HIA submission into the Victorian Rental and Housing Market

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1. INTRODUCTION

The Housing Industry Association (HIA) welcomes the opportunity to provide a submission to the Legislative Council Legal and Social issues Committee Inquiry into the rental and housing affordability crisis in Victoria.

Getting more Victorians into more homes is a priority for the HIA and its members.

At the outset we acknowledge the challenges facing Victorian renters due to an acute shortage of affordable rental properties. This problem has characterised the Victorian property market for some time. It is likely to continue to be a major problem into the future in the absence of major reforms that tackle the underlying causes of the crisis.

These include, but are not limited to:

- A shortage of shovel ready land for all housing.
- Restrictive and inconsistent planning regulation.
- Punitive property taxes and charges.

These influences are a significant handbrake on bringing new land, and new properties, to market. They continue to erode housing affordability and make investment in new housing supply prohibitive, disadvantaging both renters and homebuyers.

Our submission explores these issues in some detail, describing their impact on the Victorian housing market specifically, and accommodation market more broadly.

They are issues relevant to several aspects of the inquiry Terms of Reference, including;

- *The factors leading to low availability and high costs of rental properties.*
- *Options to address insecurity, availability and affordability issues facing Victorian renters.*
- *Barriers to first home ownership and the impact this has on rental stock.*

Accordingly, we also put forward a number of recommendations to stimulate land supply and improve the operation of the planning and regulatory system as it affects housing supply and construction.

We also discuss the taxation and related changes needed to encourage more investment in housing, and improve housing choice and affordability.

2. THE VICTORIAN RENTAL MARKET IN CONTEXT

2.1 Victorian Private Rental Market Since the Pandemic

The pandemic was a major driver of rental vacancy rates in Melbourne hitting 4.8 percent in November 2020. Families clustered together in larger household numbers and many that could move to escape Melbourne's restrictive lockdowns for the lifestyle choice of Victoria's regions did so.

At the same time, the RBA cash rate was sitting at 0.1 per cent, creating a strong incentive for home buyers to enter the property market or upsize their accommodation requirements. These influences put pressure on home 'space', with home seeker preferences oriented towards more living, entertaining and home office space.

Many rental providers took advantage of rising house prices and decided to sell. As a result, a significant number of rental properties were removed from circulation. Many tenants had to leave their former rental properties and resettle.

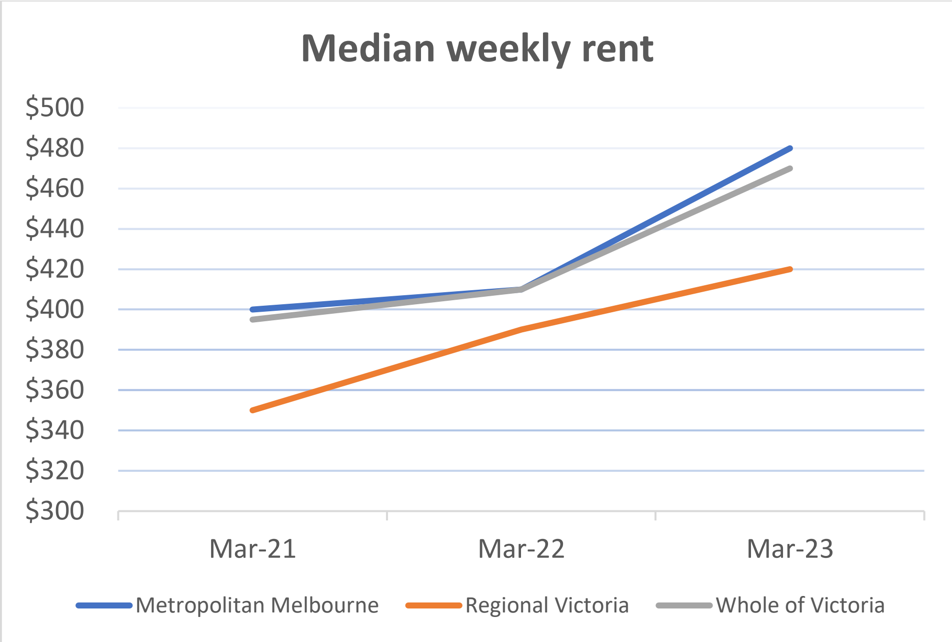
In 2021 changes to the Residential Tenancy Act required Victorian rental providers to undertake scheduled works and maintenance, including:

- Mandatory gas and electrical safety checks, including equipment upgrades to meet National Construction Code (NCC) requirements.
- Minimum standards for locks and windows.
- Mould, damp, lighting, ventilation and heating inspections.

