TEN-YEAR SOCIAL AND AFFORDABLE HOUSING STRATEGY FOR VICTORIA 2021

Prosper welcomes the opportunity to contribute to Victoria's Ten-Year Social and Affordable Housing Strategy.

We are an independent, Melbourne-based research institute with a focus on the management of exclusive and essential resource allocation through revenue policy. This includes land and other natural resources, essential services that are most efficiently provided by one supplier, and government-instituted monopolies such as taxi and fishing licences.

It is our position that the unearned and unproductive streams of private income derived from these elements of our economy should be more heavily taxed. Meanwhile, taxes on the productive sector should be eased, making for a more equitable and more efficient economy.

Prosper's submission focuses on the scope of the strategy. We do not believe that a long term strategy for affordable housing can ignore the political economy of private freehold land ownership. Understanding the distinction between owning a *home* and owning a *financial investment* is critical to resolving the wicked problem of housing affordability.

Reducing or eliminating the public subsidy of financial investment in homeownership, and replacing that subsidy with shared equity and social housing takes us in the right direction.

It is necessary to unwind popular support for inflating the private housing market to ever increasing prices for private gain, as this undermines the political sustainability of an effective affordable housing strategy.

Thank you for this opportunity to contribute our perspective. Should you wish to contact us, we have provided details below.

Warm regards,

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Victoria's affordable housing strategy must extend to the political economy of private *freehold* land ownership.

This submissions builds on previous submissions to the Victorian Treasury[1] and our Speculative Vacancies reports. In these previous submissions we provide more substantial evidence and analysis of First Homebuyer Grants,[2] Shared Equity,[3] and land supply policy.[4]

Housing affordability has been an ongoing issue for Australia (especially eastern state capital cities) for close to two decades now. The problem has been overwhelmingly political, and hence governments of both sides of politics and at state and federal levels have been unable to address it.

At the heart of the problem is the politics of private freehold land ownership. Land is the largest and fastest rising cost in housing. Approximately two thirds of households own freehold land (about half of those with a mortgage); although as affordability has deteriorated, this number has continued to decline. In short, it is not in the direct financial interest of the majority of households to vote in favour of policies that reduce the (post-tax) returns, value and growth of what is for many their biggest asset. In the case of British Columbia, Canada, once renters became a majority, the politics shifted and governments were able to become more assertive in addressing the issue.

What has been the cause of land becoming increasingly unaffordable? Land in the private market is not merely a consumed service, but it is also a financial investment. The decline of interest rates vastly reduce mortgage borrowing/holding costs, which increased the size of mortgages homebuyers could take and use to bid up prices.[5] This combined with generous/minimal taxation of land (especially for owner-occupiers), ensures very high demand and value for land as a financial investment.

The subsequent rise in prices with the fall in interest rates has presented a new problem in housing affordability. While land has always been an entry monopoly, in the era of high interest rates people's barrier to ownership was predominantly their income. Now the barrier is acquiring a deposit. Low interest rates mean it takes far longer to save for a deposit, and increases the appeal of riskier investments. This is coupled with higher prices, requiring larger deposits.

The popular policy response to this issue so far has been to reduce the upfront barrier to obtaining a deposit. Policies include: First Homebuyer Grants, Stamp duty discounts/concessions, superannuation saver schemes, and government underwriting of 5%

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[1] Prosper Australia VIC Budget submission 2021-22, https://www.prosper.org.au/wp-content/uploads/2021/03/2021-22-VIC-State-Budget-Submission.pdf
[2] Prosper Australia VIC Budget submission 2020-21 Section 3.1, https://www.prosper.org.au/wp-content/uploads/2020/02/2020-VIC-State-Budget-Submission.pdf
[3] Ibid. Section 3.2
[4] Prosper Australia Speculative Vacancies 10 Report 2020, https://www.prosper.org.au/wp-content/uploads/2021/01/Prosper_SpeculativeVacancies_FINAL_web23.pdf
[5] Saunders, T., & Tulip, P. (2019). RDP 2019-01: A Model of the Australian Housing Market. Reserve Bank of Australia Research Discussion Papers, (March).

mortgage deposits for first home buyers. All of these subsidies have put more buying power (demand) in the hands of homebuyers, which in turn has driven prices higher. Subsequently, housing is more unaffordable for the next group of buyers. This requires an endless expansion of government subsidies to chase after ever inflating land prices; to support a new influx of landowners who demand governments keep increasing prices.

