

# Targeting first home buyer assistance to new homes

September 2010

## Key Points:

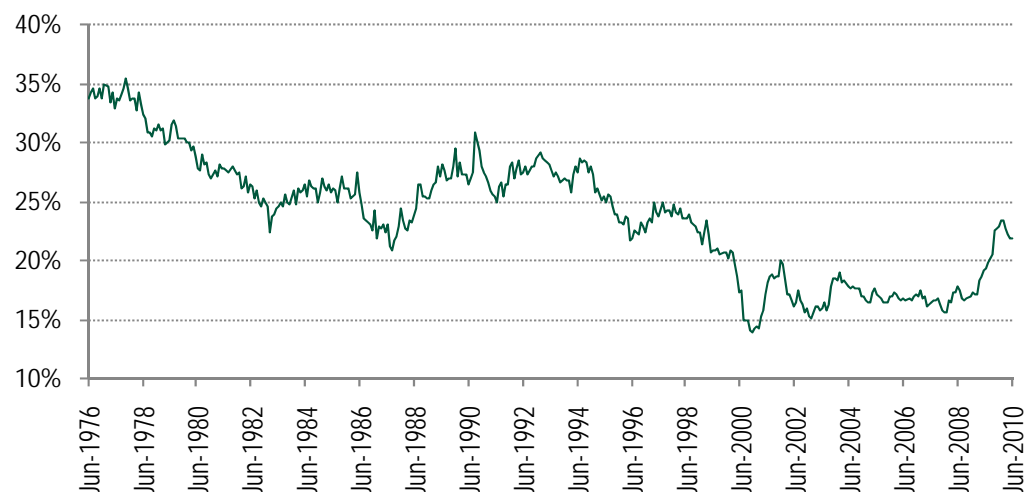
- **Housing affordability has been weighed down by constraints which hinder the supply of dwellings, such as high and complex infrastructure charges.**
- **Stamp duty is one of these constraints – it is an inefficient tax which reduces affordability and decreases turnover by locking owners into their current residence.**
- **Preliminary work by HIA Economics suggests that a first home buyer's stamp duty exemption on newly constructed Victorian dwellings would cost approximately \$93.0 million in 2010/11 and \$85.6 million in the subsequent three fiscal years.**

## *Housing affordability is declining in Victoria*

Over the last two decades, there has been a significant decline in the share of new housing loans as a proportion of total loans (net of refinancing) across Australia. Loans for the construction or purchase of a new dwelling have dwindled in terms of their share of overall loans for house purchases (see chart below). While there are many reasons for this decline, we can draw some firm conclusions.

