Regulation Economics

Where business and government interact

# Foreign Investment in Real Estate:

## Submission to the Treasury Review

**12 March 2015**

A Moran
Email: moran@regulationeconomics.com
www.regulationeconomics.com

# Foreign Investment in Real Estate: Submission to the Treasury Review[1]

## 1 Introduction

There is considerable discussion that demand from Chinese investors has raised house prices especially of high valuation inner city areas. The top end of the real estate industry has recognised the importance of Chinese speaking buyers and major firms have been hiring Chinese speaking staff.

While pictorial evidence often infers a strong Chinese presence at auctions, many of these aspiring buyers are Australian residents. Establishing the facts is difficult. Many in the industry doubt the role of foreign buyers[2] but Domain[3] estimated that one third of new home sales in Victoria in the last quarter of 2004 were to foreigners. The RBA[4] estimated that in the most recent year foreign buyers accounted for 12 per cent of new dwelling turnover and 3 per cent of sales of existing properties. These estimates were considered to be on the high side due to some approvals not being followed up by actual purchases.

At present, foreigners can apply to buy housing land and newly built dwellings but may only buy and own established dwellings as temporary residents and must sell when they leave Australia.

In response to concerns the Government has started to tighten the (previously laxly enforced) regime on foreign purchases of established dwellings[5]. It intends to reinforce this and introduce a variable tax, starting at $5000 per application (presumably reimbursed/not collected for applications that do not result in a purchase). The move has overwhelming public support with one online survey showing 83-17 in favour[6].

Ostensibly, the Government's fears are about the creation of a bubble in housing prices or perhaps a long term excessive price plateau caused by the external supplement to domestic demand.

The proposed tax on foreign purchases of new dwellings and ban on purchases of established dwellings is unusual among developed countries outside of heavily land-constrained jurisdictions (Hong Kong and Singapore). Placing a special tax on foreign buyers of housing has similarities to an export tax on domestic products. Such taxes are rarely in place for the very good reason that they deprive local producers and sellers of markets and bring about distortions in the allocation of labour and capital, with adverse impacts upon overall productivity.

Banning foreign purchases of established dwellings, other than for national security concerns, is equally unusual and would have the effect of lowering prices to the detriment of existing owners (and to state Government revenues). The corollary of this is a subsidy to domestic buyers of high valuation properties.

---

[1] Statewide Planning provided valuable assistance in the preparation of this submission.
[2] (e.g. http://reia.asn.au/wp-content/uploads/2014/03/REIA-Submission-Foreign-Investment-Inquiry-May-20141.pdf)
[3] http://www.rebonline.com.au/breaking-news/8613-foreign-investors-buy-one-in-three-homes-in-victoria
[4] http://www.rba.gov.au/publications/bulletin/2014/jun/pdf/bu-0614-2.pdf
[5] http://news.domain.com.au/domain/real-estate-news/treasurer-joe-hockey-announces-forced-sale-of-point-piper-mansion-villa-del-mare-20150303-13twhs.html
[6] http://news.domain.com.au/domain/real-estate-news/26000-people-sign-petition-for-tighter-rules-on-foreign-ownership-of-australian-property-20141121-11rn29.html

# 2 Addressing the concerns

While concerns over demand shocks or surges causing higher prices are understandable in the context of a fixed supply, housing stock is readily augmented. New housing can be built quickly and, government restraints aside, there are no bottlenecks to prevent a vast expansion in new supply.

New housing on the edge of cities comprises three components: raw land, the development of that land and the building of the housing structure upon it.

## 2.1 Raw land availability and costs

Land prices other than for housing are not increasing appreciably. Rural land, prices have not generally exhibited the inflation observed with urban land. According to ABARE[7] rural land prices in real 2005/6 dollars oscillated between $150 and $250 per hectare from the late 1970s to 2000. Though they have risen strongly to over $350 per hectare in the past few years (about $3,000 in today's dollars[8]), even at 10 blocks per hectare this represents a trivial component of the value of a house/land package. In its raw form this land as farmland (which comprises 90 per cent of its use) might be valued at $10,000 per hectare, or about $1,500 per standard detached housing block.

Table 1 illustrates that Australia has the lowest urban footprint in the developed world with only 0.25 per cent of land used for urban purposes; it is less than one per cent even in the most urbanised state (Victoria), and land availability in the Sydney area is ample (the County of Cumberland alone has sufficient land to accommodate a 50 per cent expansion of Sydney's population).

**Table 1 Urban Land in Selected Jurisdictions**

| Nation | Urban Land Area/Total Land Area | Urban Areas Over 1,000,000 Land Area/Total Land Area | Share of Urban Land in Urban Areas Over 1,000,000 | Share of Urban Population in Urban Areas Over 1,000,000 |
|---|---|---|---|---|
| Australia | 0.25% | 0.11% | 41% | 59% |
| Canada All | 0.27% | 0.05% | 17% | 43% |
| .... Agricultural Belt | 3.29% | 0.55% | 17% | 43% |
| France | 12.38% | 0.98% | 8% | 30% |
| Germany | 27.53% | 2.09% | 8% | 29% |
| Great Britain | 5.94% | 1.53% | 26% | 30% |
| . . England & Wales | 7.91% | 2.08% | 26% | 31% |
| . . Scotland | 2.14% | 0.47% | 22% | 27% |
| Ireland | 4.06% | 0.53% | 13% | 48% |
| Italy | 20.09% | 1.18% | 6% | 27% |
| Japan | 14.29% | 5.66% | 40% | 65% |
| Netherlands | 28.28% | 2.52% | 9% | 23% |
| New Zealand | 1.42% | 0.20% | 14% | 32% |
| Spain | 9.25% | 0.40% | 4% | 32% |
| Switzerland | 17.54% | 0.00% | 0% | 0% |
| United States | 2.62% | 0.95% | 36% | 53% |

Source: Demographia

[7] http://www.abareconomics.com/interactive/farm_surveys/pdf/FarmSurveyResults_nu.pdf
[8] Perhaps double this in areas subject to speculation that housing development might in future be permitted.

Over the past 40 years the price of the land component of housing has outpaced general inflation. Sydney, which has long experienced higher prices than elsewhere in Australia, saw an increase in land prices six times greater than the overall rate of inflation over the period.

As Table 2 illustrates, a once typical 135 square metres house on a 700 square metre block has seen the land component blow out to 72 per cent of the costs compared with 32 per cent forty years ago.

**Table 2 Typical New House and Land Prices by Capital City, 1973 to 2014**

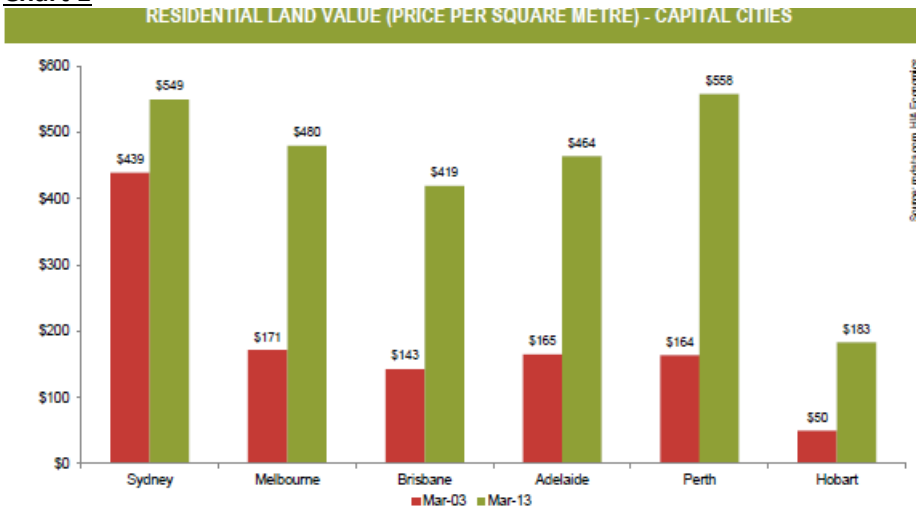
(Standardised to a 135sqm house and a 700 sqm block)