This put additional cost pressure on private landlords, in some instances increasing their motivation to sell.

Since the COVID pandemic, Melbourne's vacancy rate had fallen to 0.9 per cent by April 2023. Demand, buoyed by record levels of overseas migration, putting property supply under extreme pressure. With pandemic restrictions eased, there was also some reversal of regional migration back to the greater metropolitan area.

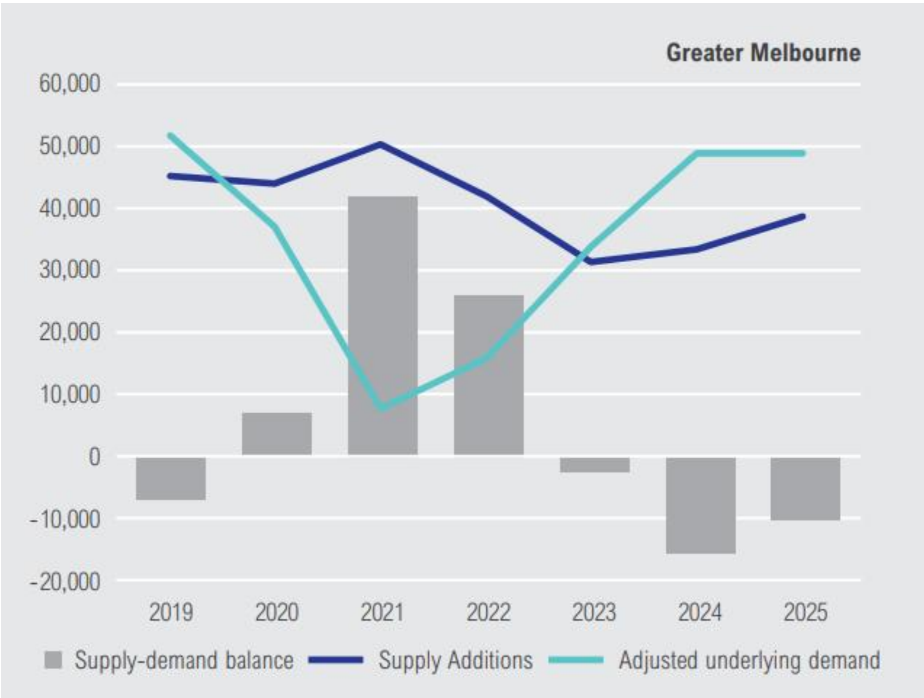
Since May 2022 the RBA cash rate has progressively increased to sit at 4.10 per cent in July 2023. The process of successive monetary policy tightening over this period has put intense pressure on investor returns, diminishing rental stock and raising rental costs across the state. As shown in the following chart: Land and property tax changes also add to the cost base for property owners and will also contribute to rent increases and lower investor returns.



Source: Homes Victoria

2.2 Pandemic Impact on Home Building

Changing consumer preferences along with the Federal Government's HomeBuilder program and other state government schemes supported very strong demand for new homes, especially among first home buyers, during the pandemic.



Source: National Housing Finance and Investment Corporation, State of the Nation's Housing 2020

Under the weight of demand and supply pressures, home building construction times and costs have been hard hit. The price of building materials has increased by an estimated overall 32 per cent since the start of the pandemic.[1] Shortages of tradespeople have contributed labour to costs rising by an estimated 20 per cent by mid-2022.[2] As a result, the cost to complete a detached family home has increased by an average 31 per cent (or $112,000) since December 2019.[3]

