Treasury

September 2021

Inquiry into housing affordability and supply in Australia

NSW Productivity Commission submission

Introduction

The NSW Productivity Commission welcomes the opportunity to make this submission to the Commonwealth Parliamentary Inquiry into housing affordability. This submission responds to the Inquiry's Terms of Reference.

The Commission recognises the challenge of improving housing affordability is not unique to New South Wales. The Inquiry is well placed to encourage adoption of reform initiatives across Australia.

Options are available to the Commonwealth to incentivise state and local government to undertake reform that would increase housing supply and ensure better use of the existing stock. These include:

- Removing financial impediments to states undertaking productivity-enhancing taxation reform that would unlock existing housing capacity
- Provide financial incentives for both state and local government to deliver increased housing supply, recognising housing is an interconnected, national market.

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The Commission outlines the following recommendations for consideration by the Panel as part of its Inquiry (as outlined in Section 3 of this submission).

Recommendation 1: The Commonwealth should remove disincentives for states to remove stamp duty from grants distribution methodologies.

Recommendation 2: The Commonwealth should establish a 'Productivity Fund' to incentivise state-based reform, including fiscal support to phasing out property-based transaction taxes.

Recommendation 3: First home buyer concessions should be reformed.

Recommendation 4: Commonwealth grants to local government should incentivise housing supply.

Recommendation 5: Other states should consider adopting New South Wales' principles-based approach to developer contributions.

1. Housing affordability and supply

Defining housing and 'housing affordability'

Housing has been a topical issue in Australia for many years now. Housing is essential to a basic living standard for all Australian residents. On the importance of housing, there is a broad community consensus. There is also a consensus that governments have a responsibility to ensure housing costs do not rise excessively out of proportion to incomes.

Beyond that, the consensus is limited. Broad agreement on the right response, or package of responses, is evasive. In part, this arises because of differences in the fundamental drivers of unaffordability. Kendall and Tulip (2018), for example, estimate a 'zoning premium' of $498,000 for the average Sydney detached dwelling, thereby attributing fault to an overly restrictive planning system.[1] This replicated Glaeser and Gyourko (2003), a study on zoning impacts in New York City.[2] Critics of the zoning explanation—for example, Murray (2020)—cite demand-side factors as the root cause.[3] These include preferential tax treatment for owner-occupied housing and extraordinary stimulatory measures taken by central banks since the 2008 financial crisis that have fuelled a housing 'bubble'.

This submission does not side wholly with either of these camps. Rather, a better understanding is needed of the nature of housing and the affordability concept in identifying solutions.

Housing is both an asset and a consumption item

Housing is unique insofar as it is both an asset and a consumption item. As an asset, it is a significant store of Australians' wealth. The Australian Bureau of Statistics (ABS) find as of March 2021, Australian residents have $8.3 trillion in wealth stored in housing, both as owner-occupiers and as investors.[4] Housing is the largest single category in the capital stock of the Australian economy.

But housing also provides essential accommodation services for all human beings. Alongside nutrition and physical and mental health, fewer things are more fundamental to our living standards. This role of housing is the starting point for its concern as a public policy issue.

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[1] Kendall, R. and P. Tulip (2018) *The effect of zoning on housing prices.* Reserve Bank of Australia Research Discussion Paper 2018-03.
[2] Glaeser E.L and J. Gyourko (2003) *The impact of building restrictions on housing affordability.* Federal Reserve Bank of New York Economic Policy Review. June 2003.
[3] See Murray, C.K (2020) *The Australian housing supply myth.* Australian Planner, 57(1). See also Murray, C.K. (2020) *Marginal and average prices of land lots should not be equal: A critique of Glaeser and Gyourko's method for identifying residential price effects of town planning regulations.* Environment and Planning A: Economy and Space, 53(1).
[4] Australian Bureau of Statistics (2021) *Australian National Accounts: Finance and Wealth. March 2021.* https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-finance-and-wealth/latest-release

In short, housing is a stock that provides the community with a flow of residential services. Even for owner-occupiers, this distinction is useful. Owners are asset holders that provide themselves with residential services. In exchange, they pay themselves 'implicit' rents in opportunity cost—the forgone revenue from leasing their properties on the market.

This discussion may seem the realm of economics textbooks. But the two roles of housing need to be carefully defined as we approach the affordability issue. This Inquiry's Terms of Reference focus on the impact of supply and tax policy on affordability. Only by isolating the demand side of the market can we estimate the affordability benefits of increased supply.

