Opening statement by Brendan Coates, Program Director for Household Finances at Grattan Institute to the Senate Economics Legislation Committee Inquiry into the National Housing Finance and Investment Corporation Amendment Bill 2019, Thursday 26 September 2019.

I appreciate the opportunity to address the Committee today.

The Scheme is likely to prove ineffective at best, and counterproductive at worst

Let me open my remarks today by re-iterating that housing affordability is a big problem in Australia.

Housing costs are a big problem for young people. Home ownership is falling fast across all age groups in Australia, but especially among the young and poor. Fewer than half of 25-34 year olds own their home today. Home ownership among the poorest 20 per cent of that age group has fallen from 63 per cent in 1981 to 23 per cent today. At this rate almost half of retirees will be renters in 40 years time.

This legislation seeks to arrest that decline by allowing first home buyers to purchase a home with just a 5 per cent deposit, without paying lenders mortgage insurance (LMI). This change is intended to overcome the deposit hurdle – which is a big barrier to home ownership in Australia.

But the problem with this Scheme – like the current First Home Super Saver Scheme and the Howard and Rudd Government's first home-owners' grants – is that it tries to fix the housing affordability problem by adding to demand for housing.

Over recent decades, Commonwealth, state and territory governments have spent billions of dollars effectively increasing the buying power of first-home purchasers, in an attempt to improve affordability.

Beyond their sizeable budgetary costs, giveaways to first home-buyers have actually worsened housing affordability by further inflating demand for housing.

While first home-buyers' grants may help some individuals to outbid an investor and buy a house, they do little to make houses affordable at an aggregate level.

Instead these policies have added to demand for housing, resulting in house prices being higher than otherwise, little increase in home ownership, with most of the benefit instead flowing to existing home-owners.

Economist Saul Eslake has suggested they are more accurately described as "second home vendors' grants"

Because it costs the budget less, this latest Scheme is less bad than its predecessors. But it still shares that same flaw.

Parliament should not be signing a blank cheque

Because the Scheme is small – the Government intends to offer just 10,000 guarantees a year – it is unlikely to make much of a difference to home ownership rates for young Australians, or house prices. Most of those taking up the scheme would probably have bought anyway.

But if the Scheme were expanded it would prove counterproductive: it would push up prices, benefitting sellers at the expense of first home-buyers, while increasing the risks of inappropriate lending at costs to both households and government.

And the clear political temptation here to do more of this. We've already seen such a call from the Property Council to expand the Scheme to 20,000 guarantees a year, and there will be others.

Given those political temptations, if the Scheme is to pass, Parliament should not do so while signing a blank cheque.

Instead the key dimensions of the Scheme should be set by Parliament in regulations that are disallowable. It is inappropriate for these key dimensions to be left to Ministerial discretion.

These dimensions are:

1. ***The annual cap on guarantees should be specified in legislation***

The annual cap on the number of guarantees – 10,000 a year – should be specified in the legislation. This would ensure any policy shift to expand the size of the Scheme is subject to parliamentary oversight, including consideration of the risks outlined above.

2. ***The legislation should also specify a maximum price cap***

The legislation should also specify a maximum price cap. We recommend a national cap of $650,000 a year. That would be sufficient to purchase the typical home purchased by first home-buyers in every major city in Australia.

Regulations could then establish lower regional limits for different housing markets.

Such a cap would align the Scheme with the price caps used for most state government first home-buyers' grants and stamp duty concessions. Many of these schemes are not indexed for increases in property prices.

3. ***The income thresholds should be set in legislation, and substantially lowered***

The income levels for the Scheme should also be set in legislation.

The Government's policy is that singles earning up to $125,000 or couples earning $200,000 should be able to access this Scheme. That means all but the top 10-20 per cent of income earners can access the scheme. This is precisely the group most likely to buy a home anyway without the scheme. After all, the typical worker in in Australia earns $58,000 a year.

To better target the Scheme, the income thresholds should be lowered to cover only those earning up to $80,000 for singles and $120,000 for couples. This change would ensure the Scheme supported only those on low-to-middle incomes who would be less likely to afford to buy a home otherwise.

The housing policies we really need.

As noted earlier, this scheme is unlikely to make housing more affordable. It is likely to prove ineffective at best, and counterproductive at worst.

Therefore if governments are serious about making housing more affordable, other policies are needed.

Affordability – both to buy and to rent – will only get a lot better if governments permit more homes to be built. The priority should be fixing state land-use planning rules that prevent higher density and therefore make housing so expensive in the first place.

And the Commonwealth Government should reform housing tax settings that artificially inflate demand for housing.

There is clear evidence that these policies would make housing more affordable. The housing boom has seen rents fall in Sydney for example.

And governments need to stop offering false hope to younger Australians through policies, such as first home-owners' grants, stamp duty concessions or deposit schemes, that are well-known to be ineffective.

And if we keep pretending there are easy answers, housing affordability will just get worse.