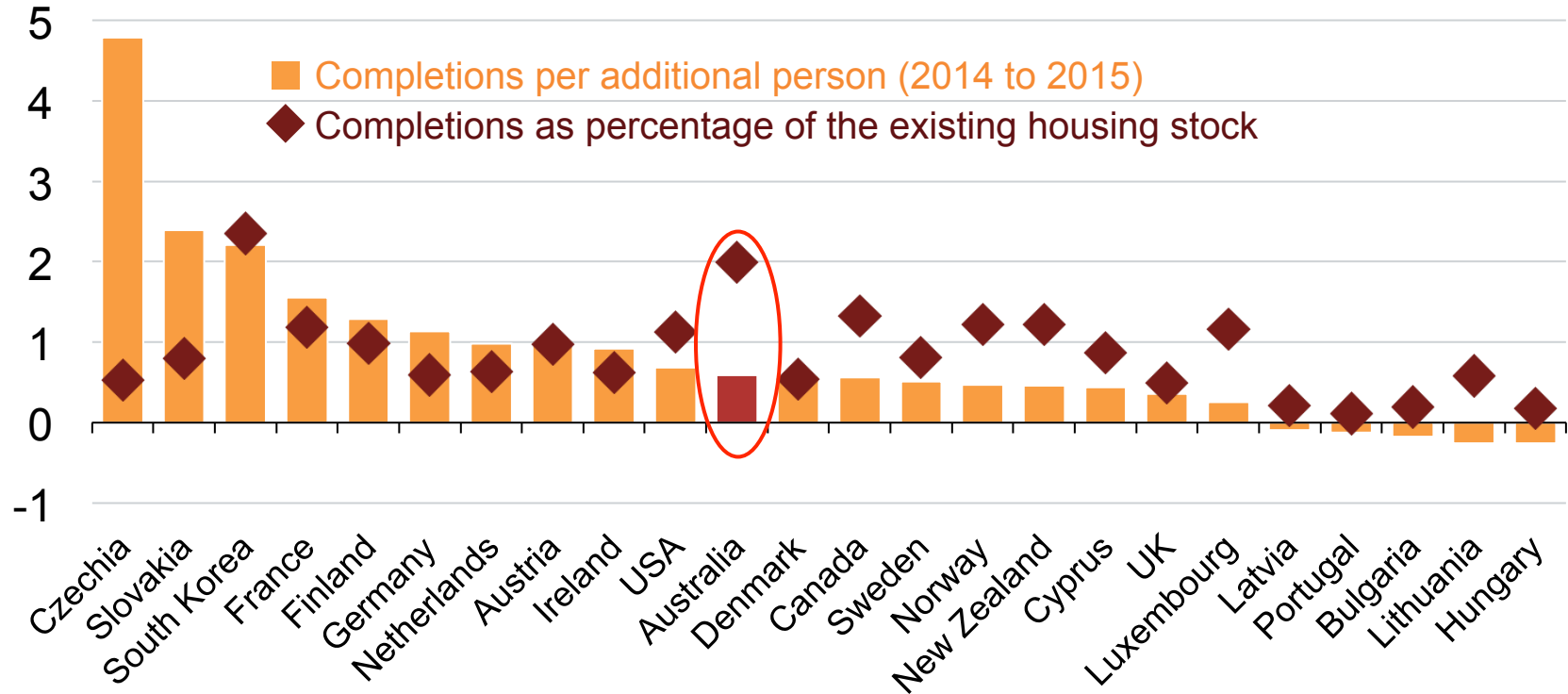


Notes: Does not take into account demolitions. The Victorian series spikes at 3,500 in 1993 (cut off to improve readability). Higher rates of home building per additional resident in the 1990s in part reflect declines in average household size among the existing population. Average household size fell from 2.8 people per household in 1991 to 2.6 by 2001. Average household size has been flat at around 2.6 people per household since 2001.

