To Lower The Cost Of Housing, Cut The Red Tape

Alan Moran
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The ALP's proposed tax concession for first-home buyers who have saved for a deposit may merely offset part of the excessive house prices they face.

The proposal is for a concessionary 15 per cent tax rate on salary-sacrificed earnings of up to $5000 per person annually for four years. On plausible assumptions, a couple each on $50,000 a year will make a saving of $14,000.

While measures such as this may help first-home buyers, lack of new housing supply is the key problem. Unless the supply of new housing is increased, the new tax concessions will merely make first-home buyers more competitive against other buyers. In the absence of increased supply, the subsidy will drive up house prices.

Ongoing restraints on supply radically distort the housing market. Normally, in helping a large class of buyers, a tax scheme such as the one the ALP proposes would mean increased demand, and this would trigger an increase in supply.

However, new supply in the housing market is totally under the control of state governments. All state governments restrain developers, builders, land owners and consumers from agreeing to convert land from existing uses into land for homes. Planning restrictions mean a suppression of the market forces that normally encourage new supply in response to higher demand.

These planning limitations are in two forms: difficulties in redeveloping established areas due to local opposition and inability to get government to allow building on the urban fringe. The latter constraints are far and away the more serious. As a result of them, new housing approvals in Sydney last month plumbed new depths while West Australian approvals last year only reached 75 per cent of the level planned by the minister. Victoria has fared better but approvals have fallen over the past few years.

Around the country, the supply of new housing has languished despite strong demand and record prices.

These supply constraints divorce the price of housing from the two key cost components: preparing the land and building the house.

The cost of preparing land for housing, including the associated infrastructure, is under $50,000 a block. A glance at any weekend paper will show many builders offering completed three-bedroom, two-garage homes of 20 square metres-plus at $120,000.

Taxes aside, the only other ingredient is the virgin land. This is valued at about $5000 a hectare as farmland. But the price is multiplied a hundred times once a regulatory tick is given for it to be built upon. Land that is worth, say, $500 a housing block sells for $100,000 once approved for housing. The value is created purely by scarcity caused by regulatory measures.

If it were not for the supply squeeze of government approval processes, we would see median houses at $200,000 rather than $350,000 in Melbourne and $500,000 for Perth and Sydney.

In addition to these land restrictions, there are other regulatory impositions on new home buyers. These include 5 Star energy requirements and over-elaborate landscaping.

These factors combined have doubled house prices in real terms over the past 30 years.

And this brings us back to the new ALP proposals.

All around Australia it is easy to achieve a price reduction of at least $100,000 solely from freeing up land from regulatory distortions.

In terms of reduced mortgage payments, a $100,000 reduction amounts to about $12,000 a year. For someone on average earnings of $55,000 ($45,000 after tax) that is an increase in real income of 26 per cent. These dwarf the benefits possible under the ALP proposals. Indeed, there are few measures that governments could take that would offer such a lift in real earnings to so many people.

While tax concessions may have a place, the real task for government is to devise ways of phasing out land regulations that are making houses unaffordable to new home owners.