Submission on NSW Productivity Commission report 'Kickstarting the productivity conversation', October 2019

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1. City Futures Research Centre (CFRC)

Established in 2005 and headed by Professor Bill Randolph, CFRC is Australia's leading urban policy research centre. Spanning the interrelated areas of metropolitan planning, housing, urban analytics and liveability, our work aims to advance understanding of how Australia's cities both shape and are shaped by social, environmental and economic change. The Centre's pre-eminent position in the Australian urban research field was officially reconfirmed in the 2018 national university research assessment exercise, the ERA. Together with Faculty colleagues, CFRC was once again rated as Level 5 – well above world standard – in the urban and regional planning field.

Reflecting our acknowledged urban policy expertise, CFRC staff members are often consulted by policymakers, by private developers and by not-for-profit organisations in Sydney, elsewhere in Australia, and internationally. Our work is also regularly cited in local and national media.

CFRC works closely with several other UNSW research groups as well as with other universities in Australia and leading international research centres in Asia and Europe. The applied focus of our research also involves strong partnerships with local, state and federal government agencies as well as industry stakeholders and community groups.

CFRC has been at the forefront of Australian, indeed global, research to establish housing as essential economic infrastructure and to begin to identify the productivity effects of key housing outcomes such as quality, cost, location and neighbourhood context on key metropolitan growth drivers including human capital, business formation/ survival and innovation (Maclennan et al 2018).

2. Housing system issues and economic productivity: comments on the report

CFRC welcomes the NSW Productivity Commission's report, and especially its inclusion of a chapter on planning and housing. We concur that the Commission's report appropriately identifies several housing system issues with wider productivity implications. As noted on p120, for example, the expanding number of families accommodated in insecure private rental housing is exposing more and more children to the risk of disrupted education, thereby impacting on educational performance and diminishing human capital formation. This builds on the discussion at p111 where it is strongly implied that government should act to enhance tenant security by reforming rental laws and/or by restructuring the rental market in favour of institutionally-funded housing where long term returns (rather than short term capital gains) are the prime investor priority.

We would concur with the implication of the first question posed at p121 – there is a case for levelling the playing field for different housing investor types. CFRC development feasibility analysis (Pawson et al 2019) suggests that an emergent BtR sector is unlikely to flourish under current tax settings. Nevertheless, as they relate to the potential productivity benefits of better educational outcomes for young people, the economic gains that could result from BtR provision will be realised only over the long term.

More broadly, Chapter 8 of the report wisely acknowledges the growing impact of agglomeration dis-economies which, in the absence of stronger government leadership, threaten to outweigh the productivity benefits accruing from Sydney's ongoing expansion. However, it is not just a case of Sydney becoming generally 'more congested and less liveable'. As demonstrated by a long-established stream of CFRC research, it is also a matter of the way that housing market sorting processes are increasingly pushing low income working households – one of the least mobile population cohorts – into the least accessible suburbs, far from the epicentres of job growth (Randolph & Tice 2014; Pawson & Herath 2015) and the as yet under-appreciated impacts on metropolitan productivity (Maclennan et al , 2019)

In recognition of the economic as well as social costs that result from these trends, government must take active steps to (a) protect such little affordable housing as remains in well-located places, and (b) engineer the expansion of affordable housing in such locations. A key lever at government's disposal but as yet hardly tried in Australia is to embed affordable provision within market housing projects through effective inclusionary zoning. Mandating the development of sub-market housing through landuse planning powers in this way is effectively sourcing required subsidy from land value uplift, the proceeds of which otherwise accrue to landowners. Government needs to clear the barriers that have, until now, prevented the realisation of the inclusionary zoning framework originally proposed by the Greater Sydney Commission in 2016 but which – more than three years later – remains undelivered.

Beyond this, the increasing exclusion of middle and low-income workers from well-located suburbs impairs Sydney's economic productivity to such an extent that more substantial government action is warranted. Demonstrating the case for such intervention, a CFRC exploratory modelling study has quantified the productivity benefits accruing from better labour market matching processes and saved travel time gains through the construction of 125,000 affordable rental homes in neighbourhoods well-located with respect to employment (Maclennan et al 2019). Modelled over 40 years, and factoring in necessary capital subsidy ($7.8 billion), the NSW economy would enjoy a net gain of some $12 billion.

3. Housing system issues and economic productivity: Beyond the NSW PC report

At the time of the NSW Commission's establishment we were encouraged by the media interpretation that the new agency was to be 'charged with tackling some of the state's most pressing challenges including the recent deterioration in housing affordability and cost-of-living pressures' (Wade 2018). A focus on the negative productivity consequences of over-expensive house prices and rents would be in tune with the growing anxieties about Sydney's unaffordable housing as voiced not only by poverty lobbyists but also business leaders and financial regulators.

Bearing this in mind, it is surprising and somewhat disappointing that economic productivity concerns linked with housing (un)affordability and associated issues are barely mentioned in the report. In our view, this is an aspect of housing system under-performance the Commission cannot ignore. In CFRC research led by Honorary Visiting Professor Duncan Maclennan, we have recently highlighted aspects of housing system performance that damage economic productivity through price and rent effects on consumption, savings and investment. Citing the relevant report (Maclennan et al 2018), associated concerns include:

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 (that arise from the inherent nature of housebuilding, a range of market factors and infrastructure spending programmes as well as planning constraints) 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 (by re-mortgaging for investment property purchase, for example), 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 50s, 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.

A study to quantify the productivity consequences of excessive housing costs forms one project within a program of housing and productivity research that CFRC is currently formulating in collaboration with the Community Housing Industry Association (CHIA). We would be delighted to have the opportunity to discuss the program with NSW Productivity Commission colleagues. We attach the two reports referred to above (Maclennan et al 2018; 2019a) with this submission for information. We are also currently preparing a forward programme of key housing-productivity research questions for co-production with housing and infrastructure sector providers (Maclennan and Randolph 2019) that can be provided for the Commission's interest upon request.

References

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