| | 1973 | 1983 | 1993 | 2006 | 2014 | Land Share 1973 | Land Share 2014 |
|---|---|---|---|---|---|---|---|
| **Sydney** | | | | | | | |
| *Land* | $9,100 | $29,400 | $107,100 | $360,000 | 414,600 | | |
| *House* | $18,900 | $43,200 | $121,500 | $128,250 | 157,700 | 32 | 72 |
| **Melbourne** | | | | | | | |
| *Land* | $6,900 | $15,800 | $49,000 | $180,000 | 325,000 | | |
| *House* | $14,000 | $35,000 | $75,000 | $112,000 | 137,800 | 33 | 70 |
| **Brisbane** | | | | | | | |
| *Land* | $7,000 | $27,000 | $60,000 | $180,000 | 319,200 | | |
| *House* | $16,000 | $37,000 | $70,000 | $165,000 | 203,000 | 35 | 61 |
| **Perth** | | | | | | | |
| *Land* | $6,500 | $17,300 | $80,974 | $180,000 | 495,500 | | |
| *House* | $12,000 | $28,000 | $60,000 | $98,000 | 121000 | 35 | 80 |
| **Adelaide** | | | | | | | |
| *Land* | $2,000 | $12,000 | $35,000 | $100,000 | 357,000 | | |
| *House* | $12,000 | $20,000 | $40,000 | $90,000 | 111,000 | 14 | 76 |
| *Australian CPI* | 20.5 | 61.6 | 108.9 | 150.6 | | | |

Source: Adapted from HIA

The following illustrates the increased cost of residential land in capital cities over the past decade.

**Chart 1**




Because urban land comprises such a trivial share of the overall land stock, absent regulatory restraints, no amount of increased conversion of land into housing blocks would lift the general cost

of land. It is planning, environmental and other restraints that have been introduced and progressively tightened over the past half century that have squeezed housing land supply and brought the high prices that we experience today.

Land rationing causing these high home prices is often motivated by ideological opposition to "urban sprawl" sometimes based on unfounded claims, discussed below, that such development will add unduly to infrastructure costs.

In many cases, zoning restraints stem from a wish to prevent development in areas that have been set aside as park and recreational land. This is notably the case in Sydney, with Australia's most restrictive planning regime (and highest housing land costs).

Land use restrictions also stem from a wish to restrict outward development so that a denser metropolitan area is created. At a local level this goal is sometimes frustrated by opposition to high rise and similar development. Such opposition further accentuates the costs of preventing urban sprawl and bringing greater population densities.

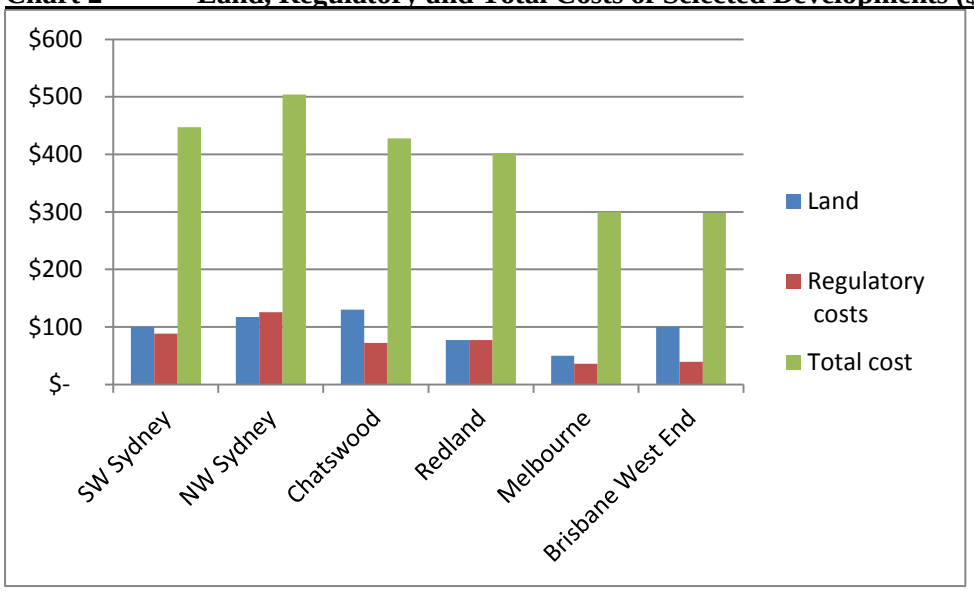
In some cases, residents' wishes are to prevent development so that their conceptions of the essential characteristics of the neighbourhood are maintained. Yet, ironically the inner areas of nostalgia were polluted, more crowded and populated by undesirable workplaces than would now be tolerated. Opposition to greater densities within certain suburbs might also be motivated by knowledge that such activity raises the value of the existing properties in the neighbourhood.

The land rationing that is creating an upsurge in Australian prices brings advantages to incumbent homeowners and governments. The former benefit from knock-on effects of supply-induced price increases on existing homes. The latter benefit from the higher transaction taxes that are linked with house sale prices as well as being able to impose charges on new developments that are swallowed up in the excess prices caused by supply restraint.

In addition to the inflated costs of raw land caused by regulatory induced scarcity, costs are further boosted by governments' so-called "infrastructure charges". The average price of a block of land in Sydney, illustrated in Table 1 at $414,600 in 2014, incorporates some of these costs. In the case of one example cited by UrbisJHD in addition to the inflated raw land costs and $50,000 land preparation costs, there were costs of $49,000 representing stamp duty on land and contributions.

The Urbis study's costs are summarised below.

**Chart 2 Land, Regulatory and Total Costs of Selected Developments ($000s)**




Source: Urbis JHD

These impositions are for costs that are largely non-existent. Local infrastructure in new developments is paid directly by the developers and hence the owners of the new properties.

Other charges on new developments are ostensibly to help defray additional costs those developments impose. However the notion that such costs are attributable to new developments and not existing ones is difficult to justify. The 'trunk' infrastructure is built to service the wider population wherever it is located. Its costs are little more for new than for existing developments and to the extent that they are the private/corporatized entities involved in electricity, telecommunications water and sewerage etc, will ensure their own outlays are recovered. All infrastructure has a life after which it must be replaced. Indeed, it is cheaper to install much new infrastructure (for example pipes) than replace existing facilities. Similarly, although schools and hospitals have to be built to service new population densities, this is a relocation exercise rather than servicing a net addition of needs other than gradual population growth. And, at least in the case of schools, the costs of relocating from (mainly affluent) central areas to the outer areas to service younger families, is offset by the value of closed schools as real estate.

New developments locate in proximity to major trunk highways (rail is less relevant) and water/sewage systems, while the electricity and telephone provision is supplied on a cost reflective basis by private or corporatised businesses. There is no net increase in resources provided for the benefit of these new areas from general taxation.

Even after the land had been released for housing development, regulatory costs amounted to as much as 25 per cent of total costs in projects studied by UrbisJHD for the Property Council[9]. This examined 13 broadhectare subdivisions across Australia and put land preparation per unit in the range $26,600 to $60,000.

[9] Residential Development Cost Benchmarking Study, The Property Council, March 2006.

Where prescriptive regulations subject to negotiation and modification are in place or where the regulations are not set down and can be highly variable, development can involve considerable holding costs. In the cases explored by Urbis these costs ranged from around $1,000 where development approval was straightforward (in Mundurah) to $17,000 in North West Sydney and $20,000 in Redland (adding 3-4 per cent to costs).

Urbis also did not include within the costs, land set-asides for common or particular usage required by councils. These range from "Rolls Royce" road width and paving requirements through insistence on more parkland than the developer judges to be sought by the target market. Other inclusions range from provision for low-cost housing through to insistence on a golf course being provided.