Rents are determined by demand and supply of housing services

As for any market, the market for residential tenancies has a demand and a supply side.

Demand determinants include both demographic and macroeconomic factors. Demographic factors encompass population growth both through fertility and net migration (overseas, interstate, and regional). Macroeconomic factors encompass employment growth and rising per capita incomes—more people in the local economy with more money to spend. This is amplified by people wanting better homes in good locations close to jobs, social networks, and environmental amenities.

Reduced population growth because of international border closures to manage the COVID-19 pandemic has seen a temporary easing of demand for housing services. Residential rents have fallen as a result. By contrast, monetary and fiscal stimulus has maintained strong demand for housing assets, and this has resulted in strong growth in dwelling prices.

But as vaccinations increase and migration restrictions are lifted, population growth will resume, unleashing increased demand onto the housing market. Rents are likely to resume their upward trend. The impact on dwelling prices will be determined by the relative strength of resumed growth to the strength of stimulatory measures, to the extend they remain or are reduced.

In the 13 years to 2005, net additions to the NSW housing stock increased by 39,000 per year, on average. But a slump in building activity between 2006 to 2013, however, saw this average fall to around 26,000 new dwellings per year.

The surge in housing construction from 2014 allowed this 'backlog' to be whittled down—but not eliminated. Housing supply increased by 54,000 per year on average between 2014 and 2020. The 2016 NSW Intergenerational Report initially reported an accumulated shortage of 100,000 dwellings.[5] By 2020, undersupply was down to an estimated 54,000 dwellings, as estimated in the NSW Productivity Commission's White Paper.[6]

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[5] NSW Treasury (2016) *Budget Paper No. 5 Intergenerational Report.* https://www.treasury.nsw.gov.au/sites/default/files/2017-01/Budget_Paper_5_-_Intergenerational_Report_2016_-_full_report.pdf
[6] NSW Productivity Commission (2021) *White Paper 2021: Rebooting the economy.*

Growth in residential rents demonstrates the impact of constrained supply

Emergence of the housing backlog from 2006 was quickly followed by material increases in cost-of-living pressures. From about 2007, residential rents began to outstrip the price of other consumer goods, peaking at the end of 2017-18. In the June quarter 2018, rents in Sydney were, roundly, 68 per cent higher than in 2005, compared to an increase in the Sydney Consumer Price Index (CPI) of, roundly, 38 per cent.[7]

The deterioration in housing affordability is greater when removing 'housing costs' from the Sydney CPI so it fully reflects non-housing consumer items. Removal of the housing component reduces the increase in CPI to around 36 per cent.

In other words, as the housing backlog accumulated between 2005 and 2018, growth in residential rents outstripped that for other consumer items significantly. In real terms—based on this adjusted CPI measure—residential rents in Sydney rose by 24.5 per cent.

Since its peak, this deterioration in housing affordability has been moderated by two impacts:

- a temporary surge in new housing delivered between 2015 and 2020[8]
- COVID-19 border restrictions limiting net migration.

The combination of these factors has moderated the extent to which residential rents have outpaced other consumer prices in Sydney. From the peak of 24.5 per cent, the real increase in rents since 2005 based on the adjusted CPI was 13.1 per cent as of the June quarter 2021.

But as vaccination rates spread, COVID cases are managed, and border restrictions are eased in the near term, rents would be expected to accelerate. That is, *in lieu* of Australian governments taking proactive steps to unlock supply of new dwellings and encourage better use of the existing housing stock. These measures would not only moderate cost of living pressures; they would also stimulate the Australian economy's post-pandemic recovery.

Growth in rents more than other consumer items has also been witnessed in the Melbourne and Brisbane housing markets, but nowhere near the extent of in Sydney (see Figure 1). These comparisons are relevant to policymakers in New South Wales insofar as the three capitals compete for attracting talent.