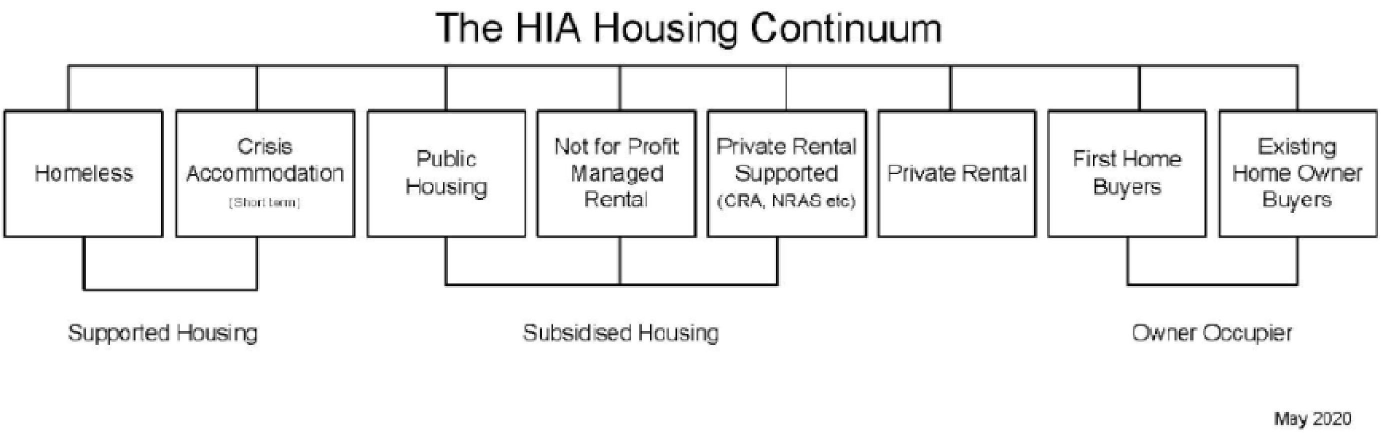
In Victoria home building contracts are subject to prohibitions on cost escalation clauses, limits on the use of cost-plus contracts, and a legislative preference for fixed price contracts. These restrictions, along with delays in the titling of land and with the commencement and completion of building work, make the task of a builder pricing a future home building project more difficult. This has been a significant, if not the major, contributor to the recent insolvencies and other financial distress for home building companies.

HIA is estimating a new seven-star energy efficiency minimum standard and better accessibility requirements will add about $20,000 to the typical cost of a new house from 1 May 2024 when it becomes mandatory for home builders to adopt NCC 2022.

As forecast by the National Housing Finance and Investment Corporation, supply levels coming out of the pandemic are under significant cost pressure which is expected to widen the supply-demand gap to the detriment of the rental market.

Housing/rental affordability principles and the HIA Housing Continuum

To assist in highlighting the connection between each cohort of the housing supply chain, HIA's concept of the 'housing continuum' was developed.



Housing affordability is generally accepted as a term that refers to the relationship between housing costs (i.e. rent, mortgage repayments) and a household's total income. The general rule of thumb applied is housing costs should not consume any more than 30 per cent of a household's income.

[1] HIA Economics

[2] HIA Economics

[3] Australian Bureau of Statistics

According to Census 2021 data, almost one third of renters in Greater Melbourne (166,000 households) had rent payments greater than 30 per cent of household income. There's little to suggest this would have eased in the subsequent two years to 2023.

Housing affordability is improved because of an adequate housing supply at an appropriate price for each cohort of the housing continuum.

When affordability is low, the ability to enter the market is restricted for those on low and moderate incomes. When affordability improves, the ability to enter the market, and remain in the market, for these households also improves.

However, in many parts of the country including Victoria, rental price growth has exceeded growth in household income, which suggests that demand is exceeding the supply for private rentals.

This private housing market is delivered by and large by a number of small 'mum and dad' investors, who in most instances supply one or two properties to the market.

While in recent times there has been some easing in building material and labour costs, the reality is new home construction costs are significantly well above their pre-pandemic levels.

With pandemic demand and cost pressures on construction of detached family homes easing, it is predicted that more resources (i.e. labour and materials) will become available when the market is prepared to build more multi-units and apartments. Traditionally these make a significant contribution to the rental housing mix. It is important however to appreciate that there are competing demands for these resources and there remains concern that large government infrastructure and building projects will use much of these resources.