The Henry Report on tax commented unfavourably on the haphazard way taxes were levied on land and housing and on the risk costs the tax regime's uncertainty bring[10].

## *2.2 Land Preparation Costs and Charges*

In present day terms, the costs of providing road, sewerage, water and other services to a new block of land in Australian outer urban areas would be under $50,000 in most places. In few such areas would the costs be over $70,000. The following is a costing for a new sub-division located in South Australia about one hour away from Adelaide but outside the urban growth boundary.

Figures extracted from a 70 Allotment Stage for a development within the City of Onkaparinga with sales starting in mid 2006. All costs have been broken down into a per allotment basis.

Civil works construction costs including:

- Establishment & Disestablishment; Sedimentation Control Works; Allotment filling; Road Formation works; Roads, pavements & gutters; Hot-mix seal coat; Stormwater drainage works; Sewer reticulation; Water reticulation; Common Service Trenching; ETSA / Telstra conduits materials; Survey Certificate; CITB levy.
- Sub-total per allotment $ 30,415

- Augmentation SA Water
- Sewer $ 2,495
- Water Supply $500

- Professional fees; Survey & Engineering $ 3,000

- Planning, registration, title fees $ 110
- **TOTAL** **$ 36,520**

With holding costs, regulatory fees, sales costs and profits, the blocks were offered at between $44,950 (for 400 square metres) to $58,950 (for 600-790 square meters)[11].

Hence, a cost in excess of $50,000-$70,000 represents a value caused by regulatory constraints on availability. That value is an "economic rent". It does not represent real worth from an economy wide perspective but is very important in terms of the distribution of wealth and income.

10 http://taxreview.treasury.gov.au/content/finalreport.aspx?doc=html/publications/papers/final_report_part_1/chapter_12.htm

11 Source: Pers corresp. Bob Day, Chairman Home Australia.

Land on the city edges of Australia is generally flat and there is a highly competitive development industry able to prepare the land itself (which largely comprises, levelling, constructing local roads, installation of utility services at a cost of considerably less than $100,000 per housing block)

## 2.3 Costs of building new dwellings

Australian house building is also highly competitive and, as advertisements in local papers throughout the country demonstrate, a new house (including two bathrooms, double garage, three bedrooms) costs less than $150,000.

The building component of new house prices has changed little in real terms, since 1973 having increased at approximately the average rate of increase in the CPI. This is in spite of regulatory impositions, especially those concerning energy, which according to the industry cost some $7,000 plus per home. Table 1 illustrated the cost stability of new houses.

House building is largely undertaken by relatively small firms who undertake extensive sub-contracting of other small firms. The process is highly competitive and the outcome in terms of the housing price/quality mix matches anywhere in the world.

In the case of apartments, build prices in Australia appear to be 12-25 per cent higher than in the US. The average cost of building a three bedroom unit in a high rise development in Sydney is about $350,000 per unit. This is 50 per cent greater than the building costs of a single story dwelling.

One reason for this is the union controlled workforce that is found in apartment building. R.S. Means[12] reports that the average cost of a high rise apartment in the US is $228 per square foot with union labour and $203 with non-union labour. A house built with non-union labour costs around $182 per square foot[13]. That difference, 12-25 per cent, is far lower than in Australia.

The union monopolies prominent in high rise construction in Australia are virtually absent in house building. The adverse impacts of these are receiving attention in the Royal Commission into Trade Union Governance and Corruption and the ACCC is now concerning itself with costs stemming from restraints of competition by trade unions.

These costs from excessive union powers may be compounded by uncertainties from additional costs and delays stemming from Australia's planning regulations. Botany, for example, has placed onerous requirements on developers including to demonstrate that the buildings will not be subject to global warming-induced oceanic rises and are required to have a double lift shaft and other facilities to give greater insurance to people with disabilities.

Such negotiations take place in a context of great inequality – the council has little to lose by delays but the developer incurs vast holding costs. And if the case goes to court and the developer prevails, the council's costs remain modest while the developer may have incurred two years of additional holding costs.

Ultimately all costs are paid for by the final consumer.

[12] http://www.rsmeansonline.com/
[13] http://www.washingtonbrown.com.au/building-cost-calculator/

## 2.5 The fusion of the different cost components

The foregoing indicates that there should be a ready supply of new housing in Australia at $250,000, as there is in jurisdictions around the world (including Texas, the mid-West, and the Carolinas in the US, most of Canada, and Germany) where regulatory conditions are not hostile to new building.

# 3 Australian home affordability compared with overseas

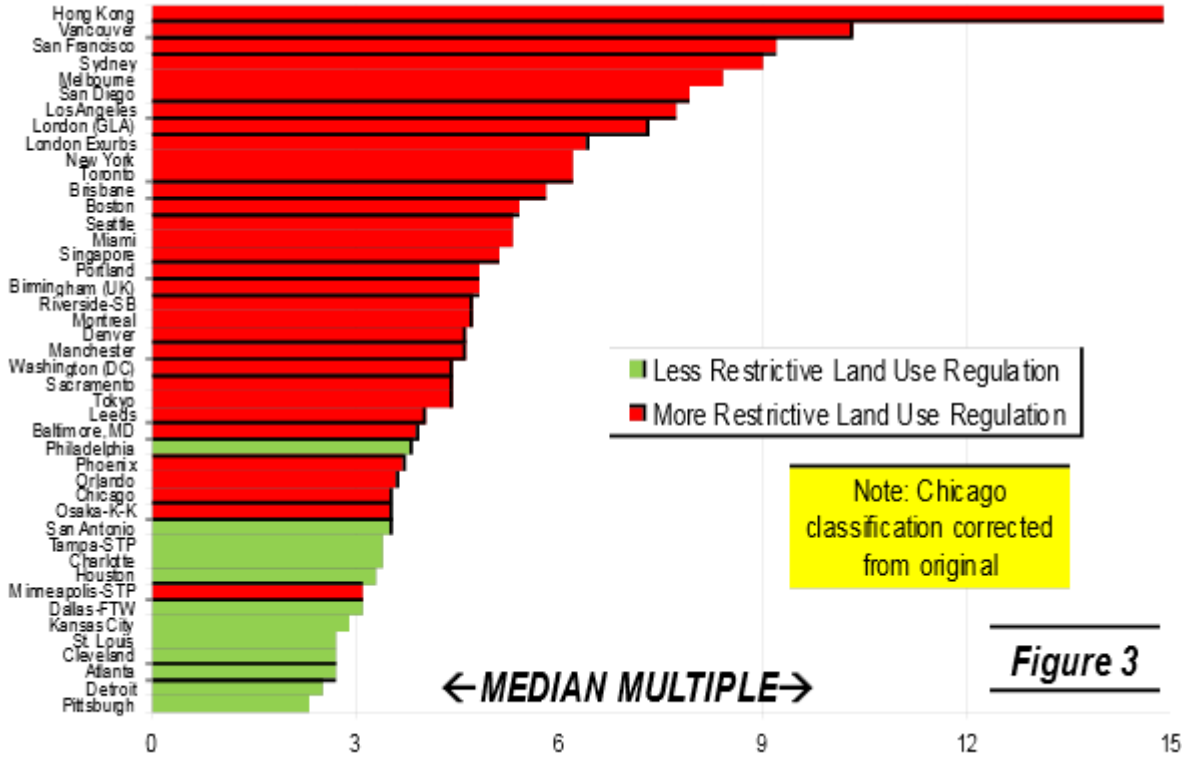
House prices in Australia have become among the highest in the world.

Several indices of housing affordability are available. Demographia's International Affordability Survey estimates the median house price by city in relation to the median household income levels. This allows for adjustments in cost differences between regions and reduces any distortion to comparisons caused by very high house prices in highly fashionable locations. Out of the 360 cities Demographia documented (in the US, Canada, UK, Ireland, Australia, New Zealand, Japan and Hong Kong), Sydney comes in as the fourth most expensive city with Melbourne as the fifth (Brisbane is the twelfth most expensive).