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[7] Australian Bureau of Statistics (2007) *Housing Occupancy and Costs, Australia, 2005-06. Cat No. 4130.0.55.001.* https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4130.0.55.001Main+Features12005-06?OpenDocument
Australian Bureau of Statistics (2019) *Housing Occupancy and Costs.* https://www.abs.gov.au/statistics/people/housing/housing-occupancy-and-costs/latest-release
Australian Bureau of Statistics (2021) *Consumer Price Index, Australia.* https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release

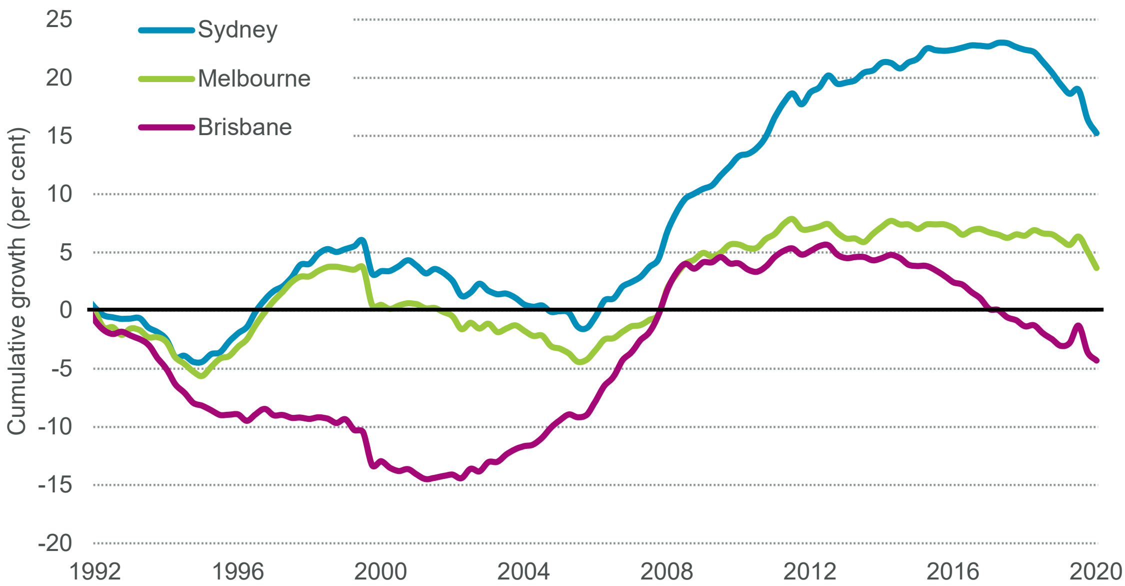
[8] Australian Bureau of Statistics (2021) *Building Activity, Australia. March 2021.* https://www.abs.gov.au/statistics/industry/building-and-construction/building-activity-australia/latest-release

Over the 13 years from 2005, Melbourne residential rents grew 9.2 per cent faster than non-housing goods and services within the Melbourne CPI. In Brisbane, rents had risen slightly greater—12.4 per cent—than non-housing goods within that city's CPI. In other words, the deterioration in housing affordability was observed in all three capital cities, but twice as pronounced in Sydney than in either Brisbane or Melbourne.

As of the June quarter of 2021, the real increase in rents in Brisbane and Melbourne based on each city's adjusted CPI was, respectively, 7.8 per cent and 5.4 per cent. But, like Sydney, the moderation of the housing affordability problem is considered a temporary benefit of COVID restrictions, not a lasting improvement in living standards. That is, without further government action to expand housing supply and unlock better use of existing dwellings, the affordability problem will deteriorate again.

As the pre-2005 data depicted in Figure 1 shows, there is no inevitability for residential rents to systematically outstrip other consumer prices. Higher rents typically impact those at the lower end of the income distribution more and make it harder for aspiring homeowners to save a deposit for their first home.

