Submission to Inquiry into the National Housing Finance and Investment Corporation Amendment Bill 2019

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Table of contents

1 Summary

We welcome the opportunity to make a submission to the Senate Economics Legislation Committee Inquiry into the National Housing Finance and Investment Corporation Amendment Bill 2019.

The Government's proposed First Home Loan Deposit Scheme (the Scheme) should not proceed. 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. 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.

The fundamental flaw with the 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. Because it costs the budget less, this latest Scheme is less bad than its predecessors. But it shares their critical flaw: it pretends we can make housing more affordable without hurting anyone.

If the Scheme proceeds, the Bill should be amended in three ways.

First, the Bill should explicitly cap the number of guarantees offered at 10,000 a year, in line with Government policy. Any decision to expand the scheme should remain with Parliament.

Second, the income thresholds for the Scheme should be reduced to $80,000 for singles and $120,000 for couples. This would ensure the Scheme assists only those who would otherwise be unlikely to be able to afford to buy a home, and more closely align the Scheme with similar schemes abroad.

Third, the Scheme should be limited to providing guarantees to homes valued at less than $650,000. Regulations could then establish lower regional limits for different housing markets. Such a cap would ensure the Scheme is targeted at those excluded from home ownership today, while also aligning the Scheme with the price caps used for most state government first home-buyers' grants and stamp duty concessions.

If governments are serious about making housing more affordable, other policies are needed. The priority should be fixing state land-use planning rules that prevent higher density and so make housing so expensive in the first place. This is primarily a problem for state governments, but the Commonwealth should provide incentives to state governments to reform land-use planning rules to allow more housing to be built in the inner and middle rings of our major cities. And the Commonwealth Government should reform housing tax settings that artificially inflate demand for housing.

Governments can make housing more affordable, but only if they face up to the size of the problem and adopt policies that will make a real difference.

2 The Great Australian Dream is slipping away

Within living memory, Australia was a place where housing costs were manageable, and people of all ages and incomes had a reasonable chance to own a home with good access to jobs. But now, home ownership is falling among all Australians younger than 65. And owning a home increasingly depends on who your parents are. Without change, the Great Australian Dream could turn into a nightmare.

2.1 Housing is less affordable than it used to be

Australian housing has become increasingly expensive. Australian house prices haven risen much faster than incomes, particularly since the mid-1990s. Low-income Australians in particular are spending more of their incomes on housing than in the past.[1]

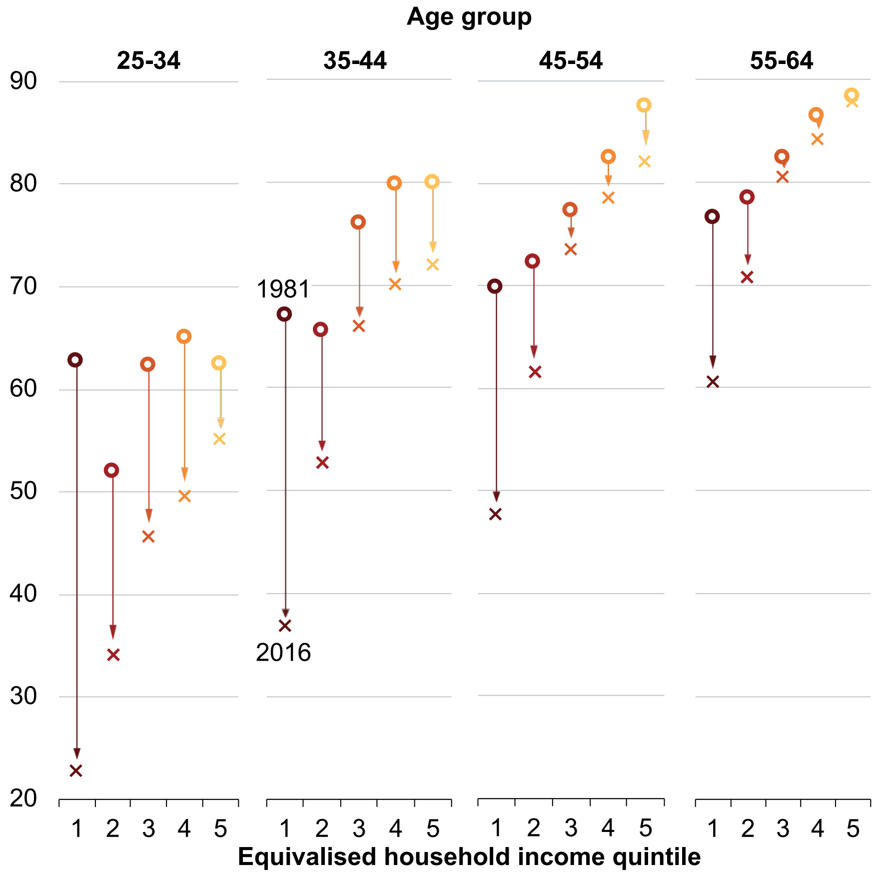
While house prices had been falling in Melbourne and Sydney until recently,[2] prices remain well above the levels of even five years ago.[3] And prices began increasing again in August 2019, the first increase in monthly values in almost two years.[4]