The increased requirement for government assistance into homeownership has undermined a key purpose for state promotion of homeownership: reduction in government costs through private self-insurance and the provision of “asset based welfare”.[6] The concurrent decline in the ability for households to obtain homeownership also continues to put pressure on the need for more rental assistance and social housing provision, or relegating those households to increased poverty and homelessnes (with all the associated public/social costs).

Housing affordability, if defined as “cheaper private *freehold* housing”, becomes a wicked problem. Making private *freehold* housing cheaper is only possible if we reduce the market price of land, which has been demonstrated as politically infeasible. The primary mechanisms to reduce prices or price growth are heavier taxation of land (especially on investors), as well as credit constraints (including higher interest rates). Regulatory constraints on investor loans (in conjunction with the banking royal commission) were somewhat effective in reducing prices, but there is pressure to wind these back.[7]

The problem is not limited to the private housing market. As homeownership levels and prices (home equity) have risen, rising personal asset wealth in landed property has shielded private homeowners from financial risk, and reduced support for the welfare safety net among this homeowning bloc.[8] Instead, they support its retrenchment in favour of more private homebuyer subsidies, lower interest rates etc. ***Increasing private home equity has become a form of (government subsidised) self-insurance.*** This dynamic has badly undermined political support[9] for public and social housing investment, in turn accelerating a vicious cycle in which we now find homeownership the key driver of intra- and intergenerational inequality.[10]

Victoria’s Ten Year Affordable Housing Strategy can begin to resolve the problem of high and growing land prices. First, the strategy must extend to the political economy of private *freehold* land ownership. It is necessary to unwind popular support for inflating the private housing market to ever increasing prices for private gain, as this undermines the political sustainability of an effective affordable housing strategy.

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[6] Lennartz, C., & Ronald, R. (2017). Asset-based welfare and social investment: Competing, compatible, or complementary social policy strategies for the new welfare state?. Housing, Theory and Society, 34(2), 201-220.
[7] Consumer groups slam move to remove responsible lending laws (Sep 25, 2020) Financial Counselling Australia Media Release https://www.financialcounsellingaustralia.org.au/2825-2/
[8] Ansell, B. (2014). The political economy of ownership: Housing markets and the welfare state. *American Political Science Review*, 383-402.
[9] Ansell, Ben, and Asli Cansunar. "The Political Consequences of Housing (Un) Affordability." (2020).
[10] Daley, J., Coates, B., & Wiltshire, T. (2018). Housing affordability: re-imagining the Australian dream. Grattan Institute.

We have a responsibility to ensure that everyone can afford a *home* - we are under no obligation to ensure citizens can afford a *financial asset*.

Too often governments have misunderstood or poorly framed their obligations to help people achieve secure and affordable housing.

Understanding the distinction between owning a *home* and owning a *financial investment* is the key to resolving the wicked problem of housing affordability. Land is the biggest cost in homeownership, and because of its commodification it is also a financial investment (as opposed to the building itself). But homeownership does not necessitate ownership over the land or its financial returns. Governments do not need to provide subsidies for people to *own* land as an investment. What governments need to do is provide affordable access to the *use* of land for homeownership.

A certain portion of households will always need subsidised *housing*; the market cannot provide for their needs. This is where social housing fills the gap. There is certainly a social housing deficit in Victoria, and policy needs to ensure that state institutions can build in passive mechanisms that at least maintain social housing at a certain proportion of dwelling stock.