Cities with highly restrictive land use regulations, like Sydney and Melbourne have the highest median prices, while those with few regulatory impediments have very low prices. Dallas, Houston and Atlanta are among these low regulation cities. In relation to median incomes, they have prices only one third those of Sydney – their median houses (which at 235 square metres are comparable in size to those in Australia) are under $200,000 compared with the $722,000 median in Sydney. Figure 1 illustrates price comparisons.

**Figure 1 Housing Affordability & Land Regulation**

METROPOLITAN AREAS OVER 2,000,000 POPULATION

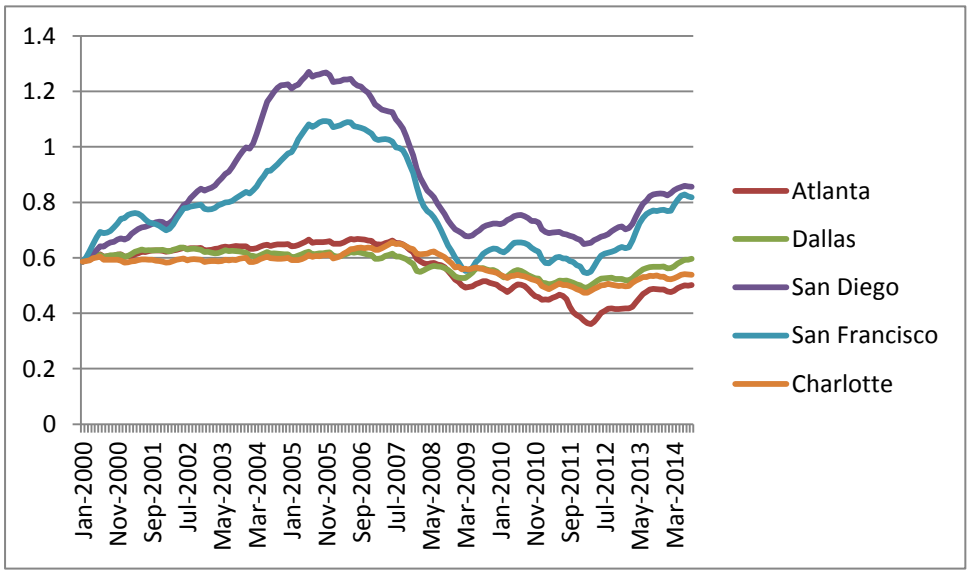



Many of the cities with light land regulations are also, unlike Sydney, growing very rapidly. The planning flexibility they enjoy means they can accommodate population growth without this putting

stress on housing supply and therefore home prices. Appendix A explores outcomes available if Australia were to adopt similar housing policies to those of Texas, which has little regulatory intrusion.

The less regulated cities also saw less price volatility in the recession of 2008. San Diego, with restrictive zoning, saw prices adjusted for inflation double between 2000 and 2006. After prices crashed, affordability has now again deteriorated compared to its 2000 levels. Lightly regulated Dallas, Atlanta and Charlotte saw much less movement in real prices throughout the period; affordability in Dallas and Charlotte is around its 1990 levels, while in Atlanta relative prices have fallen by 15 per cent. (See Figure 2)

**Figure 2 Real Price Trends in Selected US Cities 1990 -2014**




Source: Schiller

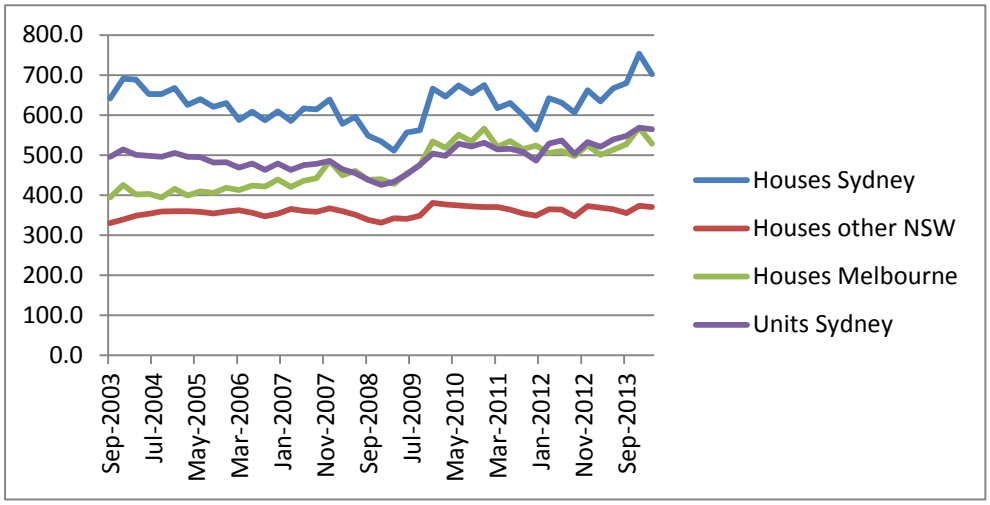
Price volatility is greater when the supply is constrained because the constraint acts as a pressure valve preventing a supply response to increased demand. This brings price surges when demand is high and a rapid deflation of the pricing bubble when demand collapses. A steep supply curve means inflexibility and much greater price falls when demand is reduced.

## 3.2 Overall Trends in Australia

It has been 25 years since Australia experienced a demand led property price boom and collapse as seen in the US 2000-2008. Volatility, measured in terms of average incomes, has been modest reflecting a mild impact from the world financial crisis of 2008. The affordability of Australian houses has continued to deteriorate.

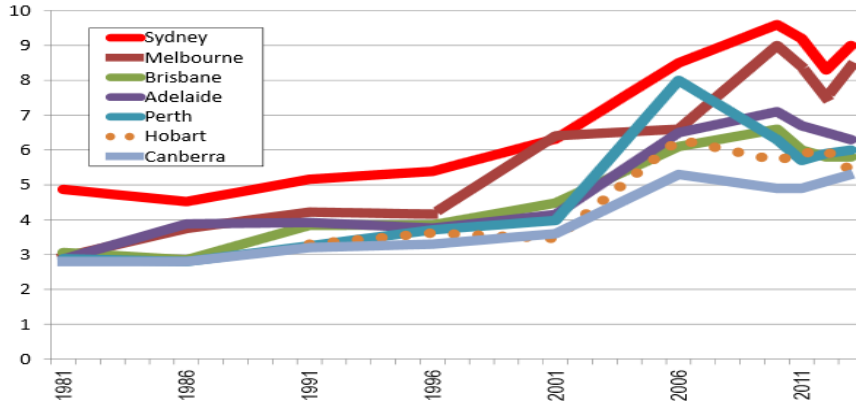
Notwithstanding government claims about promoting deregulation and announcements about land releases, an on-going constrained supply has meant a continued deterioration in housing affordability throughout Australia. Over the year to October 2014, RP Data (Figure 3) reported that the average Sydney price rose 13 per cent (house prices rose 14 per cent to $792,000 and unit prices rose 10 per cent to $590,000). Prices rose a further 2.8 per cent and 4.5 per cent respectively in Sydney and Melbourne in the quarter to February 2015

**Figure 3 Real Prices of Property over the past 10 years ($000s March 2014 prices)**




A standard level of housing affordability is a ratio of 3 for the median house price to median income. In 1981 only Sydney had a higher ratio than this and that ratio has since increased to 9. Affordability in other capital cities has also deteriorated. Melbourne's ratio of median house price to median income now stands at 8.5 (Figure 4).