2.2 It is getting harder to save for a deposit

Saving a deposit is getting harder as prices rise. In the early 1990s it took about six years to save a 20 per cent deposit for a typical dwelling for an average household. It now takes about 10 years.[5] In addition, many young households are finding it harder to save for a deposit because they face larger HELP debts and are forced to save more of their income into superannuation than their parents did 25 years ago.

Figure 2.1: Home ownership is falling particularly fast for younger, poorer Australians

Home-ownership percentage, by age and income, 1981 and 2016



Source: Daley et al (2018, Figure 4.3).

1. ABS (2019).
2. Coates and Cowgill (2019).
3. Daley et al (2019, p. 66).
4. Lawless (2019).
5. Daley et al (2018, p. 20).

Although banks no longer insist on a 20 per cent deposit, most people still try to save this much before purchasing a dwelling. The typical leverage of a first home-buyer has remained remarkably constant, at about 83 per cent between 2001 and 2014,[6] even though banks loosened lending requirements and were more prepared to provide high-leverage loans.

2.3 Home ownership is falling, especially among the young and the poor

Between 1981 and 2016, home-ownership rates among 25-34 year-olds fell from more than 60 per cent to 45 per cent. Home ownership is falling fastest in Australia among young people on low incomes. 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 (Figure 2.1). Only some of this is the result of people starting work, forming long-term partnerships, and having children, later in life. Instead, owning a home increasingly depends on who your parents are, a big change from 35 years ago when home-ownership rates were high for all levels of income.

Home-ownership has also fallen for middle-age households, suggesting that most of the fall in home-ownership is due to higher dwelling prices rather than changing preferences for home-ownership among the young. Consequently, without intervention, home-ownership rates are unlikely to bounce back over time. For 35-44 year-olds, home-ownership has fallen fast – from 74 per cent in 1991 to around 62 per cent today – and home-ownership is also declining for 45-54 year-olds.

At this rate, in 40 years' time almost half of retirees will be renters.[7] The share of over-65s who own their home will fall from 76 per cent today to 57 per cent by 2056 – and it's likely that less than half of low-income retirees will own their homes in future, down from more than 70 per cent today.

6. Simon and Stone (2017).

7. Coates and Chen (2019).

3 A deposit guarantee scheme is likely to prove ineffective at best, counterproductive at worst

3.1 Demand-side schemes don't make housing more affordable

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. Most state governments currently offer some form of grant or stamp duty concession for first home-buyers, often limited to the purchases of new dwellings.[8] These policies have typically resulted in short-term 'spikes' of first home-buyer activity (Figure 3.1), but haven't improved 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 artificially inflate the demand for housing, resulting in house prices being higher than otherwise, with most of the benefit flowing to existing home-owners.[9] Economist Saul Eslake has suggested they are more accurately described as "second home vendors' grants".[10]