For the largest number of potential homebuyers however, what is needed is affordable housing in-between this housing continuum: homeownership without owning a financial asset. This is scarcely available in Australia. The Victorian Ten-Year Affordable Housing strategy can position the Government as a general provider of *land.*

Transition out of no-strings attached financial support for private freehold housing, and into alternative models.

Declining affordability of private freehold housing has implications for Victoria's Ten-Year Affordable Housing Strategy. The use of tax concessions and subsidies for first homebuyers and owner-occupiers is increasingly used to overcome the *structural problem of entry monopoly* into the private freehold property market. Notably this merely brings forward demand[11] by allowing buyers to purchase earlier than they would otherwise, and overcome deposit constraints[12] which now are the primary barrier to obtaining a mortgage.

There are three primary ways this problem spills over into social housing:

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[11] Daley, J., Coates, B., & Wiltshire, T. (2018). Housing affordability: re-imagining the Australian dream. Grattan Institute. p.135-137

[12] The combination of lower interest rates and rising prices have meant that while mortgage servicing costs have not substantially changed, the ability to raise a deposit has. Hence increased policy focus on grants, stamp duty concessions, access to super for deposit saving, reduced deposit requirements etc.

1. It prices out a growing portion of households by pushing people further down (and off) the ladder. Relatively cheaper housing becomes increasingly demanded by middle class households, which prices out lower income households.
2. Demands on governments to provide tax/subsidy support for first homebuyers comes at the expense of funding more social housing. It also further inflates the problem by continually pushing prices higher in a vicious cycle.
3. Long term political support for social housing investment is undermined by government support for the private freehold model, in which homeowners prefer governments to divert funding into housing policy that further boosts their private asset value.[13] [14] [15]

The third point is precisely why it is so hard to undo these subsidies. However it is imperative that governments shift funding away from this unsustainable policy regime. This requires governments to transition out of no-strings attached financial support for private freehold housing, and into alternative models.

The state must recover its costs from providing financial assistance to homebuyers purchasing a financial investment, and dampen the returns homeowners make from rising prices. We want to shift the existing incentive for homeowners to support buyer subsidies at the expense of social and affordable housing. Both of these objectives can be achieved by replacing buyer subsidies with revenue neutral shared-equity models, allowing freed up funding to be redirected into social housing.

HomesVic shared equity initiative is the right approach.

Homebuyers need ways in which they can buy and own their home, without paying a premium for the right to a financial investment in the land underneath it. Shared equity allows homeowners to reduce their commitment to purchasing property as a financial investment when purchasing a home.

There are two predominant models for shared equity:

- *Private shared equity*: The government takes equity stakes to assist individual homebuyers in purchasing private freehold property. Homebuyers receive the implicit subsidy of not being required to pay the imputed rent to the government on its share of the equity. However the government also retains the right to its share of the capital gains (or loss) on sale. This in turn can make shared equity potentially revenue neutral. HomesVic is a private shared equity model.
- *Community shared equity*: The government (or not-for-profit provider), provides land on leasehold and retains the rights to all returns to the land. Homebuyers or Community Housing Providers buy/build/own improvements on their land. Examples

[13] Ansell, B. (2014). The political economy of ownership: Housing markets and the welfare state. American Political Science Review, 383-402.
[14] Ansell, Ben, and Asli Cansunar. "The Political Consequences of Housing (Un) Affordability." (2020).
[15] Kohl, S. (2020). The political economy of homeownership: a comparative analysis of homeownership ideology through party manifestos. Socio-Economic Review, 18(4), 913-940.

include Community Land Trusts, the ACT's *Land Rent Scheme*[16], and the Land Lease industry.[17]

Private shared equity has the potential, and ideally should, replace all existing homebuyer support. So long as the government limits itself to purchasing stakes in the land component of property, the risks are low, and the potential revenue neutrality of the scheme enables more funding to be freed for social housing. HomesVic is the right approach.