Research by HIA shows that from Census 2016 to 2021, the rate of growth in rental stock in Victoria fell by 19.3 per cent (+74,065 'rented dwellings') compared to 2011 to 2016 (+91,770). This is well down compared to the nation overall, which saw rental stock increase by 94.4 per cent in the five years to 2021 (+359,830) compared to the previous Census (+185,090).[4]

In addition, the federal government's National Rental Affordability Scheme (NRAS) introduced in 2008 is set to expire in 2026. The scheme was introduced as a way for predominantly mum and dad investors to provide affordable housing for renters, offering rental properties for at least 20 per cent below market rates. As of June 2017, there were an estimated 5,895 NRAS dwellings in Victoria.[5] In the absence of any new incentives, these dwellings are likely to be removed from the subsidised rental market.

[4] Haven; Home, Safe

3. KEY FACTORS THAT HAVE ERODED HOUSING AND RENTAL AFFORDABILITY

3.1 The Lack of Greenfield Land Being Brought to Market

Many Victorian renters or those choosing between renting or buying, transition to home ownership by purchasing their first home in Melbourne's greenfield/growth areas (i.e. Cardinia, Casey, Hume, Melton, Mitchell, Whittlesea, Wyndham). These greenfield sites are popular among home buyers for many reasons. Research recently published by Infrastructure Victoria titled *Our home choices*, indicates these buyers are attracted to the choice of homes available, affordability, value for money, new facilities and sense of community. The same reasons also make them attractive places to rent a variety of homes.

The Department of Transport and Planning Urban Development Program (UDP) data shows the total supply of greenfield land in Melbourne's growth areas has fallen from 423,000 lots in 2018 to 370,000 lots in 2021. The drop is primarily in 'zoned land' (i.e. 250,000 to 198,000 lots) taken up by strong demand. New land is brought to the market via the Precinct Structure Planning process, however this has on average blown out to a 5-6 year period.[5]

There is a therefore a compelling case for the Victorian Government to promote and streamline an efficient regulatory process to ensure there is an adequate minimum land supply to meet future demand (i.e. a rolling 15 years supply). With stock levels running low, some areas have fallen below 15 years supply (i.e. Wyndham 12 years) and others are nearing the mark (i.e. Casey, Cardinia, Melton 16 years, Whittlesea 17 years).

To help meet some of the demand for land in Melbourne's growth areas, developers are creating smaller lots (particularly sub 300m^2) and increasing density. The growth areas have their own 'deemed to satisfy' building code i.e. the "Small Lot Housing Code", under which a dwelling on a lot of less than 300m^2 can be approved a few weeks.

Data provided by RPM Real Estate Group shows while the average lot *price* remained relatively stable between March 2022 and March 2023 (i.e. ~$385,000), average lot *size* fell by 7-8 per cent.

Source: RMP Real Estate Group

[5] Urban Development Program, Department of Transport and Planning

As the supply of greenfield zoned land has become scarcer, developers have generally been required to pay more than $2 million per hectare versus under $1 million less than 10 years ago.
Adequate long term land supplies for housing must therefore be an essential element of the State Government's housing and planning strategy. We discuss the blockages to housing/land supply in Victoria and provide recommendations for improvements in the remainder of this section.

3.1.1 Stagnant Urban Growth Boundaries and Prolonged Precinct Structure Planning

Urban Growth Boundaries (UGBs) in various forms are a key strategy employed by governments to manage urban growth. Melbourne's UGB has not had a meaningful review since 2017 or undergone change since 2010.

UGBs create distortions in the market for land development. As a result, landowners and governments either withhold or control the supply of land to the private sector. A boundary line essentially 'quarantines' land on one side, that may otherwise have capacity for urban use and servicing capability.

With parts of Melbourne's growth area land supply falling below 15 years and others fast approaching this threshold, more Precinct Structure Plans (PSPs) are required to backfill demand. PSPs, which determine future urban zoning and land use, are currently taking 5-6 years to complete in Victoria. This delay means the 'real' stock of available new land will likely be limited in the future.

It is the responsibility of government to ensure PSPs are in place well in advance of medium to longer term land supply thresholds being met. Doing so will give first home buyers more choice and take pressure off demand for rental stock.