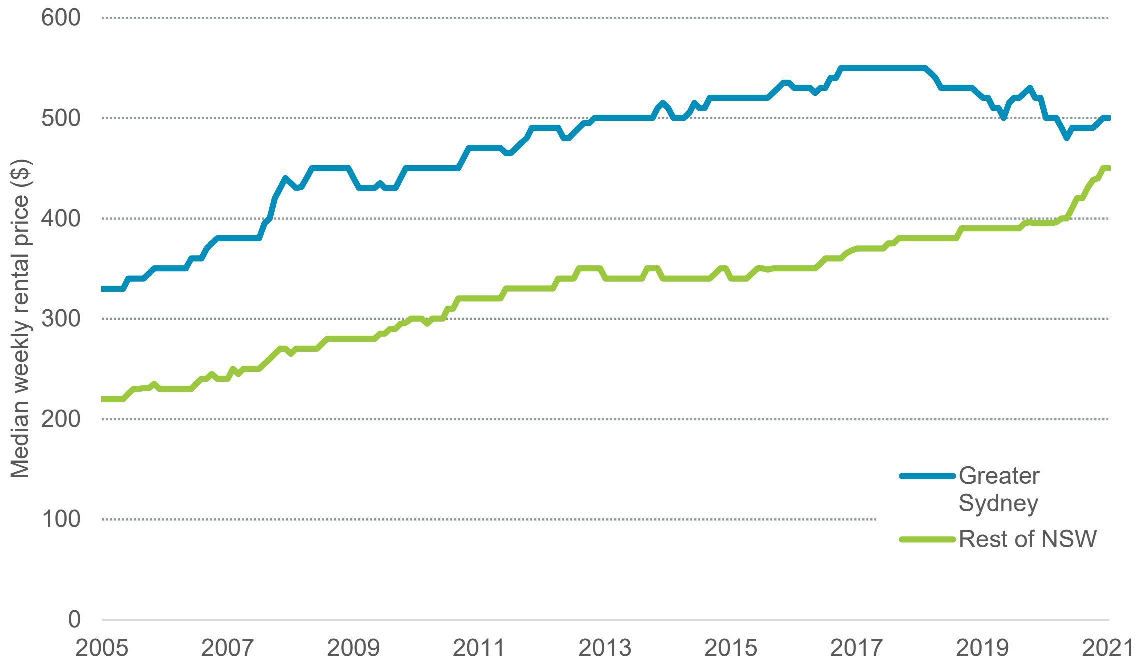
Figure 1: Sydney rents have risen faster than other consumer prices and rents in other capital cities



Note: Deflated by Capital City All Groups CPI
Source: NSW Productivity Commission White Paper (2021), ABS Consumer Price Index.

Median rents in Sydney are typically higher than areas in the rest of New South Wales. Between 2005 and 2017, rents in Sydney were about 50 per cent higher than the rest of the State (see Figure 2). Since 2017, however, the difference has been declining, with rents in Sydney now 13 per cent higher than the median for the remainder of the State.

Figure 2: Rents in Sydney are higher than the rest of NSW, but this difference has narrowed since the pandemic



Source: CoreLogic median rental rate (3 months rolling).

Dwelling prices have also been impacted by a lack of supply

Clearly, the upward trend in real residential rents since the housing backlog emerged in New South Wales in 2005 has been significant. But dwelling prices have grown even more substantially over the same period.

Consideration of housing market condition on dwelling prices needs to be caveated. Rents, not prices, are the more appropriate measure of housing affordability for the definitions given above. That is, rents are the price of housing services, not dwelling prices.

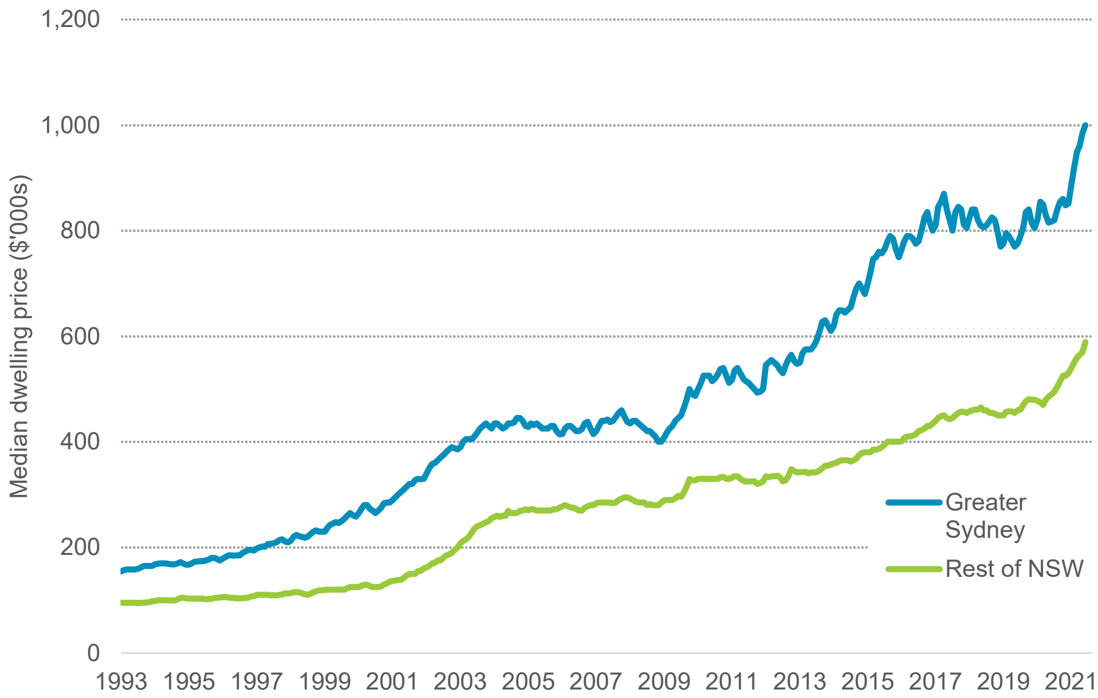
The importance of this distinction is accentuated by the post-2005 housing market conditions. Emergence of the housing backlog was followed within three years of the 2008-09 Global Financial Crisis. In response, the Reserve Bank of Australia, like its overseas counterparts, rapidly dropped the policy interest rate substantially, and it has remained very low since.