**Figure 4 Affordability Trend 1981-2013**

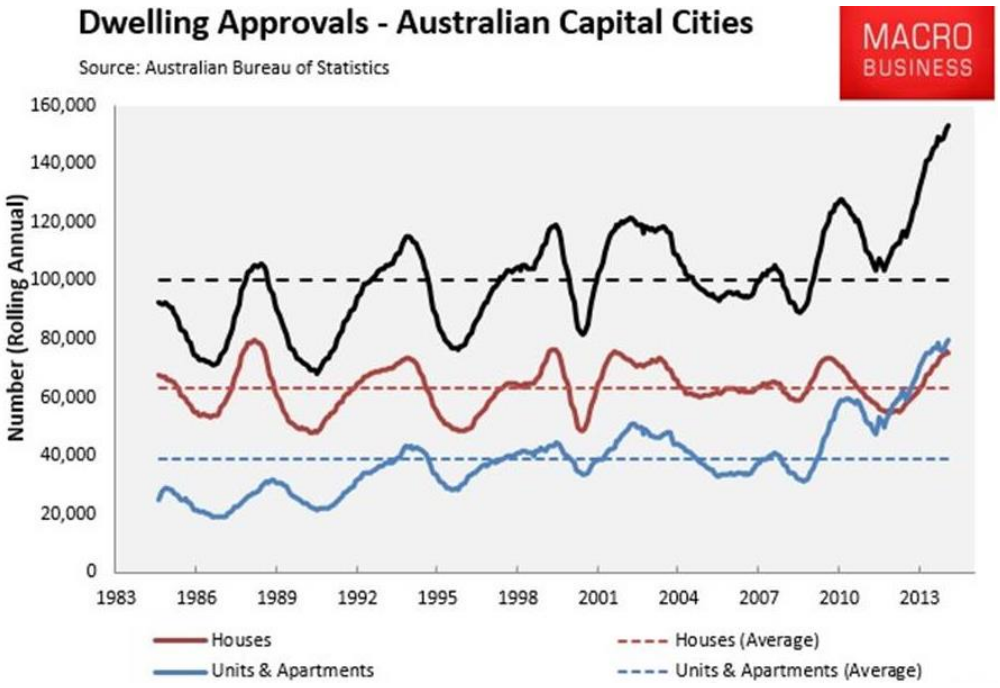



Source: Demographia

## 3.3 The Australian housing market

Although, as Figure 5 shows, Australian housing approvals are running somewhat above their historical average levels and apartment approvals are double previous years' average this does not indicate supply pressures (partly because the workforce has increased 90 per cent over the past 35 years).

**Figure 5**




## 3.3 A Shift to Apartment Building

Apartment building has grown strongly over the past 30 years, especially in NSW where it has doubled from around 2,500 per quarter. In contrast to unit commencements, Figure 6 illustrates that house building in NSW has almost halved to around 4000 per quarter over the same period. Sydney has seen unit approvals rise from about one third of the total in 1987 to 70 per cent currently.

**Figure 6 House and Unit Commencements NSW**

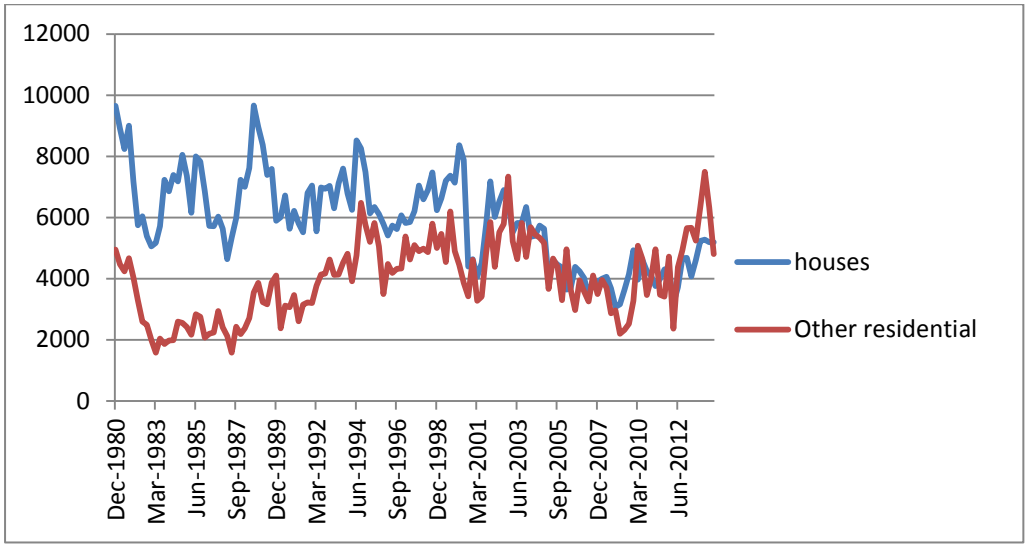



Figure 7 shows the trend to apartments, though most marked in Sydney is also strong in Melbourne and Brisbane.

**Figure 7**

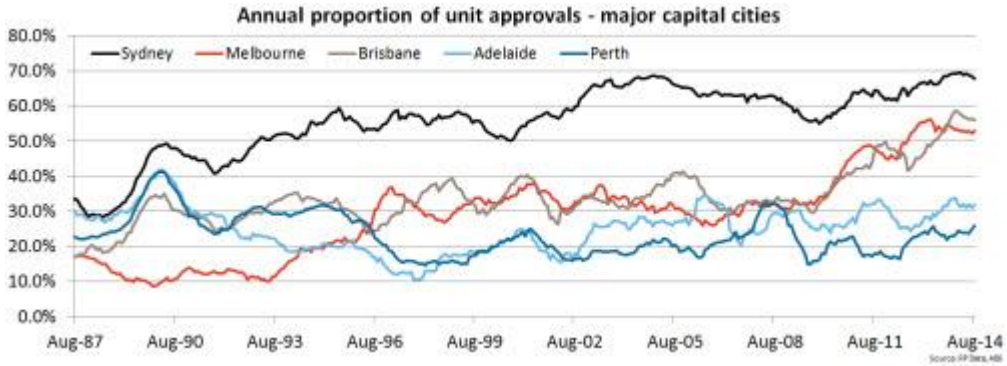
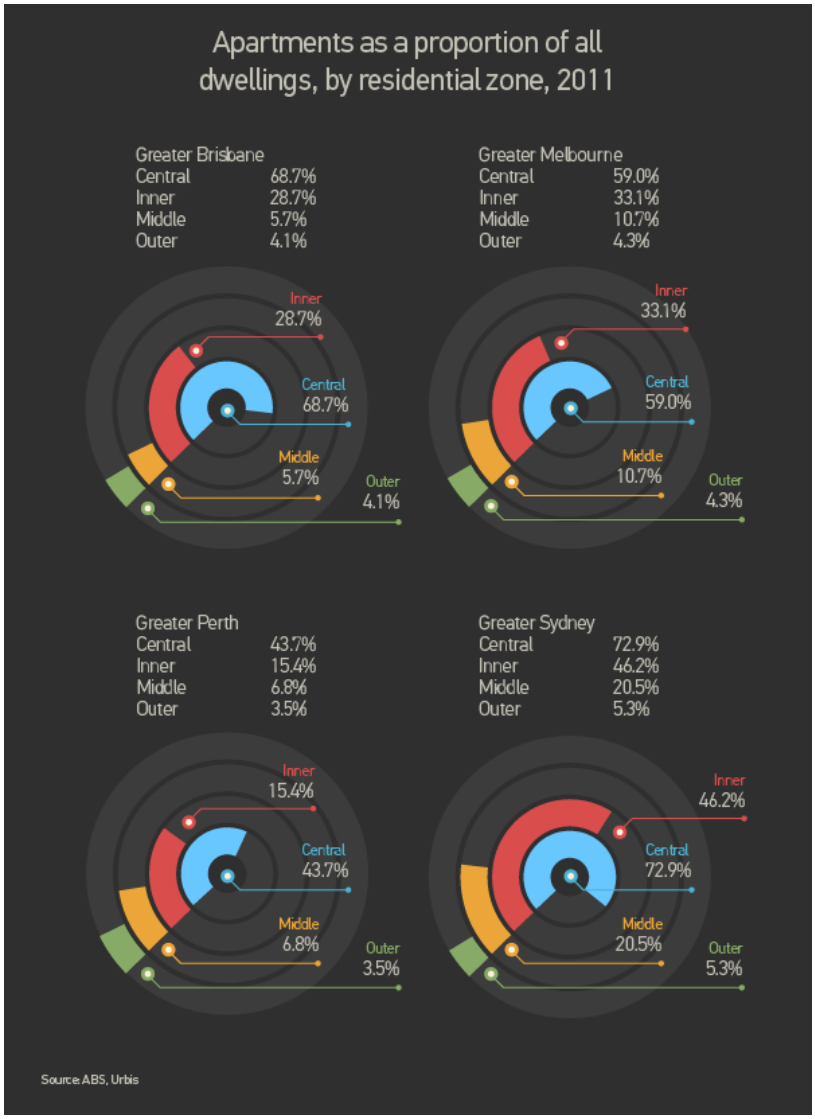



Figure 8 shows the spatial pattern of the present market with apartments in central and inner Sydney respectively accounting for 73 per cent and 46 per cent of approvals.