Recommendations

HIA calls on the Victorian Government to:

- Commence a formal review of Victoria's Urban Growth Boundaries, with a refresher every two years. The objective must be to maintain adequate greenfield land supplies in the pipeline, i.e. short (<5 years), medium (6-15 years) and long term (>15 years).
- Work with all stakeholders to innovate ways to streamline Precinct Structure Plan approvals to 2-3 years, down from the current 5-6.

3.2 The Planning System is Not Fit for Purpose

Following a two-year review, in 2021 the Victorian Commissioner for Better Regulation released a report with 27 recommendations that are urgently required to address failures in Victoria's planning and building systems.

The review focused on how to eliminate unnecessary delays and improve confidence in the system without compromising the quality outcomes be sought. The report estimates for the $33 billion construction sector, delays are costing somewhere between $400 to $600 million per year. The report states this is impacting housing affordability, and all 27 recommendations require urgent implementation.

Further planning reforms are necessary to generate net housing uplift at the local government level. These are addressing failures in the Victorian residential code assessment model (i.e. ResCode), including the impact of third party appeal rights; and making local government more accountable for housing capacity via land use planning.

3.2.1 A Flawed Residential Code Assessment Model

Victoria's residential building assessment code "ResCode" operates with discretionary approval rather than 'deemed to satisfy' performance. While a residential development can fully 'comply' with the code, a local government council is not obligated to approve it.

Victoria's generous model of third party appeal rights, also means a ResCode compliant proposal can be blocked at either (sometimes both) council and the Victorian Civil Administrative Tribunal and not proceed. This includes when height, scale, car parking provision, etc. all comply with statutory regulations.

There is severe financial risk for businesses undertaking land development in Victoria. In managing this uncertainty, developers supply fewer lots for homes than they otherwise would if there was greater confidence in the regulatory environment.

The Department of Transport and Planning ran a public consultation process at the end of 2021 with a proposed new ResCode assessment model that was largely supported by HIA.

Recommendations

HIA calls on the Victorian Government to:

- Introduce a 'deemed to satisfy' pathway into Victoria's ResCode provisions, where compliant development must be approved. This is largely consistent with the Department of Transport and Planning's "Improving the operation of ResCode" model.
- Amend Victoria's third party appeal rights legislation so that development complying with statutory regulations is exempt.

3.2.2 Council Land Use Planning Strategies Are Limiting Infill Growth

Victorian municipal and regional councils collectively determine the supply of land for housing development through their land use planning strategies, zoning and overlay decisions. In isolation, the number of dwellings a council claims are permitted by zoning is not an accurate indicator of the actual number of dwellings that can realistically be delivered. Examples of other restrictive factors are environmental, heritage, built form overlays and local neighbourhood character controls.

The imbalance of land use planning strategies failing to produce enough homes is often referred as the "zoning premium." As yield on offer is lower than what the market is prepared to deliver, the price of new stock is artificially inflated.

A 2018 study by the Reserve Bank *The Effect of Zoning on Housing Prices*, estimated apartments in Sydney come with a zoning premium of $489,000 and Melbourne $120,000. In a worsening housing supply market with underlying demand, these premiums will only grow.

Local governments should be doing more with their strategic land use planning strategies for housing and settlement to increase housing supply in established suburbs. We note Victoria in Future (VIF) 2019 provides housing growth estimates at an LGA level, which ensures targets are rigorous and transparent.

Recommendations

HIA calls on state and local governments to:

- Meet or exceed projected housing growth targets by Local Government Area through a combination of zoning uplift and the elimination of unnecessary planning controls.
- Established a regular process for reporting local government performance in increasing housing supply. These reports need to be available and benchmarked to allow for ease of assessing the comparative performance of local governments.

3.2.3 Victoria In Future Growth Projections Are Pre-Pandemic

A post-pandemic update to Victoria In Future (VIF), 2019 is urgently needed. The current, pre-pandemic VIF already forecasts average household size to shrink from 2.54 in 2016 to 2.40 in 2056. However, the pandemic may have accelerated this decline and created subsequent underlying demand for additional stock. It is critical to assess what the latest trends are moving forward and how the market pivots and resets to facilitate future demand for diverse housing.