Source: ABS 8752.0 Building Activity, Australia; ABS 3101.0 Australian Demographic Statistics; Grattan analysis

Housing construction in Australia has been strong, but so has population growth

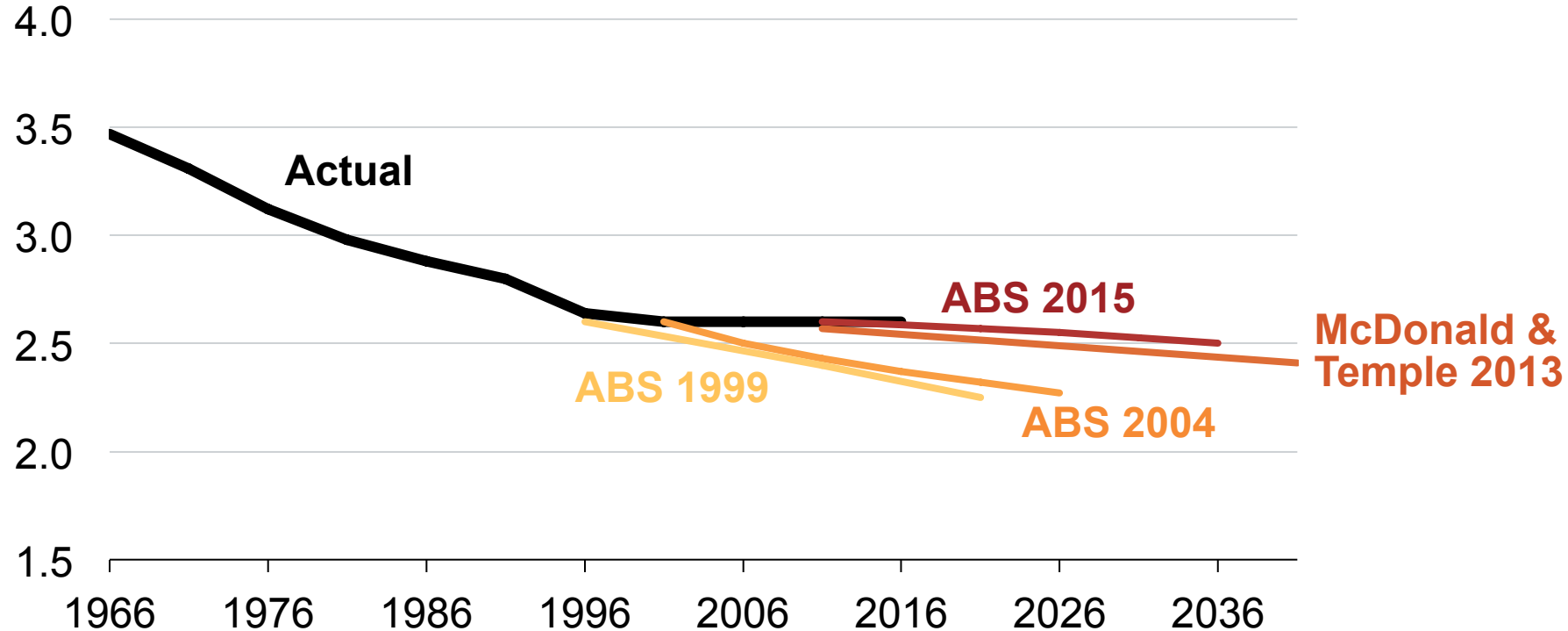
Dwelling completions in 2015



Notes: Estonia, Japan and Poland not shown due to large negative numbers. Dwelling construction data for 2015 or closest year.
Source: OECD Affordable Housing Database; United Nations population database

Household size flat-lined from 2000 due to worsening affordability ...