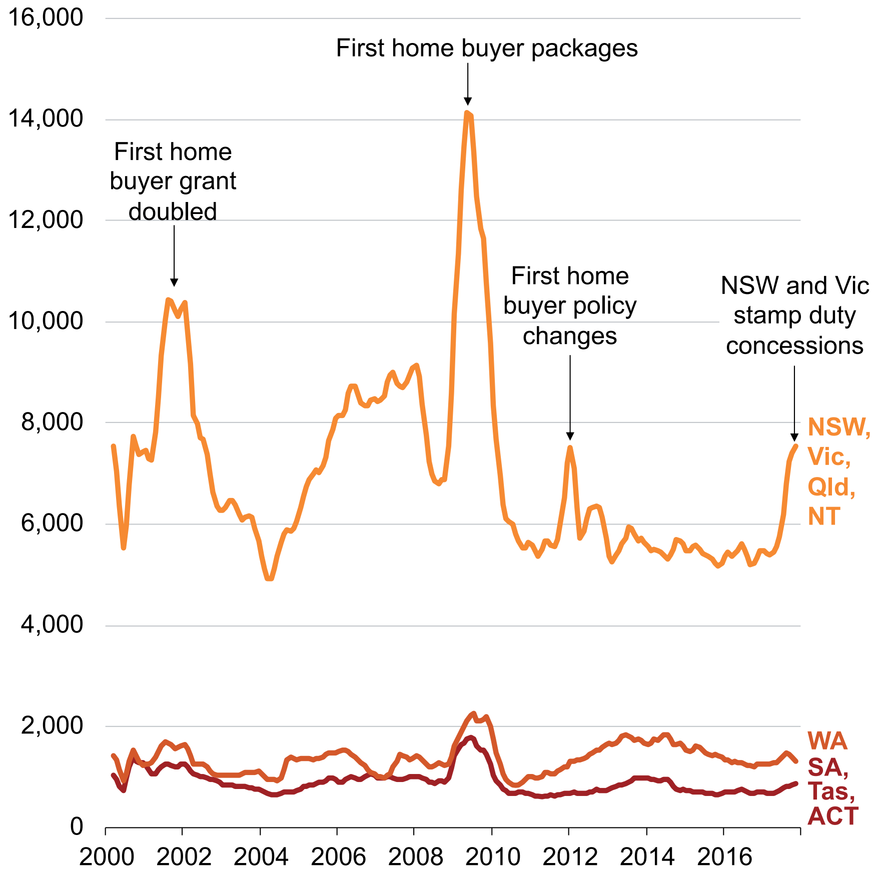
3.2 The new Deposit Guarantee Scheme is less flawed than its predecessors

The Government's new First Home Loan Deposit Scheme is the latest attempt to make housing more affordable by boosting buyers'

8. Eslake (2013). Daley et al (2013, p. 49) estimated that abolishing all subsidies for first home-buyers could save Commonwealth, state and territory budgets a combined $1.3 billion a year. Stamp duty concessions act in a similar way to cash grants for first home-buyers: Davidoff and Leigh (2013).
9. COAG Housing Supply and Affordability Working Party (2012).
10. Eslake (2013).

Figure 3.1: First home buyer grants and stamp duty concessions bring forward first home buyer activity

Number of dwellings financed, first home buyers, three-month moving average



Note: Includes refinancing.

Source: ABS (2017).

purchasing power. The Bill gives authority for the National Housing Finance and Investment Corporation (NHFIC) to provide guarantees to lenders for eligible first home-buyers.

Under the Scheme, eligible first home-buyers would be able to purchase a home with just a 5 per cent deposit. It would mean that single first home buyers on less than $125,000 a year, or couples on less than $200,000, could save $10,000 or more by not having to pay the Lenders Mortgage Insurance (LMI) that is normally required when a purchaser has a deposit of less than 20 per cent.

The Scheme might lead to higher home ownership, at least in the short-term. Some people who access the Scheme could buy their first home earlier. Others could pay a little more if they don't have to front for lenders' mortgage insurance on top of the house purchase. As a result, some first home-buyers may outbid an investor and buy a house. But in practice most people taking up the Scheme would probably have bought a home anyway. Some that take up the Scheme would simply be switching from using 'the bank of mum and dad' to help them buy a house.

In fact the best that can be said for the Scheme is that it won't have much impact on either house prices or the budget. Only 10,000 home-owners will be eligible, or around one in every 10 first home buyers each year. One estimate put the increase in home lending from the Scheme at just $3 billion a year – small fry in the context of a $6.6 trillion housing market.[11] Even in the unlikely scenario that every one of those 10,000 each year couldn't have bought otherwise, home ownership would only be 1 per cent higher after a decade.