**Figure 8 Estimate the apartment share for major cities**




Doubtless among the many reasons for this shift in favour of apartments is a rebalancing of the preference for inner city living over the greater space that is more affordable in more distant suburbs. A great deal of the shift to apartments would also have been as a result of the escalation in land prices that has been seen.

# 5 Conclusions and policy recommendations

Particularly since the ending of the mining boom, the underlying demand for and supply of residential construction can make it one of the key drivers of economic growth.

During the 1980s Australia, had a much smaller population than today but was building far more houses though fewer units. Commencements over recent years were especially subdued in NSW and Victoria, in spite of a much smaller population, has seen more commencements than NSW in every year since the late 1990s.

Australia's home prices have escalated due to the regulatory restraints on land supply and an increase in governmental charges and regulatory induced delays.

Of the market-provided elements of cost, land supply is abundant and underlying costs are at most a thousand or so dollars; land development is relatively straightforward and the very many competent providers ensure that competition keeps costs and prices low; this equally applies with houses.

For new homes on the periphery of Sydney, the government created land scarcity adds between $100,000 and $200,000 to costs where the median lot costs $250,000[14]. For apartments, the land scarcity impost would be much less than this but other costs from union monopolies are greater.

Costs of planning delays and uncertainties in Sydney are estimated to be $38,000 for houses and $37,000 for apartments (around 6 per cent of the total). In addition, there are the taxes in the form of land tax, sales tax infrastructure charges ($37,000 on average in Sydney).

The housing problem is one of supply. Foreign demand, even if it were vastly in excess of official estimates, can be readily catered for by the industry, though at present it aggravates the government induced pressures on costs. Countering the effect of foreign demand for new dwellings by placing an impost on foreign buyers is akin to imposing an export tax on Australian products to drive down local prices. Export taxes are nowadays rightly regarded as egregious measures that distort output and bring adverse developments in efficiency of production. This applies even more so in the case of houses because the expansion of supply is relatively easy and, with sensible regulatory policies, can be undertaken while also lowering the costs of housing to domestic buyers.

At present there is little incentive for the approval granting authorities to expedite new building. Indeed, many face political pressures from incumbent owners to ensure that housing is kept scarce in order to bring about price increases. Others face similar sorts of pressures from incumbents who would rather have open space in their proximity than more housing. Most operate within the context of a planning profession that wishes to impose its own preferred direction of growth; this invariably includes access to public transport, schools, child care and other amenities and while these are doubtless of value, they should not be made mandatory, as house buyers are capable of trading off different amenities for the costs they entail.

In addition, all regulatory authorities face pressures from the environmental lobby, which often builds upon the serious constraints already imposed by biodiversity and similar legislation, to prevent new development. And for those seeking redevelopment within cities there is the NIMBY opposing redevelopment of brown sites.

The Government should not proceed with its proposals to introduce a tax on foreign purchases of housing in Australia. Nor should it tighten the restraints on such purchases.

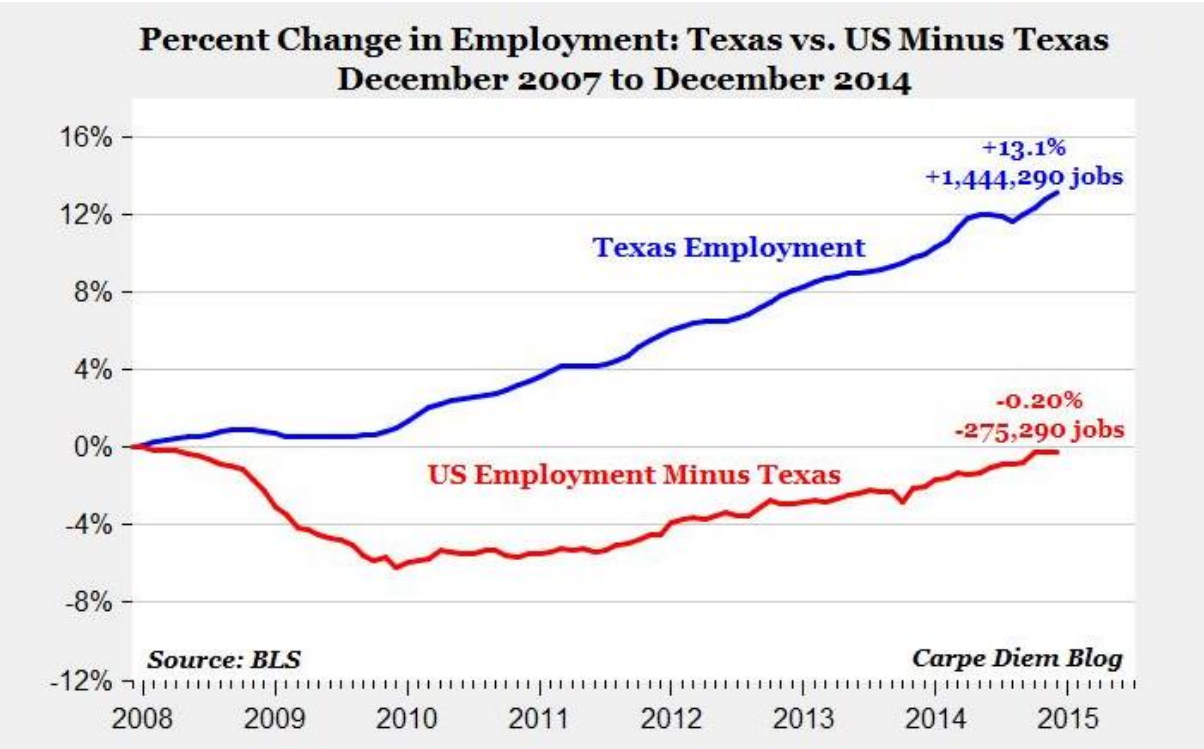
It should instead work to remove the conditions that are creating an artificial scarcity in new dwellings, thereby removing impediments to a natural expansion of the industry. The Commonwealth grant system should be amended to apply pressure to counter these anti-development trends, which greatly disadvantage those – the young and less well-off – who do not presently own their own home.

[14] The 2014 UDIA state of the land report

## Appendix A What if Australia was more like Texas?

Comparing Australia and Texas makes the effects of different regulatory regimes quite clear. Australia and Texas are quite similar in lots of ways, economic, geographic and demographic. Though Australia is ten times bigger than Texas, they share a similar level of urbanisation, population income and foreign-born residents. Significantly, in view of the comparisons, Australia is showing a much slower rate of population increase 1.3 per cent compared with 1.8 per cent.

Texas, thanks to a combination of its liberal approach to housing regulations and oil development has the fastest growing economy within the US; indeed, as the following chart illustrates, without Texas, the fledgling recovery seen in the US would be no more.