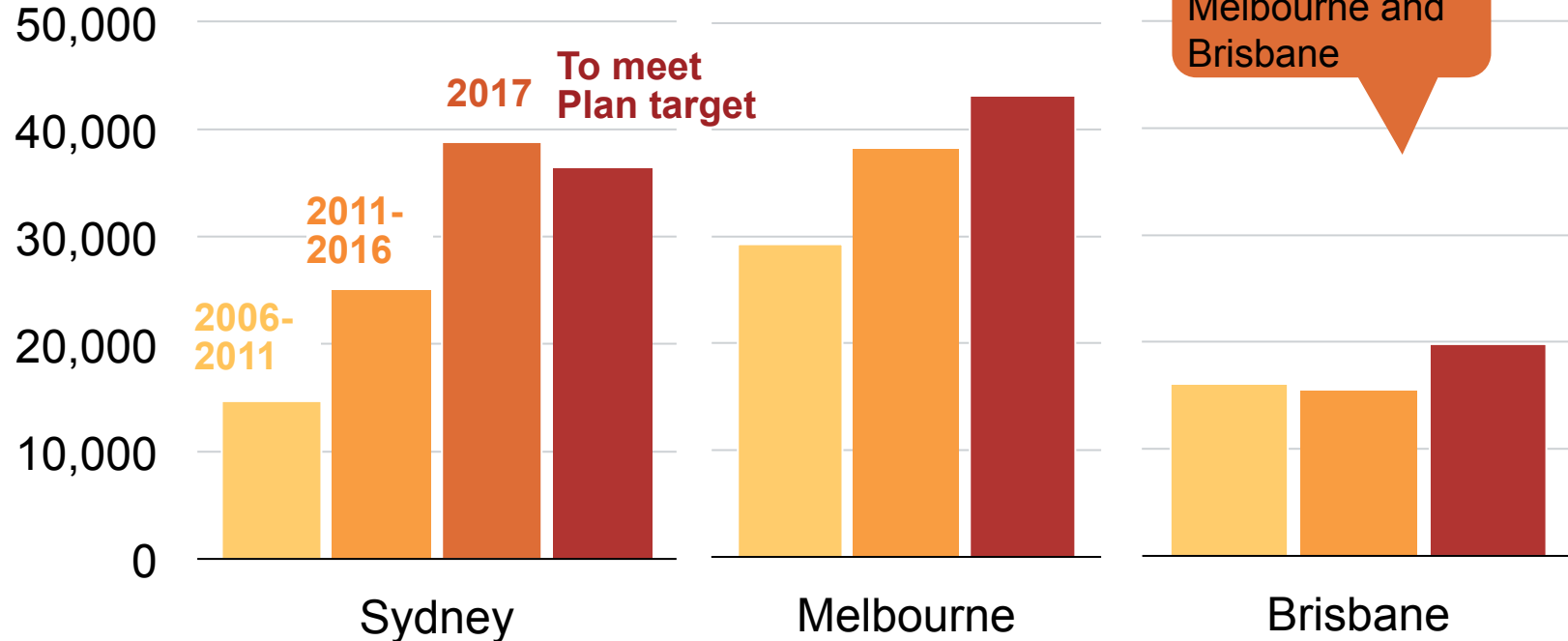
Average household size, actual and projected



Notes: ABS projections are series II/B projections. ABS 1999 projection for 2021 is for average household size to be between 2.2 and 2.3
Source: ABS; McDonald and Temple (2013)

Recent construction does not meet housing targets, let alone actual population growth