Because it costs the budget less, the new Scheme is less bad than its predecessors. But it shares their critical flaw: it pretends we can make housing more affordable by adding to the demand for housing. Just like a direct first home buyers' grant, people who access this scheme can use the subsidy to buy a house earlier and pay more for it than they might have been able to otherwise. Most of the benefits flow to existing home-owners, and in the long-run first home-buyers overall may be worse off.[12]

3.3 Expanding the Scheme would be counterproductive

Some may be tempted to abolish the 10,000-a-year cap on guarantees provided. But a bigger Scheme would be counterproductive.

If the Scheme 'succeeded' in rapidly expanding demand from first home-buyers, it would push up prices for everyone, not least all the other first home buyers trying to get into the market. Since the May 2019 federal election, the Australian Prudential Regulatory Authority (APRA) has loosened rules governing how banks assess loan applications, leading to a recovery in house prices in Sydney and Melbourne.[13] And the bigger the scheme, the greater the risks of inappropriate lending that could leave the Government on the hook if buyers default, especially in the event of an economic downturn.[14]

11. Cranston et al (2019).

12. As discussed in Daley et al (2018, p. 137), stamp duty concessions for first home-buyers in Victoria introduced in 2017 followed this pattern: there was a rush in demand, and prices increased especially quickly in greenfields areas (typically dominated by first home buyers).
13. Since December 2014, APRA has required banks to assess borrowers' ability to repay loans assuming a minimum interest rate of 7 per cent. In changes flagged soon after the May 2019 election, and finalised in July, banks are instead able to assess loan applications using current interest rates plus a 2.5 per cent buffer. Analysts have suggested the rule change has increased borrowing capacity by 10-to-15 per cent. House prices in Sydney and Melbourne have since accelerated: Coates and Cowgill (2019).
14. If a borrower who takes advantage of the Scheme defaults on their loan, the Government will be liable for 15 per cent of the secured value.

3.4 If the Scheme proceeds, the Bill should be improved

The Scheme is fundamentally flawed and should not proceed. But if it does, the legislation should be improved in three ways.

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

As drafted, the Bill provides a blank cheque to the Government to expand the size of the Scheme in future without parliamentary oversight. Instead, 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 income thresholds should be tightened to target people less likely to purchase a home otherwise

The current income thresholds for accessing the Scheme – a pre-tax income of $125,000 a year for singles and $200,000 for couples – are far too high and mean that all but the top 10-to-20 per cent of income earners are likely to be able to access the scheme.[15] This is precisely the group most likely to buy a home anyway.

To better target the Scheme, the income thresholds should be lowered substantially.[16] Lowering the income thresholds to cover only those earning up to $80,000 for singles and $120,000 for couples[17] – would ensure the Scheme supported only those on low-to-middle incomes who would be less likely to afford to buy a home without the Scheme.[18]

3. The legislation should also specify a maximum price cap

The cap on home values under the Scheme should be legislated, rather than just left to administrative guidelines. The current Bill gives broad power to the NHFIC to provide loan guarantees. While immediate plans for the Scheme are modest, there is considerable risk of 'scope creep'. A much bigger Scheme would ultimately prove counterproductive. Limiting the NHFIC's powers to guarantee loans for homes valued at $650,000 or less would prevent the Scheme from greatly expanding without further parliamentary approval.

The Scheme should be limited to providing guarantees to homes valued at less than $650,000. Regulations could then establish lower regional limits for different housing markets. First home buyers typically purchase cheaper-then-average homes.[19] A cap of $650,000 would be sufficient to purchase a house or apartment among the cheapest 25 per cent of all homes in each of the capital cities in Australia except Sydney (where a house priced at the 25th percentile was worth

15. A single-income household earning $135,000 a year would be among the wealthiest 6 per cent of single-income households aged 25 to 44 years, whereas a couple household earning $200,000 a year is among the wealthiest 23 per cent of Australian couples aged 25 to 44 years. Grattan analysis of ABS (2016).
16. For example, the New Zealand Scheme, upon which the Coalition's plan appears to be based, cuts out at pre-tax incomes of only $85,000 for singles or $130,000 for couples.
17. Three-quarters of Australian singles aged 25 to 44 years earn less than $80,000 a year and around 40 per cent of Australian couples in that age range earn less than $120,000 a year. Grattan analysis of ABS (2016).
18. For example, Western Australia's Keystart shared-equity loans are typically available to households with incomes below $90,000 (and $70,000 for singles). Daley et al (2018, p. 139).
19. For example, Simon and Stone (2017) found that the median home purchased by a first home buyer is around the 30th percentile of all homes and this has not changed much over the past decade.