Recommendation

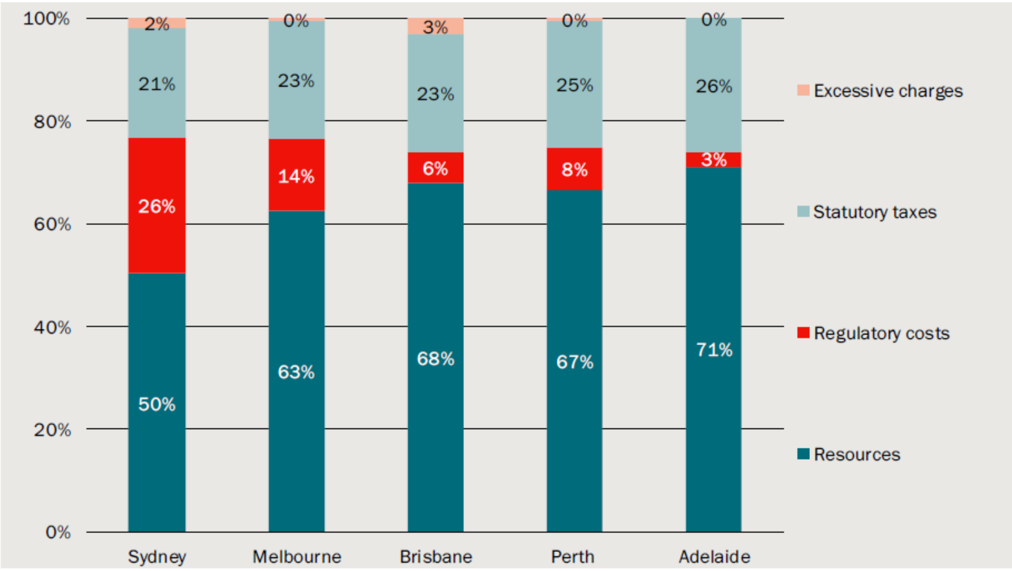
HIA calls on the Victorian Government to:

- Conduct and publish a post-pandemic update to the Victoria In Future (VIF) population forecasts.

4. PROPERTY TAX REFORM IS URGENTLY NEEDED TO IMPROVE HOUSING INVESTMENT AND AFFORDABILITY

Housing is already one of the most heavily taxed sectors of the economy. HIA modelling demonstrates that 38 per cent of the cost of a house and land package in a Melbourne greenfield estate is made up of statutory taxes and charges, planning and regulatory costs and zoning/supply premiums.

7.3 Total outlay for new homebuyer to acquire a house & land package in a Greenfield estate (component shares, 2016-17)



Data source: The CIE

Source: HIA Economics

4.1 Development Contributions Impact Housing Affordability

According to the August 2021 report *Development Contributions: How should we pay for new local infrastructure* by the National Housing Finance and Investment Corporation (NHFIC), the financial burden of development/infrastructure contributions that have broad community benefit are increasingly falling on new home purchasers.

NHFIC believes contributions used for social infrastructure (e.g. playgrounds, sports fields, community centres), which have no clear nexus to the home being purchased are contributary to affordability issues.

The NHIFC report states *"If the scope of developer charges doesn't have a clear nexus to the new housing development or costs aren't apportioned appropriately between the beneficiaries of the local infrastructure, developer contributions ultimately can act like a tax and discourage development."*

Indicative case studies sourced by NHFIC show that developer contributions can ultimately amount to between $37,000 and $77,000 per dwelling in Victoria (indexed to 2020 prices), which is a substantial cost levied on a new home.

While this research relates to greenfield areas, developer contributions for physical and social infrastructure also exist for *established suburbs*. Be they floor uplift contributions, physical and social infrastructure expansion contributions or open space contributions from subdivision, ultimately home purchasers/renters pay more.

Recommendations

HIA calls for governments to:

- Undertake a comprehensive review of state property taxes and other charges to determine their efficacy, incidence, and impact. The review should compare the competitive position of Victoria's property tax regime, compared to other states and territories, and explore options to rebalance state taxes to reduce the burden of property taxation that will support improvements in housing supply and affordability.
- Amend planning legislation to introduce a cap on the percentage of government infrastructure taxes and charges that can be sought under any infrastructure contributions scheme. The cap amount should be based on the Victorian Treasury's annual Consumer Price Index (CPI) forecast.