Average annual net housing construction



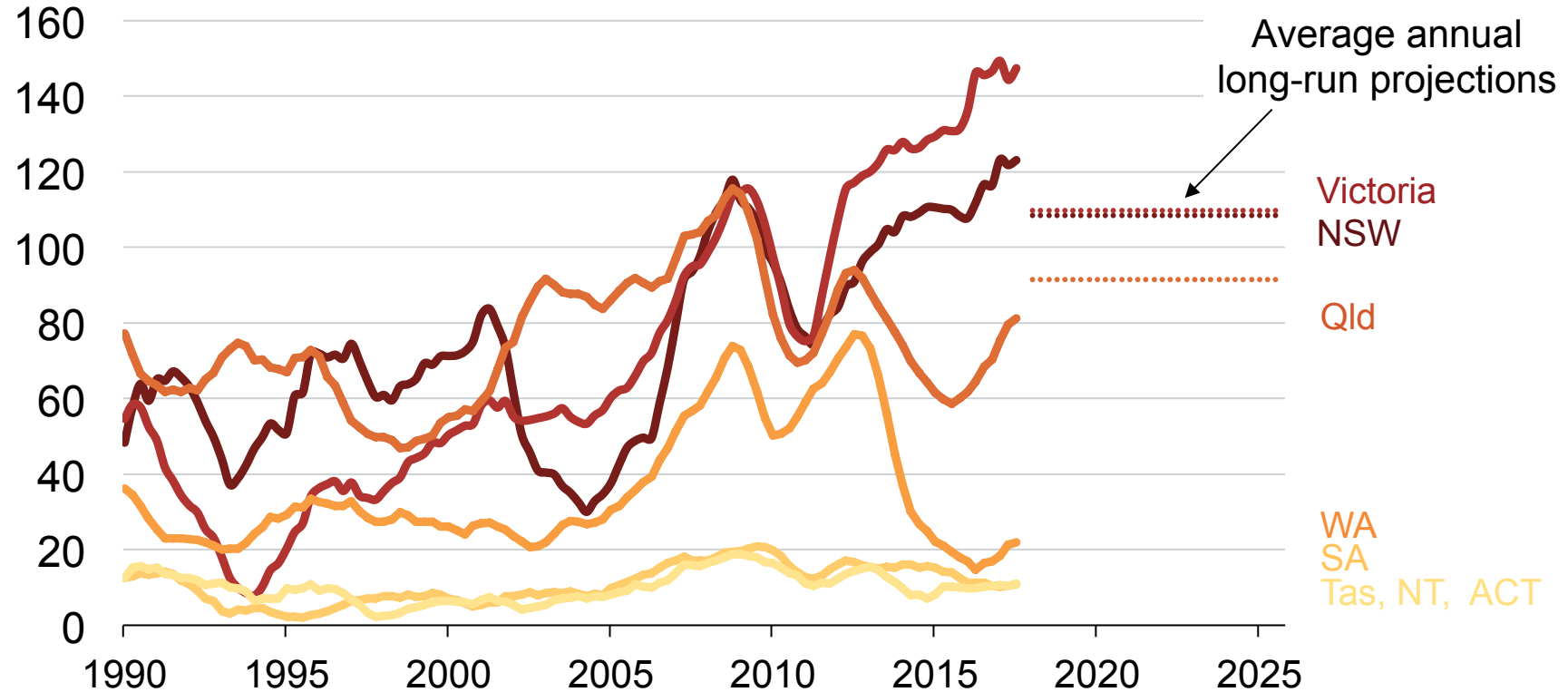
No 2017 data for Melbourne and Brisbane

Notes: Draft Greater Sydney Region Plan: 725,000 additional dwellings over 2016-2036 (excludes the Central Coast). Plan Melbourne 2017: 1,550,000 additional dwellings over 2015-2051 (based on Victoria in Future projections). For 2006 to 2016 data, growth in dwelling stock is calculated using 2016 Greater Capital City Statistical Areas. Data for 2017 dwelling completions in Sydney from NSW Department of Planning and Environment (2018). No 2017 completions data available for Melbourne

Sources: Greater Sydney Commission (2016); Victorian Government (2017); NSW DPE; Queensland Government (2017).

Victoria and NSW populations are growing much faster than in the past or projections ...

Net population growth, four-quarter rolling sum, thousands



Without more housing, it won't be affordable

Housing has become less affordable, particularly for low-income earners

Housing construction hasn't kept pace with additional demand

- Population growth jumped, and **dwelling construction did not respond** for almost a decade
- Mismatch between demand and supply ultimately clears through **larger household sizes**
- Even current record housing construction is ***barely* keeping up with population growth**

Planning policy is a problem

- Rising house prices mainly **reflect land values**, not dwellings
- The **zoning premium** in Australia is large
- We're **not building the housing people want**, where they want it