$682,000 in 2018),[20] and more than half of all homes in Australia (Table 3.1).[21]

Such a cap would ensure the Scheme is targeted at people excluded from home ownership today, while also aligning the Scheme with the price caps used for most state government first home-buyers' grants and stamp duty concessions.[22] In future, the cap could be indexed to quarterly movements in national house prices as reported by the Australian Bureau of Statistics (ABS).

Table 3.1: A $650,000 cap would be sufficient to buy a cheaper-than-average home in all Australian capital cities

	Houses		Units	
Price percentile:	25th	50th	25th	50th
Sydney	$682,000	$930,000	$580,000	$730,000
Melbourne	$580,000	$727,000	$400,000	$520,000
Brisbane	$422,000	$550,000	$330,000	$402,500
Perth	$380,750	$495,000	$262,000	$359,000
Adelaide	$370,000	$487,000	$275,000	$340,000
Canberra	$575,000	$695,000	$366,500	$430,000
Hobart	$346,000	$455,000	$278,000	$360,000
Darwin	$415,000	$505,000	–	–

Notes: Figures for 2018. Figures for Hobart and Darwin should be interpreted with caution due to small sample sizes. Darwin units excluded due to small sample size.

Source: Wiltshire (2019).

20. Based on the latest publicly available data. House prices have fallen in Sydney by 7 per cent over the past year according to Corelogic: Lawless (2019). Semi-detached and townhouses (14 per cent) and apartments (30 per cent) already account for nearly half of the housing stock in Sydney: Daley et al (2018, Table 3.2).
21. The national median dwelling price was $521,157 as of 31 August 2019, according to Corelogic: Lawless (2019).
22. State-based subsidies for first home buyers have already begun to cut out in all states for home purchases values at $650,000.

Some may argue that a cap of $650,000 is too low, especially in Sydney and Melbourne. Yet homes valued at more than $650,000 are unlikely to be affordable to Australians on below-average incomes. Even in Sydney, where house prices are highest, the NSW Government's stamp duty concession scheme begins to taper out at home values above $650,000 (Table 3.2).

Table 3.2: Income thresholds for state government subsidies for first home-buyers

State	Program	New or existing home	Maximum price for full subsidy	Maximum price for any subsidy
NSW	Stamp duty concession	Existing	$650,000	$800,000
	First home buyers' grant	New	$600,000	$750,000
VIC	Stamp duty concession	Existing	$600,000	$750,000
	First home buyers' grant	New	$650,000	
Qld	Stamp duty concession	Existing	$500,000	$550,000
	First home buyers' grant	New		$750,000
WA	Stamp duty concession	Existing	$430,000	$530,000
	First home buyers' grant	New		$750,000
SA	First home buyers' grant	New		$575,000
Tas	First home buyers' grant	New		None
ACT	Stamp duty concession	Income-based concession		

Notes: WA figure is for properties in Perth. Different rules apply to areas in the north of the state.

Sources: Various state government websites.

4 There are better ways to improve housing affordability

There are better ways to improve housing affordability and boost home ownership. Grattan Institute's 2018 report, *Housing affordability: re-imagining the Australian Dream*, showed what would work. The report evaluated a wide range of housing policy options on whether they would make a material difference to affordability without substantially dragging on the economy or the budget. It concluded that almost all of them would boost the supply of housing, while a number of tax reforms to remove distortions in housing investment would have large budgetary and economic benefits, but more modest impacts on housing demand. These options are summarised in Figure 4.2.

