

Solving the House Price Problem in 10 Minutes!

With Special Reference to the Role of
the Three Levels of Government

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House Price Inflation is a National Phenomenon

December	Sydney	Rest of NSW	Melbourne	Rest of Victoria	Brisbane	Adelaide	Perth	Canberra
Median House Price (\$000)								
2003	523	255	320	185	296	248	250	375
2016	970	435	675	319	515	450	523	650
Median Unit Price (\$000)								
2003	387	250	285	170	249	191	198	
2016	715	370	512	270	393	355	415	
Index with 2003=100								
Houses	185.5	170.6	210.9	172.4	174.4	181.5	209.2	173.3
Units	184.8	148.0	179.6	158.8	157.8	185.9	209.6	

Source: ABS, *Residential Price Indexes: Eight Capital Cities*, Dec. 2016, Cat. 6416.0

House Price Inflation: a National Phenomenon

Between 2002 and 2016: **median house price** rose by 85% in Sydney

Cf: Melbourne 111%, Perth 109%, Adelaide 81%, Brisbane 74%, Canberra 73%

Between 2002 and 2016: **median unit price** also rose by 85% in Sydney

Cf: Perth 110%, Adelaide 86%, Melbourne 80%, Brisbane 58%

Sydney: Rents Stable in Relation to Median Household Income

Year	Median household gross income (a)	Median household disposable income (a)	House (3 bedrooms) median rent per week (b)	Unit (2 bedrooms) median rent per week (b)
2000	47,154	35,674	230	250
2016	100,343	77,386	470	520
Ratio	212.8	216.9	204.3	208.0

(a) For 1999-2000 and 2015-16. Source ABS and author estimates.

(b) Source: Family and Community Services

Sydney: Rents Stable in Relation to Median Household Income

Median 3-bedroom house rent / household income

2000	33.5%	2016	31.6%
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Median 2-bedroom unit rent / household income

2000	36.4%	2016	34.9%
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These are selected statistics but they are typical.

Causes of House Price Inflation

We must therefore look for:

- National causes of house (asset) price inflation
- Changes that have occurred between 2002 and 2016

The Elephant in the Room: Interest Rates 2002-16

	RBA Cash rate	Borrowing rate (RBA) (a)	Effective overall rate (b)	Effective rate index
2003	5.23	7.05	6.69	100.00
2004	5.25	6.60	6.33	94.68
2005	5.50	6.70	6.46	96.62
2006	6.25	7.45	7.21	107.84
2007	6.75	7.95	7.71	115.32
2008	4.35	6.20	5.83	87.20
2009	3.74	6.00	5.55	82.98
2010	4.75	7.15	6.67	99.76
2011	4.30	6.55	6.10	91.24
2012	3.03	5.70	5.17	77.27
2013	2.50	5.10	4.58	68.50
2014	2.50	5.10	4.58	68.50
2015	2.10	4.85	4.30	64.31
2016	1.80	4.50	3.96	59.23

(a) Standard owner rate with discount. Arguably borrowing rates are lower, but these are consistent data.

(b) Assumes 80% at borrowing rate and 20% equity at cash rate.

The Elephant in the Room: Interest Rates 2002-14

Interest cost on 2002 dwelling @ \$400,000 × 6.7% = \$26,800 p.a.

Allow 41% ↑ CPI, 2002-16: \$26,800 × 1.41 = \$37,788 in 2016 prices.

Interest 2016 dwelling (up 85%) \$740,000 × 4% = \$29,600.

The real cost of interest payment is lower in 2016 than in 2002 even with 85% higher house price.

Of course, same is true for comparisons at all higher and lower house price levels.

The fall in interest rates is responsible for virtually all, if not all, the rise in house and unit prices.

Nearly all commentators ignore this key cause, including the RBA.

Changes in other causal factors are minor

Increase in foreign demand (modest nationally)

Note also housing quality change (1% p.a.)

Housing supply (completions) has minimal effect

Australian dwelling completions – average p.a.