Building more homes would make housing more affordable

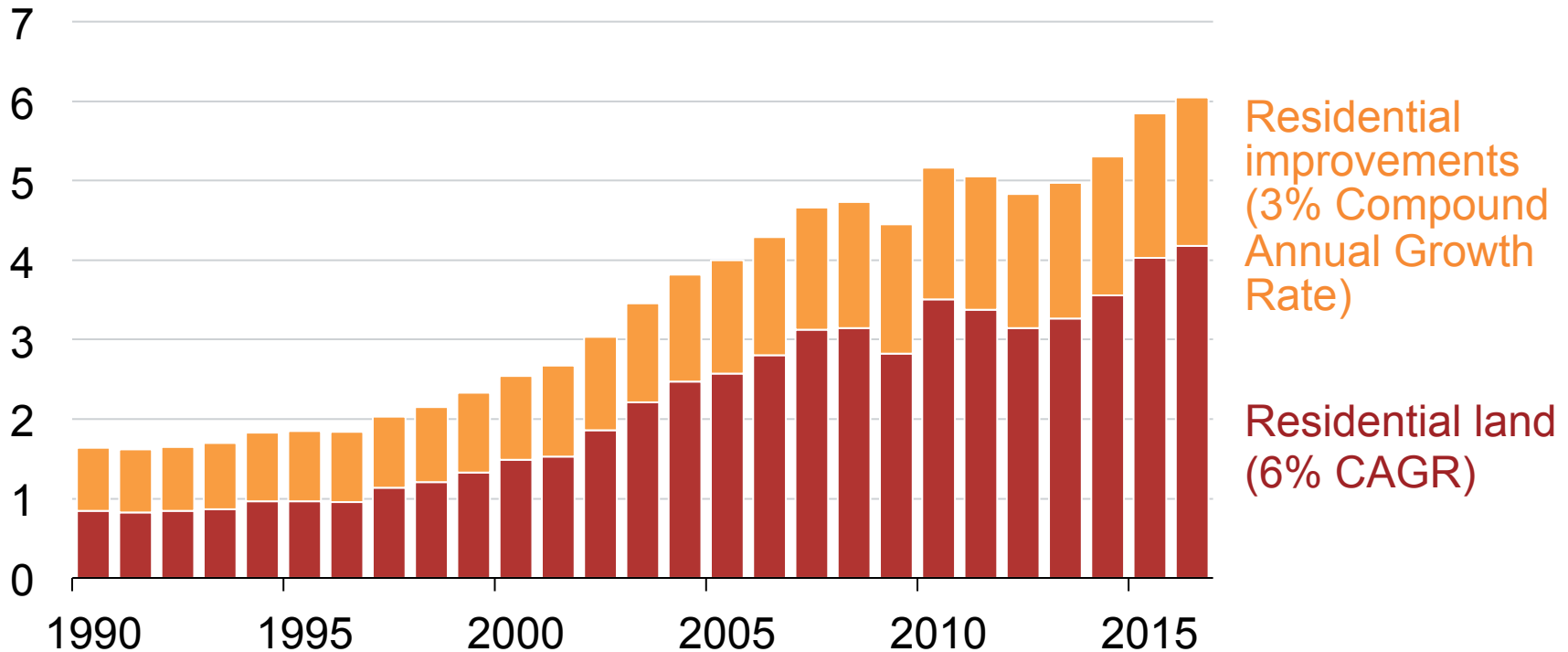
- Building an extra 50,000 homes a year for a decade could see house prices 10-15% lower

Other policies alone are unlikely to be enough, or produce collateral impacts

- (Premature) interest rates hikes have economic costs
- Macro-prudential rules have short-lived impact
- Tax reforms would make housing modestly more affordable
- Slower migration would improve housing affordability, but has collateral impacts

Housing prices increased mainly due to higher land values, although buildings are also better