Community shared equity is an innovative way to provide an affordable middle ground between social housing and private shared equity. It allows homebuyers to massively reduce housing costs compared to private rental through purchasing a home without purchasing the financial investment in the land. This can also be implemented by governments in a revenue neutral way.

All of these models involve some 3rd party (usually the government, not for profit, or corporation) owning the land and its financial investment rights, and leasing it (potentially at nominal amounts) to the homeowner who owns their house on the land.

Currently Victoria's HomesVic shared equity scheme allows up to 25% of the property purchase price (with various means tests and price thresholds) to be purchased by the government as equity. In effect the government owns 25% of the property, but doesn't charge the owner 25% of the market rent (which becomes a housing subsidy).

Given the cost and ownership of land is the issue, shared equity could be tweaked so governments would only take shared equity in the land component of the property (potentially up to 50% or even 75%). This would reduce the risk to the government in eliminating ownership over improvements (which the occupant can alter), while increasing capital gains returns and the capacity of the government to provide assistance. This would need to be coupled with contribution limitations tied to multiples of income, and potentially include an annual land rental fee indexed to the cash rate to ensure potential rises in interest costs do not jeopardise the financing of the program.

Increasing land supply and relaxing planning controls does not make housing more affordable

Development and property industry groups often claim that concessionary (or removal of) planning controls and the accelerated approvals to "increase land supply", is key to constraining the cost of housing. In 2020, the Government committed $52 million to "implement the Commissioner for Better Regulation's planning reforms and to grow housing supply across the State through the Victorian Planning Authority programs Affordable by Supply and Streamlining for Growth.'[18]

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[16] For more details see: Murray, C. (2020). Unspoken alternatives to expensive housing. https://www.prosper.org.au/wp-content/uploads/2018/09/Unspoken-Alternatives-final_print_web.pdf

[17] Residential Parks, Manufactured Home Parks, or Caravan Parks: https://rlla.com.au/wp-content/uploads/2017/06/Productivity-Commission-Briefing-Paper-8th-July-2015.pdf

[18] A Place to Call Home: Victoria's Big Housing Build, Victorian Budget 2020/2021, https://www.budget.vic.gov.au/place-call-home-victorias-big-housing-build

However, deregulation and increasing supply to developers has not, and will not, bring down the cost of private freehold housing, and alleviate Victoria's housing affordability problems.

Plan Melbourne states 15 years supply as a sufficient public policy aim. The most recent Urban Development Plan - Broadacre report found available land supply averaged 21 years across our growth areas.[19] Melton has 42 years and Hume-Mitchell 30 years available land supply. The Victorian government has more than doubled the broadacres supply from the pre 2010 era of 150,000 lots to some 350,000 lots over the following 8 years.

However, this supply pipeline has not reduced the price of housing as the market power of big (land rich) developers encourages them to reduce supply when prices decrease - developers ration quantity rather than reduce prices.[20] Despite more than 30 years available land supply, prices continue to head northwards in Mickleham, home to some of the nation's largest master-planned communities. The slight pricing downturn in early 2020 was immediately followed by the countervailing change in supply, indicative of price preservation.[21]

Recent analysis has found a supply surplus, rather than shortage of new dwellings, and "planning approvals typically far exceed dwelling construction, implying that more approvals or changes to planning controls on the density and location of development cannot accelerate the rate of new housing supply".[22] Therefore, increasing available development land is an ineffective policy strategy for improving housing affordability.

Relaxation of planning controls is really a windfall boon for landholders. It doesn't make housing more affordable - which would require prices to slow in growth, or decrease. Industry does not lobby for policies that reduce the value of one of the biggest assets on their books, or force them to be more competitive and erode their profit margins.

Providing lax planning controls does not make housing more affordable, conversely the opposite is true. Furthermore, arguments against the use of inclusionary planning mechanisms, or compensating subsidies for such requirements, are flawed. Increasing planning requirements via inclusionary zoning does not make housing less affordable either. The financial onus falls on the landholder, who takes reduced profit in the form of lower land rent.