Since Texas has (much) less land, more population, is faster growing and is more productive (both overall and per person) and has an even larger share of its population in its five major metropolitan areas, it would seem likely that housing would be much more expensive in the metropolises of the Lone Star State than in the cities of our island continent.

Yet, precisely the opposite is true:

## Table A1 Australia and Texas Compared

| | Median multiple | Median home price | Median income |
|---|---|---|---|
| Dallas Fort Worth, | 3.1 | $181,300 | $58,000 |
| San Antonio, | 3.3 | $175,000 | $52,400 |
| Houston, TX | 3.3 | $186,600 | $57,000 |
| Austin, | 3.7 | $225,300 | $60,500 |
| | | | |
| Adelaide, SA | 6.3 | $392,000 | $61,800 |
| Brisbane, QLD | 5.8 | $442,100 | $75,900 |
| Melbourne, VIC | 8.4 | $595,500 | $70,800 |
| Perth, WA | 6 | $508,000 | $84,800 |
| Sydney, NSW | 9 | $722,700 | $80,500 |

Despite the fact that the five largest Australian metropolises have almost the same average median income as the five largest Texan metropolises in local dollar terms, metropolitan housing in Australia averages two-and-a-half times the price in local dollar terms of that in Texas.

Australia does not have a housing demand problem, it has a housing supply problem resulting from regulations on land and structures.

Had land prices remained stable or increased only at the rate of underlying inflation, as occurs in almost all US jurisdictions where no "smart" growth planning restraints are in place, average new house prices would have been the level presently observed.

Finally, the respective shares of houses and other dwellings, which in Sydney is now around 30/70, compares with 80 per cent of homes being classified as single dwellings in the liberalised planning regime of Houston[15].

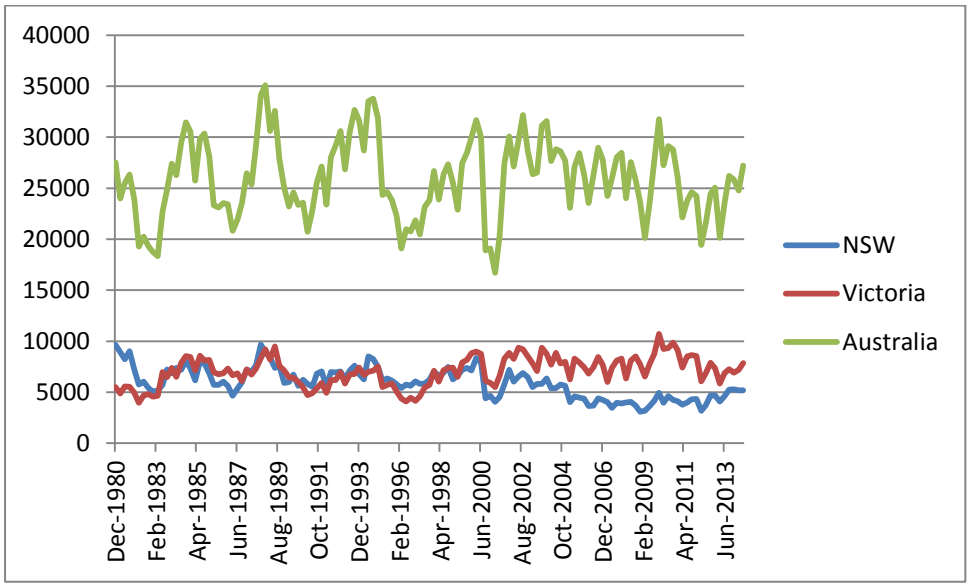
[15] http://www.builderonline.com/local-housing-data/houston-sugar-land-baytown-tx

# Appendix B Specific developments in New South Wales' new home building

## Trends in NSW Approvals

New South Wales has been under-providing new homes, even compared with other states, for over two decades. Figure B1 shows home building commencements in NSW and Victoria, which has a population one fifth smaller.

**Figure B1 Home Building Commencements**




In 2009/10 Sydney had just 43 new homes approved per 10,000 residents compared with 106 in Perth, 103 in Melbourne and 77 in Brisbane. This is a development that derives from a particularly rigid emphasis in NSW state policy on inhibiting new developments rather than fostering them.

**Table B1 Dwelling Commencements 2013/14**

| | NSW | Vic | Qld | SA | WA |
|---|---|---|---|---|---|
| | 20905 | 29242 | 19288 | 7892 | 22570 |
| Total Dwellings | 45877 | 50447 | 35191 | 10626 | 28873 |
| Population | 7500 | 5821 | 4709 | 1683 | 2566 |
| New Dwellings/ ten thousand people | 61 | 87 | 75 | 63 | 113 |

Source: ABS

For NSW, the process of restraining development started prior to that of other states. New South Wales was an earlier adopter of the philosophy behind the UK's *Town and Country Planning Act* 1947, which reversed the previous right to build by requiring *all* development to receive planning approval and *all* local authorities to produce land-use planning maps backed up by strong planning controls. In 1951 the New South Wales *Local Government (Town and Country Planning) Amendment Act* followed the UK blueprint. It aimed to regulate and control the use of land and envisaged a population growth from 1.7 to 2.4 million over 25 years. It incorporated a green belt—that is, a limit on the spread of urban growth—reserved land for open space and future highways. The actual rate of population growth was almost double what the plan envisaged. This restraint on development in the state was given some impetus under the administration of Premier Carr (1995-2005), who had a deep philosophical concern about over-population.

The present government – and indeed the preceding Labor Government's Minister Sartor - has sought to expedite development. Current plans are to build 25,000 new homes per annum and to improve affordability. These intentions notwithstanding, developers find it hard to navigate the thicket of laws and administrative controls which remain in place. The state is still building 40 per cent fewer dwellings in relation to the population than Victoria and 25 per cent fewer than Queensland.

It is a testimony to the philosophy of regulatory induced land shortages, especially in the Sydney region, that Premier Mike Baird, in announcing a "doubling" of new land releases, used the figure of an additional 5,000 per annum[16]. This, on current levels of new dwellings (45,877 in 2013/14), would still leave NSW far short of Victoria or Queensland –neither of which have stellar records – in new dwellings per head of population. Thus, an announcement of an expansion in new dwelling permits, made with some fanfare would barely make a dent in the long-standing housing shortage created by restrictive planning arrangements.

Sydney was a forerunner in Australian metropolitan planning and the other cities remain more cautious in the use of land control measures. That Sydney house prices became notoriously high was hardly a coincidence.

Land access constraints are aggravated by regulations inhibiting the move from in-principle building authorisation and on-going difficulties in addressing planning hurdles prior to construction commencing. These have meant the state continues to lag Victoria, Western Australia and Queensland, in spite of a recent apartments building revival. And, as a result, New South Wales prices continue to escalate partly because of low new building rates.

## Imposts on Development in NSW

### *Broad State Imposts*

Leaving aside Commonwealth general taxation provisions (GST, and income tax), State Government and Local Authorities both impose taxes and other charges onto new homes.

Under the growth centres policy the current state tax rate is set at a little under $200,000 per developable hectare which is estimated to be $13,000 per dwelling (at 15 dwellings per hectare). For units, especially high rise units, these costs are quite modest. Together with the regulatory induced new housing land scarcity this will have contributed to lower relative costs and hence a greater popularity for apartments compared with houses.

Although developers already pay the full cost of new infrastructure, the water, electricity, sewerage, telephone and drainage costs that are the basis of modern living, a Special Infrastructure Contribution of $347,000 per hectare (said to represent $23,000 per average residential development) is required. There is no contribution required for retail or commercial uses and the contribution for industrial uses is set at $150,000 per hectare. These rates are indexed to the changes in land values and construction costs. The contributions are to cover 75 per cent of the

[16] http://www.smh.com.au/nsw/nsw-state-election-2015/nsw-election-2015-baird-pledges-hed-double-land-release-for-new-housing-20150306-13x8un.html

costs of rail, bus services, open space, planning and delivery costs and land for "social infrastructure".