Real market value of Australian property, \$2016, trillions

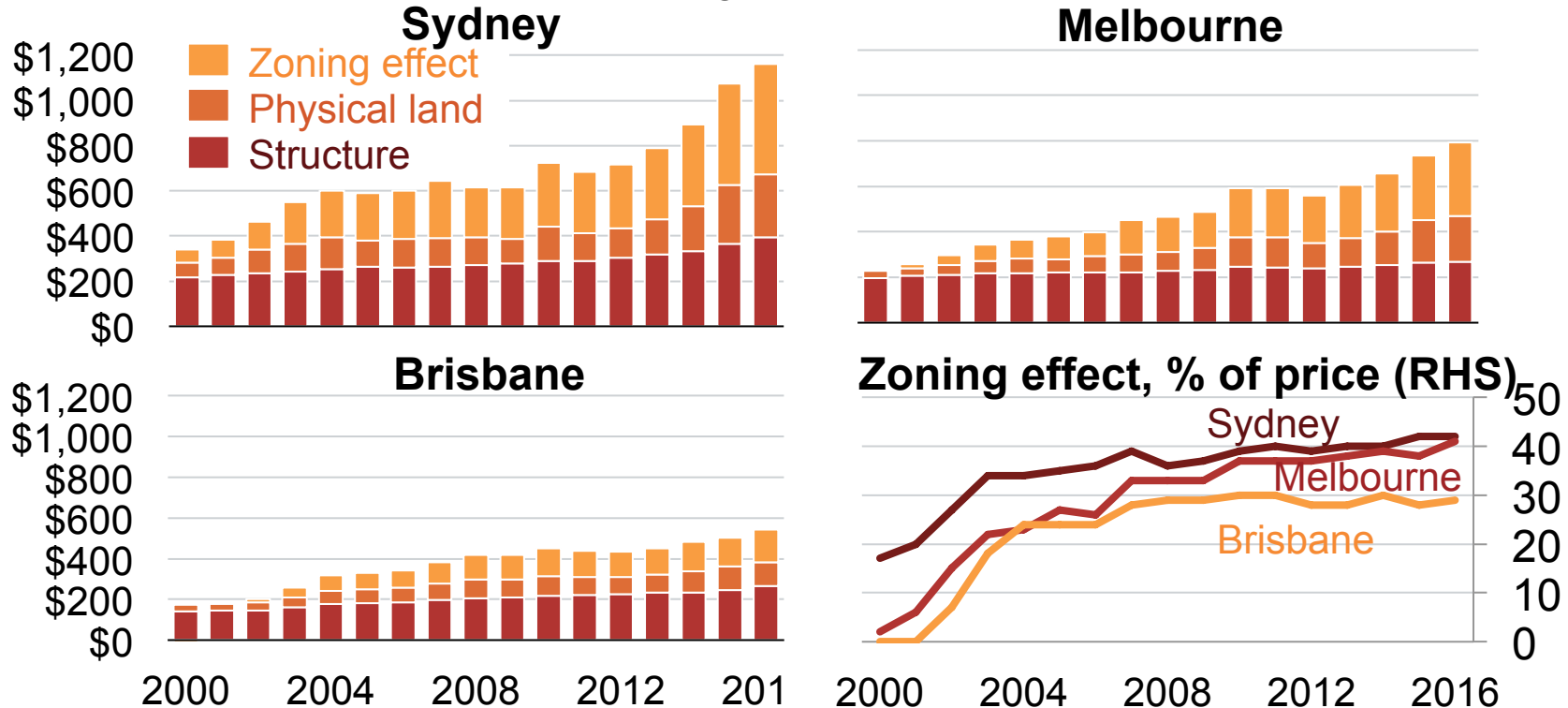


Notes: 'Residential improvements' consists of the value of the stock of dwelling construction; historical figures are deflated by the Consumer Price Index to \$2016.

Source: ABS 5204.0; ABS 6401.0; Grattan analysis.

Planning restrictions have pushed up the price of houses in Australia's major cities

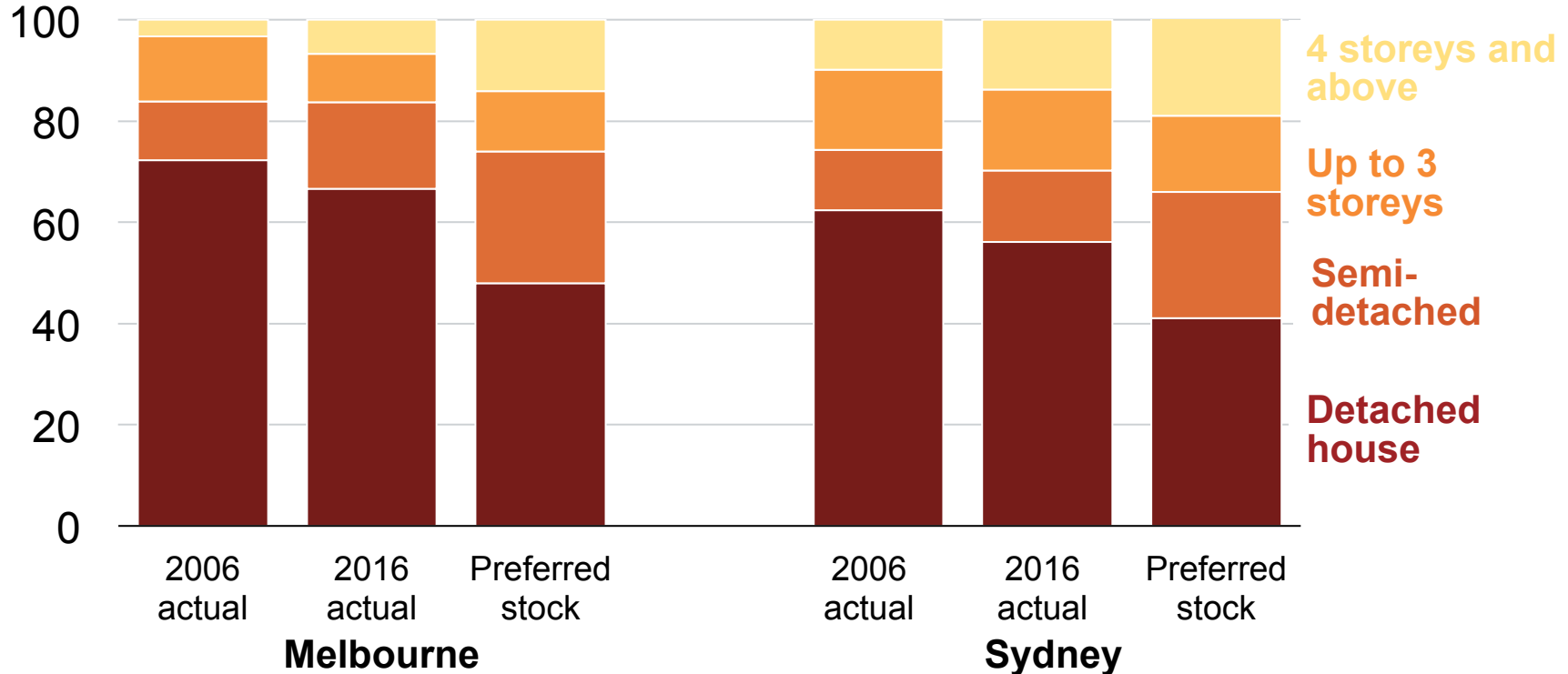
Contribution to the price of an average detached house, \$000s