The impact on developers is dependent on whether they were the landholder before the change in planning controls. However regardless of whether developers take the loss, their development incentives are not adversely affected. In fact it is possible for developer

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[19] Urban Development Plan - Broadhectare Metropolitan Melbourne report, table 2, p14 https://www.planning.vic.gov.au/land-use-and-population-research/urban-development-program

[20] C Murray, Marginal and average land lots should not be equal: A critique of Glaeser and Gyourko's method for identifying residential price effects of town planning regulations, https://journals.sagepub.com/doi/abs/10.1177/0308518X20942874?ai=1gvoi&mi=3ricys&af=R

[21] The absence of accurate data on the time taken for housing to reach the market is overlooked. Inaccurate vacancy figures have allowed these "supply-side" narratives to dominate the public debate.

[22] C Murray, The Australian Housing Supply Myth, 2019, https://econpapers.repec.org/paper/osfosfxxx/r925z.html

charges to bring development forward due to the reduced financial gain from delaying development.[23]

Prosper supports the adoption of mandatory requirements for affordable housing through the planning system

As noted by AHURI research, there is scope to increase the use of mandatory inclusionary planning mechanisms in high growth residential areas of metropolitan and regional Victoria. Prosper supports the adoption of mandatory requirements for affordable housing through the planning system. Mandatory affordable housing provisions ought to be conceived of in the same way as existing minimum car parking requirements. As it stands, the absence of affordable housing represents an externality and entails a social cost; it's a collective action problem and a market failure. Mandatory requirements (like the minimum car parking) are factored into development costs and ultimately hit the land residual - a very efficient base.

At present, many inner-city council areas e.g. Moreland are seeking to reduce minimum car parking requirements as part of a policy response to both an oversupply of car parking, and environmental risks posed by car use. Perhaps, there is an opportunity to parlay existing minimum car parking requirements into a mandatory affordable housing levy in these areas. The net cost of providing the required on-site car parking could be levied as cash-in-lieu and hypothecated to the Victorian Property Fund or existing Local Government affordable housing fund. A scheme like *'car parks for housing'* meets existing market expectations, as the mandatory inclusion is well established.

Any new mandatory inclusion, if incorporated into the Victorian Planning Provisions eg. an affordable housing overlay, would require a long transition period to enable market adjustment. Marginal developers could go under due to planning changes. In that case, developable land assets would need to be transferred to new developers, delaying development. Grandfathering or long lead in times would be necessary.

Victoria should capture rezoning windfalls to help fund affordable housing

Value capture mechanisms would not require a transition period. Rezoning for new, intensified land uses expands the development potential of a site, increasing the residual land value. This benefit is entailed upon existing landholders. At present, Victoria does not capture this rezoning windfall for public benefit.

The existing Growth Area Infrastructure Contribution is a very limited rezoning windfall gains tax. The liabilities are based on historical market values of land brought into the urban growth zone, levied on a per hectare basis. However, the GAIC could be expanded and extended to encompass all land rezonings in Victoria. A reimagined GAIC would operate similarly to the ACT's Lease Variation Charge. Proponent developers seeking a planning

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[23] Murray, C. K. (2018). Developers pay developer charges. Cities, 74, 1-6.

scheme amendment to rezone a property would be liable for a charge equivalent to 75% of the uplift in the market price generated by the rezoning.

Revaluations are already provided annually by the Valuer-General, and liabilities could be calculated on a property by property basis, or based on a standardised charge that aligns with local market movements as per the ACT. Such a scheme could be administered by the State Revenue Office under the framework currently used for the GAIC. Taxing rezoning windfalls would deliver significant revenue. Estimates of forgone value for Victoria are in the range of $5.7bn p.a. There is an obvious opportunity to apportion some of this funding stream to the Victorian Property Fund.

For areas with existing development rights inclusive of height limits, Prosper supports the expanded use of floor area ratio/floor area uplift schemes with defined public benefit inclusions. The existing c270 amendment scheme operating in the City of Melbourne provides a blueprint.