### Share of New Homes - Australia

Source: ABS 5609, HIA Economics

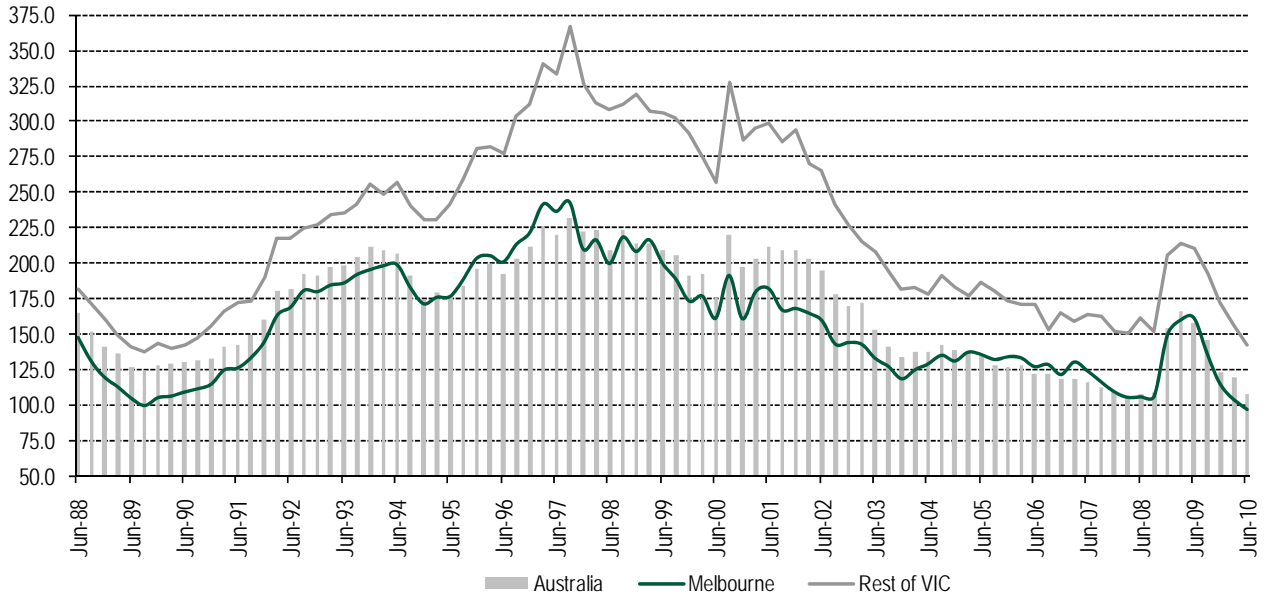


One obvious cause of this decline is the ongoing deterioration in housing affordability. Housing affordability is fast approaching the worst level seen in recent history, and Victoria is no exception to that. Since Victoria's peak of affordability in the September quarter of 1997, the housing affordability index for Melbourne has declined by 135.9 percentage points, and the index for the Rest of Victoria has declined by 210.4 percentage points (see chart below).



## Housing Affordability in Victoria

Source: HIA-CBA Affordability Report



The decline in housing affordability is contributing strongly to the fall in new housing loans. Many first home buyers are not in a position to make the transition to home ownership as they simply cannot afford it. While many factors contribute to the housing affordability picture, a major cause of falling affordability is that house price growth has outpaced labour earnings growth over recent years. In December 1999 the median established house price in Melbourne was \$181,000 and by December 2009 this price had increased to \$458,000. This represents a total increase of 153.3 per cent for annual growth of 9.7 per cent.

Over the same period, full-time earnings have increased from \$38,870 to \$61,807, an increase of just 59 per cent. It is true that there has been a small increase in the incidence of dual income households over this period, however the proportion has not altered greatly in the first home buyer end of the market which is dominated by young couples and singles.

The erosion of housing affordability has been particularly marked in the new housing sector. This is related partly to an escalation in the cost of construction. The cost of new home construction is growing at a rapid rate, which is putting downward pressure on new home building activity, and subsequent pressure on market prices. The following table indicates the escalation of the cost of constructing a new home in Victoria over the last decade (adjusted for inflation).

| Cost of Construction - Melbourne  |             |             |
|-----------------------------------|-------------|-------------|
|                                   | Dec '00 Qtr | Dec '09 Qtr |
| Average size by outer wall (sq.m) | 244         | 250         |
| Average value per sq.m            | 628         | 969         |
|                                   | \$ 153,232  | \$ 242,250  |

\* Private sector houses

Source: ABS unpublished building approvals data

| Cost of Construction - Regional Victoria |             |             |
|--|-------------|-------------|
|  | Dec '00 Qtr | Dec '09 Qtr |
| Average size by outer wall (sq.m)        | 213         | 239         |
| Average value per sq.m                   | 619         | 930         |
|  | \$ 131,847  | \$ 222,270  |

\* Private sector houses

Source: ABS unpublished building approvals data

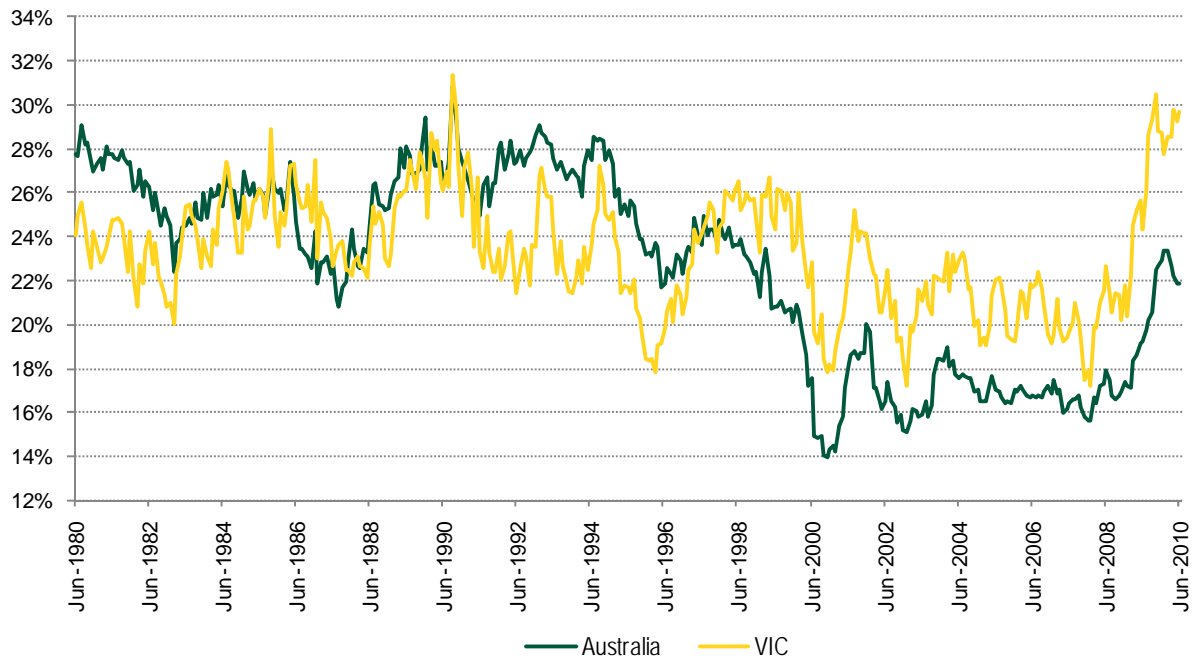
The overall costs of a new home on land has been driven higher by inequitable taxation of new home building, pervasive infrastructure charges, skills shortages and raw land value appreciation. These factors, combined with the supply of housing not keeping up with demand, have directly fed into strong gains in house and land package prices. This price appreciation, combined with six interest rate hikes by the RBA since September 2009, has seen new housing move further and further out of the reach of first home buyers.