This makes it difficult to estimate the extent to which inadequate housing supply has fuelled higher prices, relative to the effects of monetary stimulus and other factors impacting asset prices. Some models have estimated the supply-price link—see, for example, Abelson (2005)—for Australia, but replication of this analysis is beyond the scope of this submission.[9]

[9] Abelson P. and D. Chung (2006) *The Real Story of Housing Prices in Australia from 1970 to 2003.* Macquarie University.

Greater Sydney has experienced strong growth in dwelling prices, especially since 2013. In real terms, prices are more than two and a half times more expensive than they were in 1980, when the median sales price was $65,000. Since July 2021, the median dwelling price in Sydney has exceeded $1 million.

Figure 3: Price growth between Sydney and the rest of New South Wales has diverged since 2012

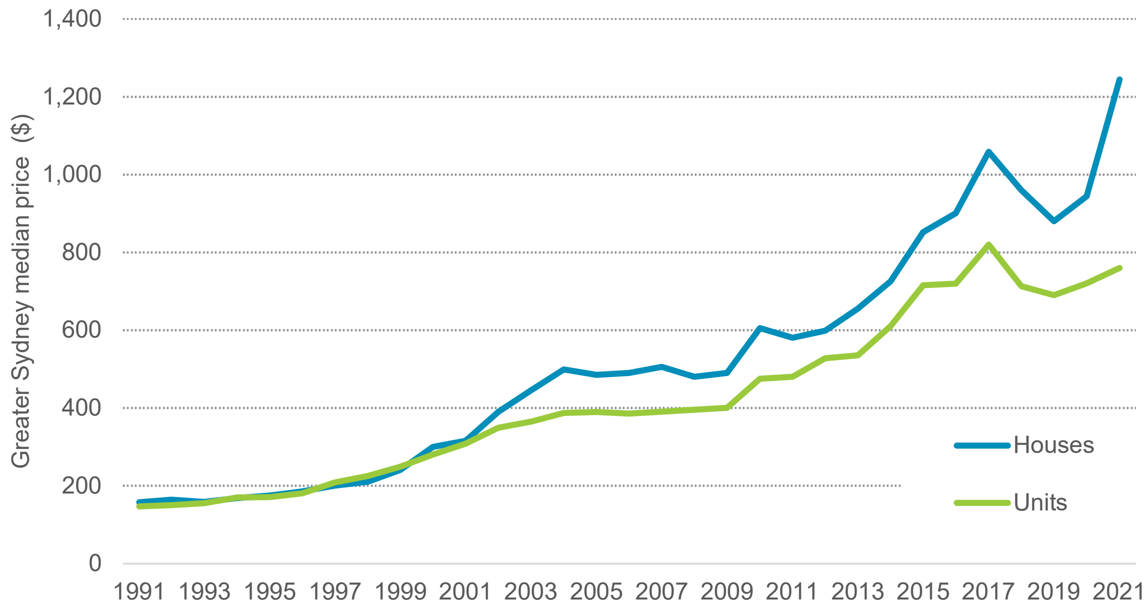


Source: CoreLogic monthly estimated median sales value (3 months rolling).