1990-96	149,000
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1997-2001	141,000
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2003-06	156,000
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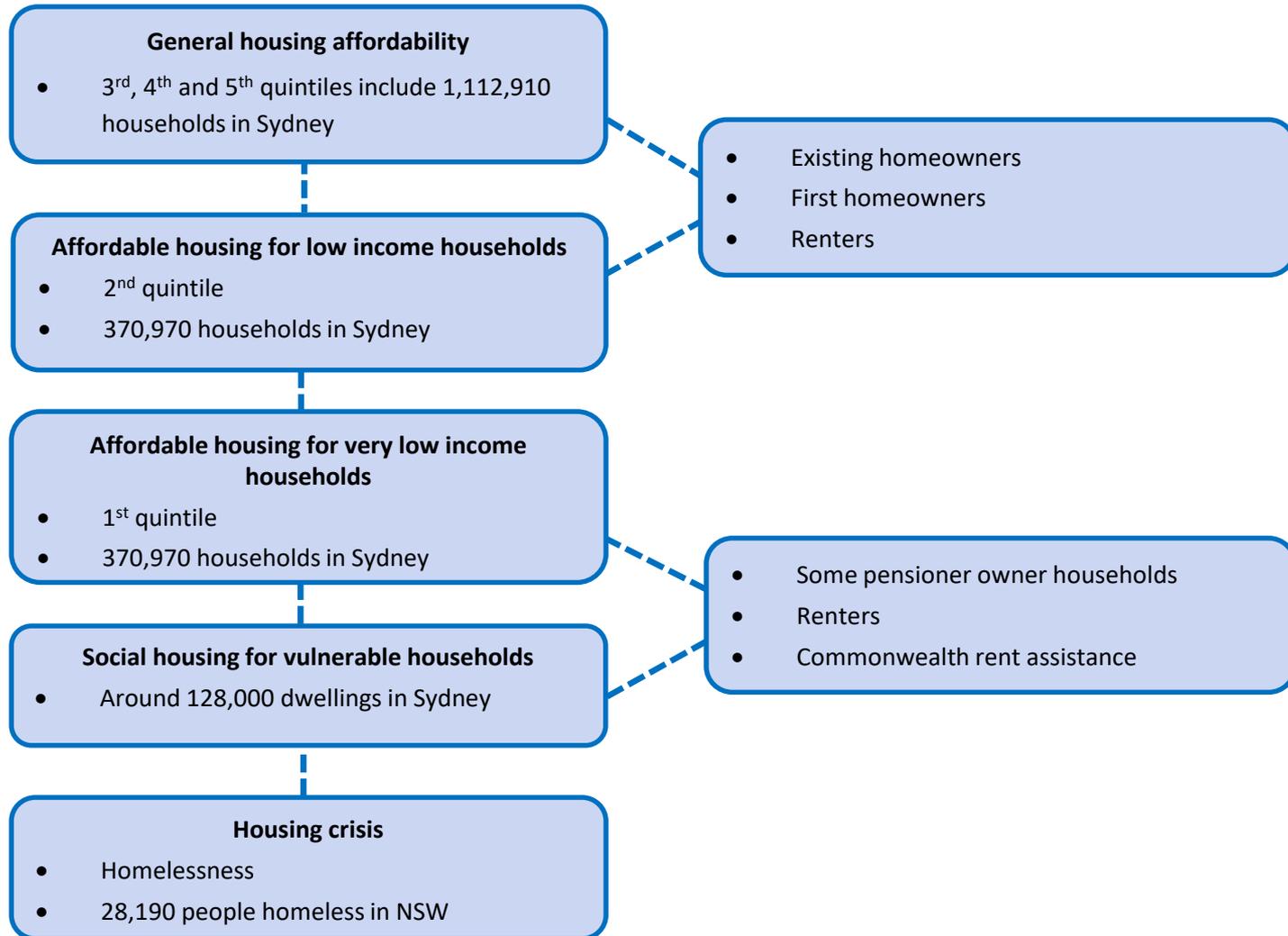
2007-11	152,000
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2012-16	177,000
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Sydney has slight variations – but broadly similar profile.

House completions have broadly matched population increase.

Some Core Sydney Data 2014: Quintile Picture



More Core Data: Housing Stock, Annual Completions

There are about 1.9m dwelling units in Sydney, including 1.85m privately owned and 125,000 social housing.

Dwelling completions average around 22,000 per annum (cf turnover about 100,000 dwellings per annum).

Annual completions are about 1.1% of the housing stock.

Changes in Housing Stock and House Prices,

Australian and international econometric evidence: holding other factors constant, a 1% increase in total housing stock causes 3% fall in prices.

If Sydney dwelling completions increase to 35,000 p.a., total dwelling stock would increase by 0.6%, and house prices fall by about 2%. Hardly noticeable.

If house prices fell by more than that, the inter-city house price equilibrium would change and more people would migrate into Sydney.