### First home buyer incentives work

The decline in housing affordability and the fall in new housing loans as a proportion of total loans, clearly advocates the need for ongoing first home buyer assistance. Victoria's recent history is a proven example of the success of first home buyer assistance in boosting the share of housing loans for the purchase or construction of new dwellings.

### Share of New Homes - Australia & Victoria

Source: ABS 5609, HIA



The strong upswing in November 2008, shown above, coincided with the tripling of the First Home Owner Grant. First home buyers who purchased an established home received a boost of \$7,000 and first home buyers who built a new home or purchased a newly constructed home received an extra \$14,000 to take their grant to \$21,000. A stage one scaling back of the Boost occurred in September 2009, with the second stage and final removal occurring on December 31<sup>st</sup>, 2009.

During this time, the share of new housing loans as a proportion of total loans (net of refinancing) in Australia increased significantly. For Victoria, the share of new houses increased from 20 per cent in November 2008 to a peak of 31 per cent in October 2009. The number of new housing loans issued in Victoria in November 2008 was 1,586; compared with 3,526 in October 2009. There is a clear correlation between the extent of first home buyer assistance and the demand for loans for new housing.

From July 2009 to September 2009, the Victorian Government supplemented the First Home Owner Boost with an increase in the financial incentive of its own First Home Bonus for newly constructed dwellings. This contributed to an increase in the share of new housing loans as a proportion of total loans of at least 3 percentage points, taking it to 29 per cent. By contrast, the national share of new loans never reached the heights seen in Victoria, with a peak of only 23 per cent in October 2009. While a few other States were offering first home buyer assistance, Victoria's scheme was by far the most generous.

Despite the removal of the First Home Owner Boost, Victoria has managed to maintain an enviable share of new housing loans thanks to its decision to retain the First Home Bonus program. The share of new housing loans as a proportion of total loans has not fallen below 28 per cent in 2010, and currently stands at 30 per cent as of June 2010. Targeted first home buyer assistance for new housing not only alleviates the housing affordability problem, but it is also a successful catalyst to boosting the share of new housing loans as a proportion of total loans.

### ***Stamp duty causes an inefficient use of the housing stock and decreases affordability***

There is consensus amongst economists that stamp duty is an inefficient tax. As stamp duty is a transaction cost, it locks owners into properties, meaning that home owners less readily upsize or downsize as their life circumstances change. Because of this, stamp duty acts to limit the number of transactions, with the removal of stamp duty estimated to result in a significant increase in turnover.

However, stamp duty is an important and growing source of state government revenue, so its removal needs to be offset by an increase from other sources of revenue, with a broad-based land tax being the most commonly agreed best replacement.

Either way, a number of Australian states and territories have recently moved to reduce or remove stamp duties, particularly in the case of elderly Australians or for pre-construction purchases of dwellings. This is to be applauded as, in addition to inefficiency, stamp duties add to upfront housing costs and make it more difficult for home buyers to secure credit.<sup>1</sup>

Stamp duty exemptions on newly constructed dwellings have the additional benefit of directly stimulating economic activity and adding to housing supply. This is a very important consideration given Australia currently has an undersupply of dwellings.