It is argued that such contributions are necessary since the land "simply won't be attractive to the market if infrastructure isn't provided"[17]. This is a bold statement for a government entity to make - entrepreneurs are better placed to make such judgements which they back with their own money

### *Regulatory Requirements*

Underpinning notions of planning as they apply in NSW and elsewhere in Australia is a notion of "holistic" control over individual preferences which involves the subordination of private markets to collective democratic controls[18]. Planning has therefore migrated from a system that sought to align common use services like infrastructure into collectivist ideals administered by consent authorities. The rules governing this allow for vast exercises of discretion.

Where discretion is allowed planning authorities', arbitrary decisions are made on issues like the amount of open space required and the robustness of infrastructure. Even more uncertainty may be injected if there is considerable discretion given to the consent authority with regard to the nature of accommodation to be built.

### *Metropolitan Plan for Sydney*

The developer has to meet market needs and this provides strong disciplines to ensure the package of features that comprise the home on offer is attractive to buyers. An isolated development that does not link into general infrastructure is unlikely to meet such conditions. Home buyers engage in thorough research for what to most people is the most expensive purchase they ever make and this buyer/seller interaction ensures value is created. Under prevailing competitive conditions, even a level of assessment to oversight this needs only a light touch.

However, the metropolitan plan requires developers to convince the planning authorities that their proposals are consistent with 30 Strategic Directions and sub-directions. And the Planning Framework goes much further. For example it requires evidence that the development seeks "to contain the urban footprint to achieve a balance between greenfields growth and renewal". This is not something an individual developer can influence. Nor is it justified and quantified as a sound policy approach.

Other provisions require the applicant to demonstrate that the land in question is not needed to support industry and freight needs, that it support the "increased density and liveability" of the city.

The Planning Framework also seeks "To produce housing that suits our expected and future needs" and "to improve housing affordability". While such goals are superficially unexceptional, closer examination of their implications reveals severe cost-imposing potentials. The builder is in competition with many others and this forces a focus on the needs of consumers in trading off such attributes as location, building finish, unit sizes and so on. This automatically leads the builder into providing product packages that the market wants. But if an independent party, no matter how expert, intervenes in that process by demanding additional features, affordability or consumer satisfaction will invariably be reduced.

[17] Special Infrastructure Contribution, NSW Growth Centres Commission
[18] P Healey, Collaborative Planning, 1997

And if, in pursuit of affordability, the builder is required to adapt the supply goals to include houses or apartments that are low cost then this must mean a diminished value of the whole development. In competitive markets, the immediate cost of this distortion is borne by other buyers within the project– it is a form of selective tax on specific new buyers.

If a subsidy is to be provided it is not reasonable that the burden should fall on buyers of new properties and not on the community generally, especially since new home buyers are often not the more affluent citizens.

Furthermore the requirements to incorporate welfare housing in a development can never have more than a trivial effect on providing low cost housing. This is easily demonstrated by examining the housing market. If 16,000 new houses per year are built in Sydney, a new "affordable" house or apartment costs $300,000 and an average new house costs $500,000, a low income levy on the latter even at three per cent yields only $15,000 and would finance only 800 "affordable" houses per annum.

Gaining access to this stock would be a lottery, require quite considerable administrative resources, and be open to abuse. Moreover, the eligibility for subsidy of occupants of the low income housing changes over time and those who have the benefit of a subsidy would need to be constantly re-assessed and required to move where their circumstances have improved. Far better, if housing is to be subsidized, that a rental subsidy be provided and eligibility for it be annually assessed.

### *State Environmental Planning Policies*

There are some 70 different checklist policies a NSW developer needs to navigate. Some cover rural landsharing communities, land remediation, bird habitats bushland in urban areas. Those likely to offer regulatory barriers to a development in the city centre, may include:

- land remediation especially concerning old factory sites;
- design quality of flats, a matter often subject to judgments;
- Sydney Harbour catchments, as a result of the river and the requirement of the SEP to examine cumulative issues.

The Productivity Commission was implicitly critical of NSW planning in that its referral requirements were the most extensive of all the states, as Table B2 illustrates.

**Table B2**

**Development assessment required to be referred — affects a prescribed matter, June 2010[a]**

| Development relates to, has an effect on, or is in proximity to one or more of these matters: | NSW[b] | Vic | Qld[c] | WA | SA | Tas | NT |
|---|---|---|---|---|---|---|---|
| Aboriginal heritage | ✓[d] | | | | | | |
| Airports | ✓ | | ✓ | | ✓ | | |
| Aquaculture | ✓[d,e] | | | | | | |
| Bushfire areas | ✓[d] | ✓ | | | ✓ | | |
| Catchment areas | ✓ | | | | | | |
| Coastal development | ✓ | | ✓ | | ✓ | | |
| Developments in Central Business District (CBD) | | | | | ✓[h] | | |
| Endangered species (flora and/or fauna) | ✓ | | | | | | |
| Electricity infrastructure | | ✓ | ✓ | | | | |
| Environment | ✓ | | | ✓ | ✓ | ✓ | ✓ |
| Heritage | ✓[d] | | ✓ | | ✓ | ✓ | ✓ |
| Historic shipwrecks | | | | | ✓ | | |
| Koala habitat | ✓ | | ✓ | | | | |
| Marine vegetation | ✓[d] | | ✓ | | | | |
| Mining | ✓[d] | | | | ✓[i] | | |
| Murray River and related areas[f] | ✓ | | | | ✓ | | |
| Occupational health and safety[g] | | ✓ | | | | | |
| Main roads/transport | ✓[d] | ✓ | ✓ | | ✓ | | |
| Rain forests | ✓ | | | | | | |
| Vegetation | | ✓ | ✓ | | | | |
| Water catchment area | ✓ | ✓ | ✓ | | | | |
| Floodplain | ✓ | ✓ | ✓ | | | | |
| Fish habitat | ✓ | | ✓ | | | | |
| Conservation estates | ✓ | | ✓[j] | | | | |
| Community infrastructure | | | ✓ | | | | |
| Wetlands | ✓ | | ✓ | | | | |
| Total number of matters | 20 | 7 | 14[c] | 1 | 10 | 2 | 2 |

## *Local Government Regulatory Issues*

With local councils, development levies are capped at $30,000 per unit for greenfield sites and $20,000 for in-fill.

Additional charges are negotiated as “voluntary planning agreements” (VPAs), which have no ceiling. On top of this there are development consents which often specify additional conditions like provision of cycle paths or undergrounding of power lines. Under the VPAs, the planning authority can withhold assent to a development that meets guidelines unless additional measures are agreed. Developers usually have restricted window opportunities and need to decide whether to accede to the VPA sought – and incur additional costs or value reductions - or to contest the claims and see delays.

In either case the costs almost invariably fall onto the consumer. Either the developer incurs costs that are sub-optimal to the customers being targeted or land is withheld and its scarcity costs further increased.

The powers of the consent authorities are considerable. Even though section 93L(2) of the Environmental Planning and Assessment (Development Contributions) Act 2005, precludes a consent authority from refusing to grant development on the grounds that a planning agreement has not

been concluded or offered by the developer but other provisions (including 93L(3)) weaken this. Moreover, Section 93J(1) excludes an appeal to the Land and Environment Court against a failure of the planning authority to enter into an a planning agreement and any such appeal must be other grounds.

The Practice Note issued in 2005 recognises the "imbalance in bargaining power between the planning authority and developer" and abilities of the consent authority "to extract unreasonable public benefits under a planning agreement". The note calls for "a generally applicable test for determining the acceptability of a planning agreement which embraces among other things concepts of reasonableness". It also calls for open and published rules with expeditious and accountable planning systems under which planning agreements run parallel with applications so that delays are avoided. And it recognises a potential conflict of interest between planning authorities as a consent body and as an agent of the council.

An alternative to a code might be some penalty or compensation payable by councils which are found to have needlessly prevented a development; such a payment might encourage greater responsibility on the part of the regulatory authorities.