The two critical social problems

Higher deposits for first time buyers

- Say first home owner paid \$300,000 for dwelling in 2002 and (85% more) \$555,000 in 2016
- In 2016 prices, 20% deposit on \$300,000 = \$60,000 × 1.41 inflation = \$85,000
- 20% deposit on \$555,000 = \$111,000
- The deposit has increased by 30% in 2016 dollars

The two critical social problems

High rents for very low / low income households

- Large gap between social housing assistance and CRA: values at about \$12,000 and \$4,000 p.a. respectively
- About 40,000 households on waiting list for social housing in Sydney
- ABS data 2013-14: 150,000 households in lowest two income quintiles in NSW pay over 30% of income in rent
- Probably 80,000 to 100,000 households in lowest two quintiles in Sydney experience severe income / housing stress (exact number depends on definitions)
- These are **not** households in the middle-income quintile

Strong Solutions

1. A fundamental shift in central government macroeconomic policy using fiscal policy more and monetary policy less. ESA paper 19 July (Commonwealth role).
2. More support for low income / low wealth first-home buyers (State) – higher deposit assistance
3. More State rental support for very low income households

State Government can fund (2) and (3) from windfall \$bn revenue in stamp duties (courtesy of RBA's low interest rates) or via an affordable housing levy on new housing (see below).

Modest Solutions

Increasing housing supply: Rezoning is major driver

Need robust CBA methodology based on housing demand, development costs, transport costs and environmental amenity

This has **never** been supplied by DPE or GSC

Two possible strategies within overall rezoning strategy

- Rezoning industrial land
- Dual occupancy town houses (but not complying development)

Improving transport infrastructure – yes, but note, this increases house prices!

Incentivising local councils with adequate cost-based developer contributions.

Two Poor Solutions: Inclusionary Zoning (Rent Control)

Mandatory provision of rent controlled housing in (some) new residential developments:

e.g. 20% rent reduction on market rent on 10% of new residential space created.

This has efficiency, equity and administrative issues with minimal impact on supply of affordable housing

Two Poor Solutions: Inclusionary Zoning (Rent Control)

Efficiency issues: disincentives to household movements (sub-optimal location decisions), under-maintenance of housing (rent control classic), possible minor impacts on supply and design of housing.

Equity issues: does not assist key low income groups needing assistance (only middle-income households can afford rent, even reduced, on new housing) and major tenant selection problems.

Administration issues: house sharing / sub-letting, changes in tenant incomes, and inconsistency with multiple managers of rent-controlled housing.

There is an alternative –affordable housing levy

Financially equivalent affordable levy on new housing units =
1.5% of house sale values = loss in capital value associated with
20% rent controls on 10% of new residential space.

With revenue accruing to centrally controlled affordable housing fund, this avoids virtually all efficiency, equity and administrative disadvantages of an inclusionary zoning (rent control) policy.

Levy would have negligible impact on house prices; it would mainly reduce land prices by small amount (about 2% to 3%).

Rezoning lifts land prices – windfall profits to land owners.

This is much more efficient and equitable housing assistance policy than rent controlled housing.

Another Poor Solution: The 40-day DA Furphy

It generally takes 2-3 years (often longer) to plan, design and construct new housing. Reducing DA approval time from 60 to 40 days has **no material impact** on total developer / landlord cost.

DA approval times can be reduced by refusing DAs rather than discussing / inviting amendments. But this leads to 2 DAs and increases total DA time.

Let's get perspective – houses stand for 50 years. Taking 2-4 weeks extra time to get improved outcomes is entirely appropriate.

Of course, inefficient administration sometimes occurs, but overall the cry for all DAs in 40 days is a development furphy.

Conclusions

1. House price inflation is a national asset pricing problem caused almost entirely by low interest rates.
2. The top of the asset price bubble has probably been reached. Gradual lift in interest rates will help control house prices (Commonwealth Role).
3. State role: state should (a) increase deposits for low-income first-home owners and (b) provide more support very low income rental households.
4. This can be funded from stamp duty (itself a result of low interest rates) or an affordable housing levy.

Conclusions (cont)

5. The State should not adopt inefficient, inequitable and complex rent control policies.
6. Increasing housing supply nationally will have a small impact on house prices. The state should develop robust housing development policy based on housing demand, land and development costs, transport and environmental inputs and appropriate cost-based development levies.
7. Local councils have role to help develop and implement appropriate local environmental plans.