Notes: Zoning effect as % of price is negative for Brisbane from 2000 to 2001, so not shown. Zoning effect is the sale price less structure and land costs.
Source: Kendall and Tulip (2018) 'The Effect of Zoning on Housing Prices', Reserve Bank of Australia.

There's a shortage of medium density housing compared to what people want

Per cent of housing stock, actual and preferred



Notes: 'Preferred stock' is from the survey of 700 residents about housing preferences from Grattan's 2011 report, *The housing we'd choose*. Data may not sum to 100 due to rounding. Excludes dwellings listed as 'Not stated' and 'Other dwellings', such as caravans. Source: Census; *Housing we'd choose*; Grattan analysis

Without more housing, it won't be affordable

Housing has become less affordable, particularly for low-income earners

Housing construction hasn't kept pace with additional demand

- Population growth jumped, and **dwelling construction did not respond** for almost a decade
- Mismatch between demand and supply ultimately clears through **larger household sizes**
- Even current record housing construction is **barely keeping up with population growth**

Planning policy is a problem

- Rising house prices mainly **reflect land values**, not dwellings
- The **zoning premium** in Australia is large
- We're **not building the housing people want**, where they want it

Building more homes would make housing more affordable

- Building an extra 50,000 homes a year for a decade could see house prices 10-15% lower

Other policies alone are unlikely to be enough, or produce collateral impacts

- (Premature) interest rates hikes have economic costs
- Macro-prudential rules have short-lived impact
- Tax reforms would make housing modestly more affordable
- Slower migration would improve housing affordability, but has collateral impacts

Building more homes could substantially improve affordability, in the long-term

Housing demand is price inelastic

- **Abelson (2005)** – a 1% increase in housing stock per capita led to a 3.6% fall in real house prices, based on 1970-2003 in Australia
- **Girouard et al (2006)** – an analysis of 20 studies across 12 countries found that elasticity of real house prices to housing stock is ~3.1%

Building more homes would make housing cheaper

- Building an extra **50,000 homes a year = 500,000 extra homes in a decade**
- Roughly equivalent to an extra **4% of the existing housing stock**
- Given observed elasticities, **house prices could be 10-15% lower** after a decade

Without more housing, it won't be affordable

Housing has become less affordable, particularly for low-income earners

Housing construction hasn't kept pace with additional demand

- Population growth jumped, and **dwelling construction did not respond** for almost a decade
- Mismatch between demand and supply ultimately clears through **larger household sizes**
- Even current record housing construction is ***barely* keeping up with population growth**

Planning policy is a problem

- Rising house prices mainly **reflect land values**, not dwellings
- The **zoning premium** in Australia is large
- We're **not building the housing people want**, where they want it

Building more homes would make housing more affordable

- Building an extra 50,000 homes a year for a decade could see house prices 10-20% lower