### ***HIA Economics' preliminary estimates of the costs of stamp duty exemptions***

HIA Economics undertook to provide preliminary estimates of the cost to the Victorian Government of a number of options regarding stamp duty exemptions on newly constructed dwellings:

1. full stamp duty exemption on newly constructed dwellings for all purchasers;
2. full stamp duty exemption on newly constructed dwellings for first-home buyers only;
3. 50 per cent stamp duty concession on newly constructed dwellings for all purchasers; and
4. 50 per cent stamp duty concession on newly constructed dwellings for first-home buyers only.

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<sup>1</sup> As stamp duty is a cost placed on top of the purchase price rather than being incorporated into the overall value of a given property

Cost estimates are outlined for each of the four fiscal years from 2010-11 to 2013-14. The results are based upon HIA Economics' housing starts forecasts and are based on a number of assumptions including:

- that there will be increased turnover due to the stimulatory impact of a stamp duty exemption or concession with the assumed increase based on historic trends in the demand impact of policy;
- HIA forecasts of housing starts are used for 2010-11 and 2011-12, with starts for 2012-13 and 2013-14 assumed to be at the same level as 2011-12;
- that a variety of sales will already be exempt from some portion of stamp duty as they will fall under the Victorian State Revenue Office ruling DA.048;
- duties are based on Melbourne construction and land costs, excluding cost estimates for regional Victoria. This was due to time restrictions under the project - however, further detailed analysis incorporating regional Victoria can be conducted upon request; and
- cost estimates have been based on detached dwellings only, therefore there is a downside risk to the projections given that stamp duty paid on multi-units will generally be less than that paid on a detached house.

### ***Preliminary estimates of costs***

#### ***1. Full stamp duty exemption – new dwellings – all home buyers***

HIA Economics carried out an analysis of a full stamp duty exemption on the construction of new dwellings which would be available to all purchasers. This is the preferred policy option for boosting the supply of new dwellings in Victoria to address the housing shortages that are prevalent throughout the state. (Housing shortage information for Victoria can be found in the HIA Economics *Housing to 2020* publication. Please see the HIA Economics website for a copy of the full report: <http://economics.hia.com.au>).

- The estimated cost to government of a stamp duty exemption on newly constructed dwellings for all home buyers is: \$390.9 million in 2010/11 and \$359.9 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

#### ***2. Full stamp duty exemption – new dwellings – first home buyers only***

HIA Economics carried out an analysis of a full stamp duty exemption on the construction of new dwellings but limited to first home buyers only.

- The estimated cost to government of a stamp duty exemption on newly constructed dwellings for first home buyers only is: \$93.0 million in 2010/11 and \$85.6 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

#### ***3. A 50 per cent stamp duty concession – new dwellings – all home buyers***

HIA Economics carried out an analysis of a 50 per cent stamp duty concession on the construction of new dwellings which would apply to all home buyers.

- The estimated cost to government of a 50 per cent stamp duty concession on newly constructed dwellings for all home buyers is: \$188.1 million in 2010/11 and \$173.2 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

4. *A 50 per cent stamp duty concession – new dwellings – first home buyers only*

HIA Economics carried out an analysis of a 50 per cent stamp duty concession on the construction of new dwellings and limited to first home buyers only.

- The estimated cost to government of a 50 per cent stamp duty concession on newly constructed dwellings for first home buyers only is: \$41.5 million in 2010/11 and \$38.2 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

5. *Full stamp duty exemption – all dwellings – first home buyers only*

HIA Economics carried out an analysis of a full stamp duty exemption on both new and established house transactions but limited to first home buyers only.

- The estimated cost to government of a stamp duty exemption on all house transactions for first home buyers only is: \$713.2 million in 2010/11 and \$704.0 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

If the exemption were only to apply for dwellings under a **capped value of \$600,000**, then the cost to Government would be reduced.

- The estimated cost to government of a stamp duty exemption on all house transactions under a value of \$600,000 for first home buyers only is: \$670.4 million in 2010/11 and \$661.8 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

6. *A 50 per cent stamp duty concession – all dwellings – first home buyers only*

HIA Economics carried out an analysis of a 50 per cent stamp duty concession on both new and established house transactions but limited to first home buyers only.

- The estimated cost to government of a stamp duty exemption on all house transactions for first home buyers only is: \$318.3 million in 2010/11 and \$314.1 million in each of fiscal years 2011/12, 2012/13 and 2013/14.

If the concession were only to apply for dwellings under a **capped value of \$600,000**, then the cost to Government would be reduced.

- The estimated cost to government of a 50 per cent stamp duty concession on all house transactions under a value of \$600,000 for first home buyers only is: \$299.2 million in 2010/11 and \$295.3 million in each of fiscal years 2011/12, 2012/13 and 2013/14.