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A Report to the New South Wales Federation of Housing Associations

Short Summary

MAKING BETTER ECONOMIC CASES FOR HOUSING POLICIES

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Making Better Economic Cases for Housing Policies: Short Summary

This document summarises a report commissioned by the New South Wales Federation of Housing Associations.

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Thinking Housing for the Economy

This report is prompted by the housing affordability challenge in Sydney and its consequences for the growth and productivity of the metropolitan area.

The first half of the reports lays out ideas, definitions and frameworks to help shape a new, economically informed narrative for metropolitan housing policies.

Housing providers and advocates in Australia have long argued that there needs to be greater provision of good quality homes for lower income households. These 'merit good' arguments have occasionally led to augmented spending. However, the last two decades have seen rising housing needs and homelessness outstrip the provision of adequate, affordable low-income housing. Over the same period governments, when investing to pursue macroeconomic stabilisation aims, have increasingly favoured infrastructure over housing as it is argued to create future productivity benefits to the economy.

This report recognises the merits of the traditional social investment arguments for housing, but its concern is different. The report argues for a new narrative for housing policy discussions that considers housing arrangements that will best sustain metropolitan economic development for the long term. Housing outcomes, including house price and rent levels, have a range of unrecognised and unmeasured effects on the economy, so that supporting housing policies is about more than social justice.

The need for an economic perspective on housing outcomes in Australian cities has never been greater. The growth of metropolitan economies in Australia has been a major competitive success story, and larger cities have had productivity performances above national averages. Sydney and Melbourne have become renowned world cities, not just for their scale and high quality urban outcomes. Global city reviews by commercial real estate experts consistently show Australia's two leading metropolitan areas are successful because they are home to growing skilled labour forces, and are strong innovative places for the start-up of new firms and new ideas. The same global city reviews and rankings have also indicated, for a decade and more, that the rising real costs of housing detract from the high rankings of these cities as places to start new lives, new businesses, new ideas and educational careers. Major businesses in Sydney increasingly share that view, and there is increasing anecdotal evidence of firms and skilled labour leaving Sydney for more affordable places to live and work (as has already begun to happen in New York, San Francisco, Vancouver, London, Auckland and other cities). There are growing concerns in these cities that past productivity premiums vis-a-vis national averages are now falling. These observations need a stronger evidence base, but there is a prima facie case that housing outcomes are damaging the growth potential of the metropolitan economy.

There is, in contrast, a strong evidence base on the extent to which housing payment burdens have risen in Sydney, and a growing recognition of housing affordability difficulties for a large share of the population, across much of the income distribution. This difficulty is manifested not just in rising real housing payments, with potentially important implications for consumption and saving in the economy, but in a later start to independent living for the young, and reduced rates of home ownership for the under 40's. These difficulties are not new. The patterns have been developing for two decades, but their corrosive effect on the economy has only been recognised as the problems have become acute.

In recognising these difficulties, earlier this year the Federal Treasurer, the Hon Scott Morrison, remarked that Australia would not solve these issues by 'doing business as usual'. The state governments in New South Wales and Victoria have also recognised the need to act in relation to the current difficulties. The housing provider sector now needs to do its strategic thinking differently, to build economic concerns into its policy arguments. This report confirms the sector has begun to embrace a wider system view of its roles and impacts. Governments also need to think differently about metropolitan housing systems and how they shape growth and productivity. There is merit in seeing housing as an essential economic infrastructure and not simply a social policy concern. Over the last two decades housing policy interests at federal and state levels have contracted from a near system-wide perspective to a social welfare policy focus on the very poor and homeless. However, productivity gains from urban growth processes do not accrue automatically to firms and places. They require gains to be managed in relation to supply side and other constraints. A social welfare definition of housing policy is too narrow a basis on which to govern metropolitan areas for growth. Whole of housing market strategies are required.

The organisation of government within NSW and Victoria is not well designed to manage the housing market and allocate bureaucratic and Ministerial responsibilities to deal with housing market pressures. A similar policy gap exists at the Federal level. World class cities need good governance to remain at the leading edge for the long term. In the governance interface between housing and the economy, the absence of a whole of housing system portfolio is exacerbated by Finance Ministry evidence bases and housing sector modelling capabilities that have limitations. If the housing provider sector wants to develop an economic narrative, then government must be ready to listen with an informed ear that reveals an awareness of how housing markets really work, and not just the theoretical principles of microeconomics. Both new stories and new understandings are needed to create economic policy narratives for housing.

Looking for Housing Effects in the Economy

The second half of the report identifies ways in which links between housing and the economy can be explored, starting with the perspective of housing as infrastructure and the need to analyse systems, identify problems and model and deliver investment packages jointly with transport. It notes that housing as an activity (planning, building, selling, etc.) has important impacts on aggregate demand and multiplier effects (and these are well known and readily measured). Housing as a physical structure, location, neighbourhood and capital asset also has multiple characteristics that have a wide range of effects on households' behaviour. These behaviours impact productivity indirectly, by having effects on human capital, business investment and innovation. It is important to identify and, wherever possible, estimate these effects to improve the understanding of the economic rationales for housing policy interventions.

A key finding from the research interviews with housing providers and government officials is that housing is an area of analysis in government that is at times supported by subjective and sometimes overly simplistic theoretical thinking. Instead, it requires an evidenced based approach that takes into account the real operational complexities of the housing system and its strong connections to other metropolitan systems.