4.2 Abolish Stamp Duty

The rate at which stamp duty is charged is most punitive in Victoria, costing the typical Victorian homeowner $39,170 on the purchase of a median property worth $735,000. Nationally, the typical stamp duty bill for the median property is around $26,245. In Queensland, it is even lower at $12,715.[6]

HIA reinforces its consistent view that in the longer term, major changes to Victoria's tax mix are needed to facilitate the abolition of land transfer duty.

If stamp duty were not levied, homebuyers would have the choice of buying the same home with less debt, as they could put down a larger deposit. Therefore, stamp duty causes homebuyers to borrow more to cover the cost of stamp duty.

Where home buyers are not borrowing more to cover the cost of stamp duty, they are compelled to search for and purchase a less expensive home than they could if stamp duty was not levied. These home buyers are effectively covering the cost of stamp duty by forgoing a back garden, reducing the space of their home environment, increasing their commute to work, and/or reducing their proximity to friends and family. Isolation, increased travel time and potentially foregone employment opportunities are not the hallmarks of liveable neighbourhoods.

Not everyone is able to remain in their existing property indefinitely. Stamp duty falls on vulnerable households that must move homes due to changes in life circumstances, such as the death of a family member or loss of income.

Because young people typically move more frequently than people who are older, this age group is paying more towards state government revenue than households who move less frequently.

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[6] HIA Stamp Duty Watch, Autumn 2023. Page 4.

In short, stamp duty distorts the decisions of households to move in and out of homes that are either too large, too small or even too costly for their needs.

HIA considers several steps can be taken to lower the stamp duty hurdle in Victoria, creating an environment for improved home ownership and increased housing turnover and transition rates (from renter-to-owner) across different age and income cohorts.

Recommendations

HIA calls on the Victorian Government to:

- Remove stamp duty for homes valued up to $750,000 and give a concession for properties valued up to $1 million.

  In the absence of this reform:

- Index stamp duty thresholds annually to keep pace with rising house prices. At a minimum they should be indexed to inflation, but ideally adjusted to reflect median house price growth.
- Expand the First Home Owner Grant to $20,000 for eligible participants buying or building a new home in metropolitan Melbourne (the same amount available for new homes built in regional areas).
- Maintain real funding for the Homebuyer Fund over the State Budget forward estimates period.
- Reform fund eligibility requirements so that all participants only require a 3.5 per cent deposit and are eligible for a 35 per cent shared equity contribution.
- Consider the development and application in Victoria of a low entry cost/low deposit lending model, such as the Western Australian Government's Keystart initiative.

4.3 Educate the Market About Negotiated Inclusionary Zoning Opportunities

Mandated quotas for affordable housing via inclusionary zoning is not financially viable in the highly regulated and inflationary Australian housing market. Being forced to give away or heavily discount stock at the point of sale is too much for the market to bear and would only push up house prices further. A dwelling which is mandated to be sold as an 'affordable house' still costs the same to build but must be marketed and sold for less with no guarantee it is not on sold at the market rate.

The planning system facilitates negotiated affordable housing supply during the development application (DA) process. This is typically secured via a section 173 agreement included in the planning permit and registered to the future land title.

A constructive 'model' for increasing affordable housing via the DA process is for developers to negotiate for improved development rights, such as height and floor area uplift beyond discretionary standards. As long as these are not linked to incremental development contributions, it allows developers to improve their bottom line in exchange for choosing to set aside a dwelling(s) for reduced market rent or disposal (their choice).

Feedback provided to HIA is developers are willing to work with authorities to target negotiated affordable housing supply, but some authorities lack the knowledge and experience to apply the tools available during the DA.

Recommendation

HIA calls on the Victorian Government to:

- Engage the services of the Department of Transport and Planning to prepare a *Planning Practice Note* or similar Guidance material, for facilitating negotiated affordable housing supply through the development application and planning scheme amendment processes.

5. BARRIERS FOR RENTERS TRANSITIONING TO HOME OWNERSHIP

In this submission, HIA has already touched on the impact of rising interest rates, dwindling land supply, failures in the planning system and high property taxes impeding affordability. All these factors limit the ability of new home owners to transition from renting to home ownership.