4.1 Relax planning rules to allow more density in Australia's major cities

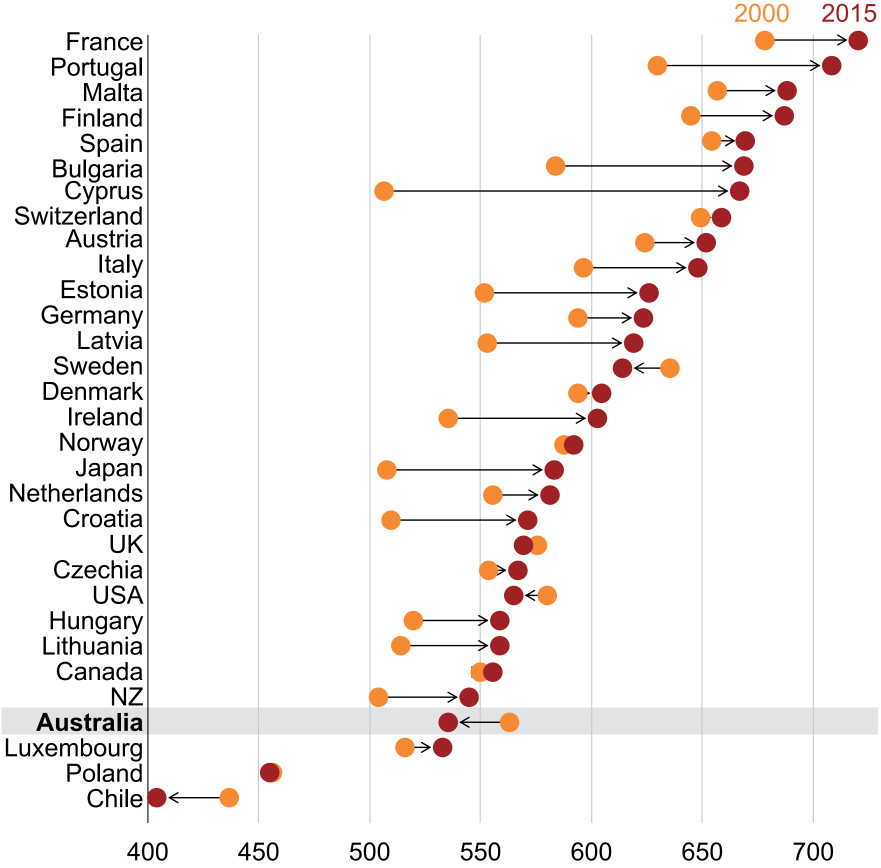
Affordability – both to buy and to rent – will only get a lot better if governments permit more homes to be built.

Australian cities have not built enough housing to meet the needs of Australia's growing population. Australia has 535 dwellings per 1,000 adults, which is among the least housing stock per adult in the developed world (Figure 4.1). The mismatch between supply and demand has created a 'zoning premium' for well-located housing[23] that benefited existing property owners, but imposed additional costs on new purchasers and renters.

The NSW, Victorian and Queensland governments have all changed planning rules and processes over the past five years or so,[24] which