The report provides a brief description of the major changes in the Sydney housing market 2006-2016. Using a framework that classified different types of housing effects (physical, locational, neighbourhood, price etc.) the report reviews a wide range of evidence to identify the likely effects of housing outcomes on productivity. The key channels of effects from housing to the Sydney economy are:

1. Multiple influences on economic productivity through negative impacts on quality and accessibility of human capital (workforce)

i. General proximity of affordable housing for workers to jobs – partly the flipside of travel time and congestion costs, but also understanding that commutes longer than 30 minutes deter many important worker groups from reaching their full economic capacity in a metropolitan city (i.e. they take a lesser skilled job closer to home, work in a smaller centre in the city with lower agglomeration economies, or leave the city all together).

ii. Diversity/density of low income workers closer to city centres (relevant labour market thickness) for large businesses is not satisfied.

iii. Skilled workers for high innovation and knowledge based work (the most regionally and internationally mobile workers) dislike long commutes. They are often in the 25-39 year age group and report lack of quality and variety in rental housing close to workplaces.

iv. Workers for 24-hour industries (entertainment and tourism etc.) with a long commute - in an 18-hour public transit system this is a problem.

v. Key human and justice service industries with long shifts or fragmented work patterns (nursing, care workers, police etc.) are problematic.

vi. Needs of family worker households with local travel needs (child care etc.) are not satisfied – mainly reduces female workforce participation.

vii. Poor and unstable living arrangements for children, leading to attenuated learning and impaired future human capital formation.

viii. Growing concentrations of the poor, reflecting housing market opportunities, in relatively remote low-income suburbs, with education and work entry for teenagers negatively affected by peer group behaviours that reduce future labour productivity.

ix. Poor quality and badly heated/cooled housing has significant effects on worker health and absenteeism.

2. Effects of price and rent outcomes on consumption, savings and investment

i. Distorted investment capital decisions towards lower productivity construction industries from higher productivity industries when there is a sustained housing boom (the construction industry has relatively low productivity).

ii. If housing takes on a preferred investment asset status (including through the effects of subsidies and tax expenditures), either on the part of home-owners or landlords, prevalent supply inelasticities may mean that prices rise more than output. This locks up investment capital that adds nothing to growth and productivity but adds to scarcity rents and 'rentier' returns, and constitutes a major distortion in the functioning of the economy that has both federal and state implications.

iii. There is growing evidence that rising housing wealth results in increased consumption, and this is likely to be pro-cyclical spending that raises the amplitude of metropolitan economic cycles. This will increase instability and reduce productivity.

iv. There is likely to be a much more significant, and negative, effect on consumption when rising housing costs capture a disproportionate share of disposable household income. Consumption will be reduced in sectors that have productivity higher than housing construction, and investment in existing stock it is likely to lead to a significant net reduction in consumption and productivity.

v. Rising house prices have seen a growing number of older entrants to home-ownership (men divorcing in their 50's, for instance) work well past average retirement ages. This adds to productivity if workers would otherwise retire from the labour force.

vi. At smaller scales, housing size and amenity have important roles in shaping the formation of new home-based businesses, and net housing wealth can play key roles in financing the expansion of existing small businesses.

3. Other Key and Spatial Influences

i. There is research evidence that rising housing costs and flat income growth is producing increasingly income segregated neighbourhoods, with remoter locations often being the poorest. It is likely that the location and mix of these peripheral places will be problematic in periods of economic downturn, and that more mixed neighbourhoods (depending on their scale, location and degree of mix) might generate a lower cost to the public sector in the long term and produce a more cohesive city. It is also likely that both unstable housing arrangements and increased low income segregation will reduce labour force participation.

ii. Evidence indicates that concentration of lower socio-economic groups leads to higher financial costs to provide government health and justice services.

iii. Increased residential densities may contribute to productivity growth by facilitating increased employment densities without disproportionate travel cost. Some of the gains claimed from transport policies arise through increased residential densities.

iv. There are several areas in which the strong substitution relationship between housing and transport costs in metropolitan markets means that housing and transport modelling and investment decisions need to be taken simultaneously. Affordability measures should include both housing and transport costs, and transport and housing effects of investment need to be modelled simultaneously. Housing is a key mechanism for realising land value gains from transport investment.

v. When housing and land prices rise persistently there is a strong case for inclusionary zoning to play a much-enhanced role in affordable housing provision. Municipalities in central Sydney understand they could deliver a significant programme from such sources. Extracting 'scarcity rents' from land and property owners is a much more efficient form of 'tax' than the wide tax mix the state would have to use to subsidise affordable housing.

vi. The widespread under-occupation of family housing by small, elderly households frustrates the efficient use existing housing stock and the productivity of the housing system and economy. Incentive-led policies to address this need more consideration.

Supplying Answers

Further progress in firming up an economic narrative for housing policy debates and decisions in Sydney requires a serious commitment to modelling the kinds of effects noted above. Existing CGE models can be applied to some but not all of these questions, to test the scale of particular effects. That work needs to be done, disseminated and discussed.

With strong growth in the future there will be sustained price pressures in the Sydney market. Pressures and price gains will not go away. But they do not have to run at 20 percent in a year, nor result in static supplies of affordable housing. The State could choose to manage the housing system differently and strategically support significant new supply development in a pro-active fashion. This means managing the market to meet metropolitan economic goals more effectively, rather than waiting for it solve serious shortages in short periods of time. Meanwhile there are signs in global cities overseas that the housing difficulties of 25-40-year-old households are now forcing policy rethinks at a fast pace. Housing policies that prevailed over the last quarter century no longer meet metropolitan economic challenges. A new policy narrative, with the economic effects central to housing decisions, is needed now.

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