Research commissioned by HIA showed that 85 per cent of renting households aspire to own their own homes, yet only 42 per cent feel they will achieve it.[7]

Home ownership rates in Australia peaked in 1966 at 71 per cent. However, following a decline, first home buyer activity dropped to the lowest level on record in 2011. This was matched with similarly weak activity during 2015 to 2017.

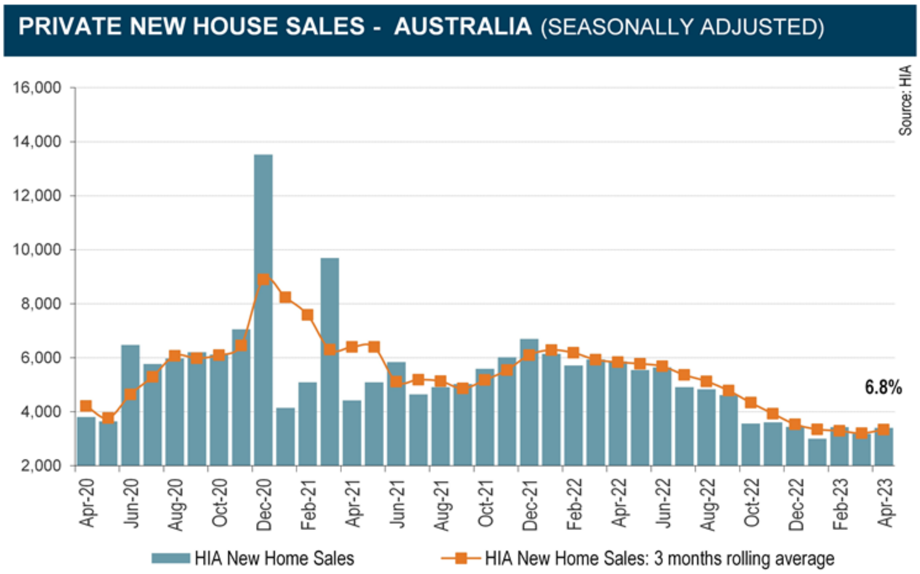
By the time of the pandemic, home ownership rates had dropped to 66 per cent with renters, young and old, not seeing themselves ever realising their home ownership dream.

Governments around the country have responded with a range of fiscal measures to support home buyers enter the market. In addition to the Commonwealth HomeBuilder scheme, Victoria also adjusted stamp duty concessions and introduced the Homebuyer shared equity scheme to reduce up-front costs for first home buyers.

The majority of these measures aimed to assist buyers overcome the 'deposit-gap' by reducing the time that it takes to save a deposit through cash grants, concessional lending, tax concessions and loan guarantees.

However, the cost of such programs has risen over time which has led to a rationing of support through a tightening of eligibility criteria and caps on the number of participants.

[7] HIA Economics



Source: HIA Economics

Recommendations

HIA calls for governments to:

- Expand the current scheme for first home buyers to co-purchase their home with the Victorian Government.
- Introduce targeted measures to assist non-first home buyers re-entering home ownership, thereby relieving rental market pressure.

6. CONCLUDING COMMENTS

The critical issue for rental and housing affordability is supply. This is a simple and now difficult truth to ignore. This submission summarises some of the key actions that can help to improve the supply of homes and help alleviate the housing affordability crisis we now face.

HIA acknowledges that the Victorian government is working on a housing statement. Public comments by the government indicate that there is strong desire to increase the supply of new homes in established suburbs to achieve a long desired change to the mix between greenfield and infill development. There are sound reasons why population density in established suburbs should be increased but there will be many challenges. Increased housing in established suburbs is also unlikely by itself to be sufficient to achieve the needed increase to housing stock. A wide range of policy changes are required from the government.

In the absence of clear guidance from the government it is not possible to identify whether the policies in the housing statement will make a meaningful difference to the current housing affordability difficulties Victorians face. What is clear is that supply of housing stock needs to respond to consumer demands across all segments and markets.

Any housing statement needs to promote measures that lead to homes being build that Victorians will want to live in. This includes tenants as well as owner occupiers.