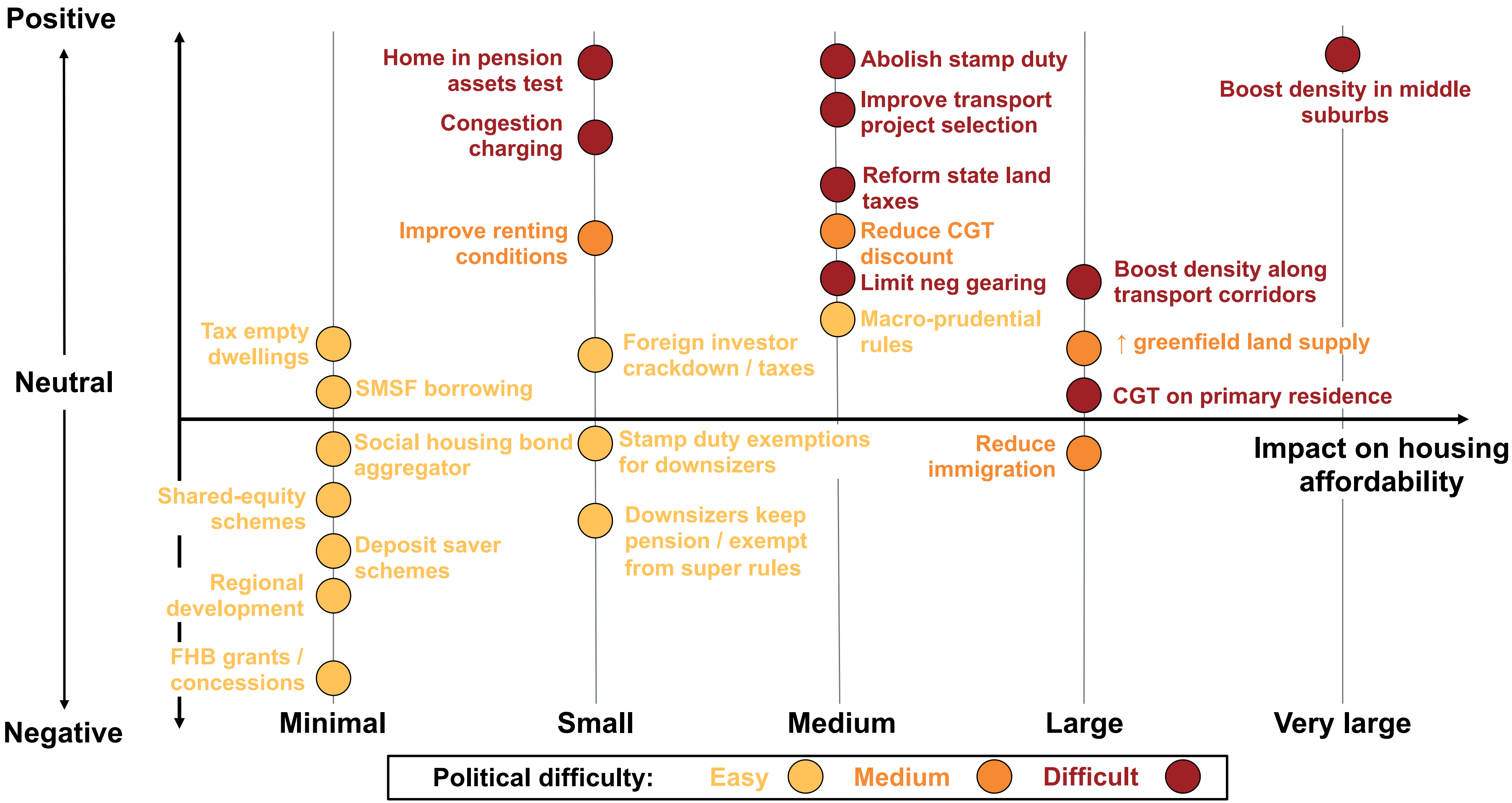
23. Kendall and Tulip (2018).
24. The NSW Government expanded use of independent panels and its fast-track development process. The Victorian Government made modest improvements to zoning rules, and invested in reducing the time for council decision-making. Brisbane City Council substantially improved planning rules, which led to

Figure 4.1: The amount of housing per adult has fallen in only six countries since 2000, and Australia has had the second largest fall
Dwellings per 1000 people aged 20 and older, 2000 and 2015



Source: Daley et al (2019, Figure 5.1).

Figure 4.2: Only some policies will actually improve housing affordability, and these are politically difficult
Summary of economic, budgetary, and social impacts



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. Our estimates of the economic, budgetary, or social impacts should not be treated with spurious precision. For many of these effects there is no common metric, and their relative importance depends on the weighting of different political values. Consequently our assessments are generally directional and aim to foster a more informed discussion.

Source: Daley et al (2018, Figure 5.2).

resulted in new building briefly catching up with additional demand. The extra housing supply has contributed to housing prices and rents flattening off in Sydney, Melbourne and Brisbane.[25] Building an extra 50,000 homes a year for a decade could leave Australian house prices and rents 10-to-20 per cent lower than they would have been otherwise.[26]

This is primarily a problem for state governments: they set the overall framework for land and housing supply, they govern the local councils that assess most development applications, and they set building regulations that affect building costs. But the Commonwealth can encourage the states to boost supply by reforming land-use planning and zoning laws and releasing greenfield land.