Other policies alone are unlikely to be enough, or produce collateral impacts

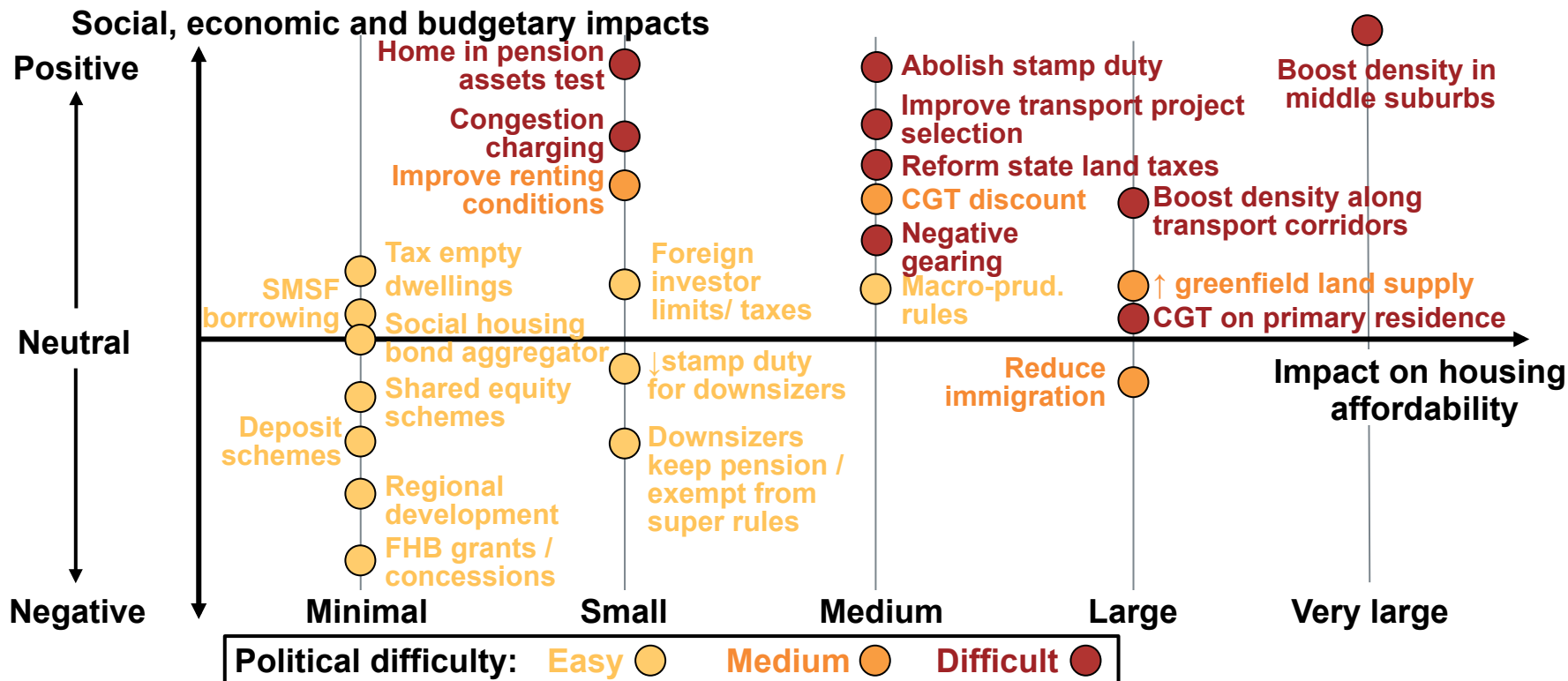
- (Premature) interest rates hikes have economic costs
- Macro-prudential rules have short-lived impact
- Tax reforms would make housing modestly more affordable
- Slower migration would improve housing affordability, but has collateral impacts

Other housing policies are likely to prove unattractive, or only modestly effective

	Housing	Economy	Budget
Interest rate hikes	Would substantially reduce house prices (<i>if they rise</i>)	Hiking rates prematurely has large economic costs	
Tighter macro-prudential rules	House prices fall short-term, little impact long-term	Positive if used to mitigate financial risks; otherwise not	
Abolish negative gearing + 25% CGT discount	Prices ↓ ~2% overall, more at bottom Rents won't rise	Reduces over-investment in housing	\$5 bn / yr
Home above \$500k in pension assets test	Prices ↓ ~1% overall Few pensioners downsize		\$1-2 bn / yr
Stamp duty – land tax swap	Better use of housing stock (i.e. spare bedrooms) Prices ↓ ~6%	Big economic benefits (~\$17b / yr)	Budget neutral swap
Curb migration (i.e. 50,000 less a year)	House prices 6-7% lower than otherwise after a decade	Small reduction in GDP per capita	Hits budget balance

Notes: Excludes policies explicitly intended to improve affordability for low income earners via housing subsidies, such as more social housing, or increases in Commonwealth Rent Assistance.

All the important reforms are difficult; all the easy reforms are cosmetic



Source: Grattan analysis.

Notes: Prospective policies are evaluated on whether they would improve access to more affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Estimates of the economic, budgetary or social impacts should not be treated with spurious precision.

For more ...

GRATTAN
Institute

March 2018