The median dwelling price in Sydney has always been higher than the rest of New South Wales. Since 2012, however, the gap between the median Sydney dwelling price and the median price for the rest of New South Wales has increased (see Figure 3). The gap is now over 70 per cent, compared to about 50 per cent in 2009.

Detached houses in Sydney have seen the largest increases in price, reflecting the fact that land in Sydney is a constrained input. Since 2001 house prices have risen more sharply than apartment prices, and the median house price in Sydney is now above $1 million (see Figure 4). Between 2017 and 2019, median apartment prices declined, before recovering in 2020 and 2021.

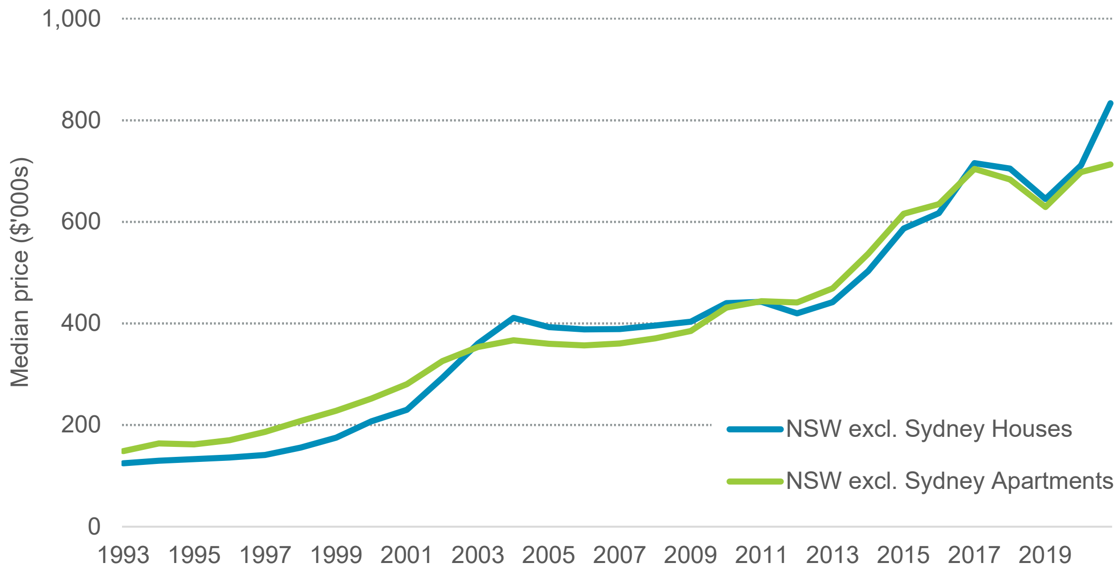
Figure 4: Detached house prices have grown more than apartment prices in recent years.



Note: Data taken from June of each calendar year.
Source: CoreLogic monthly estimated median sales value.

Outside of Sydney, the difference in median house and apartment prices is relatively small. In part, this is due to regional areas having a higher proportion of detached houses compared to apartments. Further, apartments outside of Sydney tend to be concentrated in major centres such as Newcastle and Wollongong and are therefore relatively more expensive. The past two years, however, have seen median house prices outside of Sydney begin to diverge from apartment prices (see Figure 5).

Figure 5: Outside of Sydney, house prices have diverged from apartments since the pandemic