Coordinating action by the states is worthwhile because improved housing supply in one state spills over into lower prices in other states. And the Commonwealth tax base is more likely than the state tax base to capture the increased revenues that flow from higher economic growth as a result of better housing supply.

The Commonwealth Government should provide incentives to state and local governments to increase the supply of housing in good locations. Under the National Competition Policy reforms of the 1990s, the Commonwealth Government provided financial incentives to the states.[27] The Commonwealth Government has sought to use the new intergovernmental housing agreement to encourage state and local governments to boost housing supply.[28] But the Commonwealth has not put enough money on the table to get states to make the politically difficult decisions on planning reform.[29]

4.2 Reform tax and welfare rules to reduce demand for housing

Housing demand would be reduced a little if the Commonwealth Government reduced the capital gains tax discount and limited negative gearing – and there would be substantial economic and budgetary benefits.[30] The effect on property prices would be modest – they would be roughly 2 per cent lower than otherwise – and would-be homeowners would win at the expense of investors. House prices at the bottom would probably fall by more, since these tax breaks have channelled investors into low-value homes that are lightly taxed under states' progressive land taxes and tax-free thresholds.

The dominant rationale for these reforms is instead their economic and budgetary benefits. The current tax arrangements distort investment decisions and make housing markets more volatile. Our proposed reforms would boost the budget bottom line by about $5 billion a year. Contrary to urban myth, rents wouldn't change much, nor would housing markets collapse.

Including more of the value of the family home in the pension assets test would also marginally reduce housing demand.[31] Under current

increased apartment supply on the CBD fringe. Meanwhile Tasmania's Affordable Housing Strategy recognised the importance of releasing land for residential development, and South Australia and Western Australian noted in their housing affordability strategies that planning was a key reform area. See Daley et al (2018, p. 58), Department of Housing (2010), Department of Human Services (2013) and Housing Tasmania (2015).

25. Domain (2019).
26. Daley et al (2019, p. 68).
27. Productivity Commission (2005). A total of $5.7 billion was allocated for payments from 1997-98 to 2005-06.
28. The National Affordable Housing Agreement specifies national performance indicators including the total number of dwellings relative to the population, and increases in the number of dwellings permitted by zoning in major cities. But no funding is attached to achieving these milestones. Daley et al (2019, p. 70).
29. The Commonwealth's City Deals could be used for this purpose, but so far they have focused not on housing affordability but on the broader objectives of increasing economic growth and stimulating urban renewal.
30. Daley et al (2018, p. 97).
31. Many Age Pension payments are made to households that have substantial property assets. Half of the government's spending on the Age Pension goes to

rules only the first $210,500 of home equity is counted in the pension assets test; the remainder is ignored. Inverting this so that all of the value of a home is counted above some threshold – such as $500,000 – would be fairer, and contribute to the budget. Again the dominant rationale for this reform is the budgetary benefit, rather than housing affordability. Many Age Pension payments are made to households that have substantial property assets.

4.3 But progress requires making some tough choices

Australian governments have historically avoided the hard choices on housing affordability, preferring policies that merely appear to help. The politics of reform are fraught because most voters own a home or an investment property, and mistrust any change that might dent the price of their assets. But if governments keep pretending there are easy answers, housing affordability will just get worse.

If governments really want to make a difference, they need to stop offering false hope through policies, such as first home-owners' grants, stamp duty concessions or deposit schemes, that are well-known to be ineffective. Governments have no chance of bringing the community with them when they keep telling voters that the easy policies will do the job. Instead they need to explain the hard choices, to prepare the ground for the tough decisions that need to be made. Either people accept greater density in *their* suburb, or their children will not be able to buy a home, and seniors will not be able to downsize in the suburb where they live. Economic growth will be constrained. And Australia will become a less equal society – both economically and socially.

Policy can make a difference. But only if we make the right choices.

people with more than $500,000 in assets. Excludes impact of changes to the Age Pension assets test that took effect from 1 January 2017, reducing the pension entitlements of 326,000 pensioners. But these changes will reduce overall pension payments to part-rate pensioners by only about $1 billion in 2017-18, which is unlikely to substantially change the distribution of pension payments by net wealth, given total pensions spending of $45 billion in 2017-18. Daley et al (2019, p. 69).

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