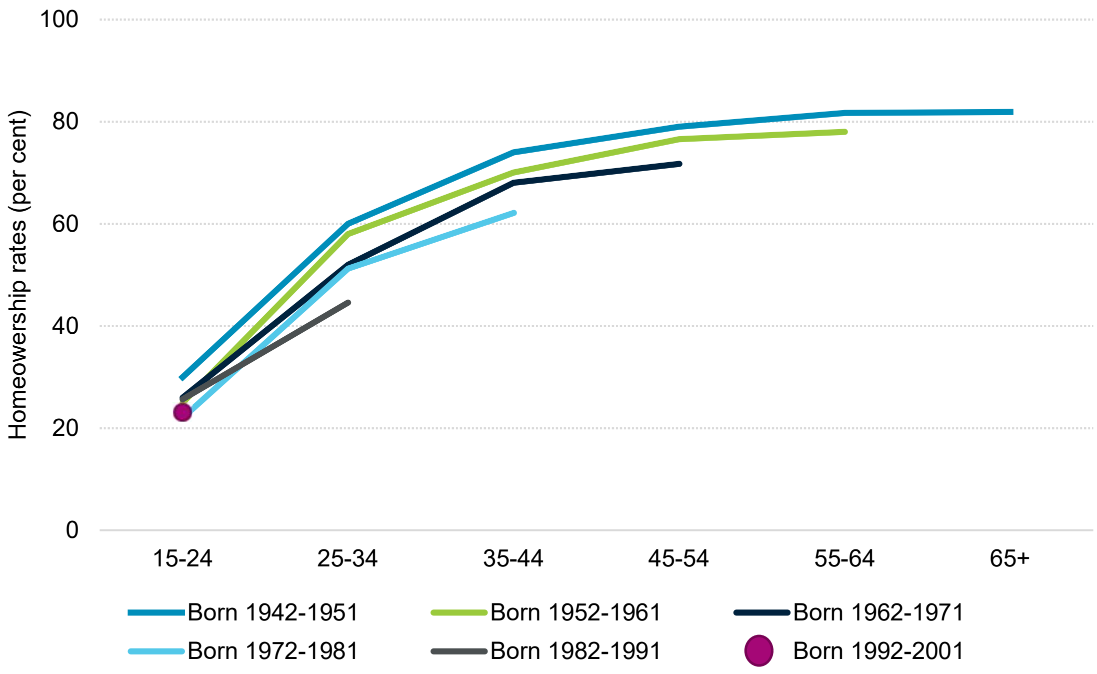
Source: CoreLogic estimated median sales value.

Slow wages growth means that people are spending higher proportions of their income on rents and mortgage repayments over their lifetimes.

How people have responded to declining affordability

As rents and prices rise—and saving for deposit therefore becomes more difficult—each generation faces lower homeownership rates than of those preceding (see Figure 6).

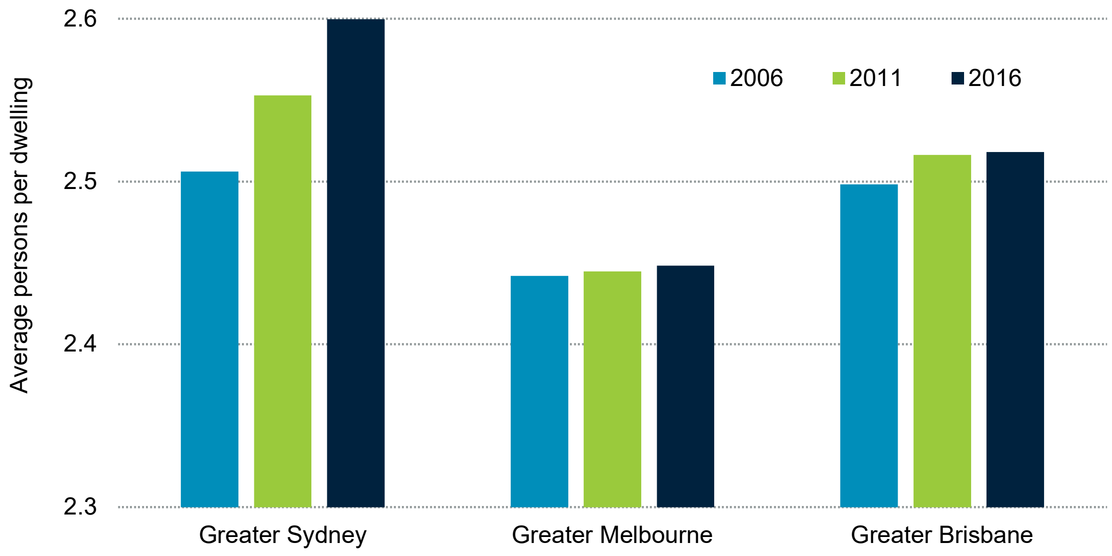
Figure 6: Younger generations are less likely to own a home



Source: 2021-22 NSW Intergenerational Report.

Consequently, people are more likely to live in less preferable arrangements because they are unable to afford their own place. They might delay moving out of (or move back into) their parental homes, postpone starting their own families, and/or share housing with other strangers. Between 2006 and 2016, the average household size in Greater Sydney grew from 2.5 to 2.6. By contrast, the number of persons per dwelling in Melbourne and Brisbane remained steady, despite them experiencing faster population growth (see Figure 7).

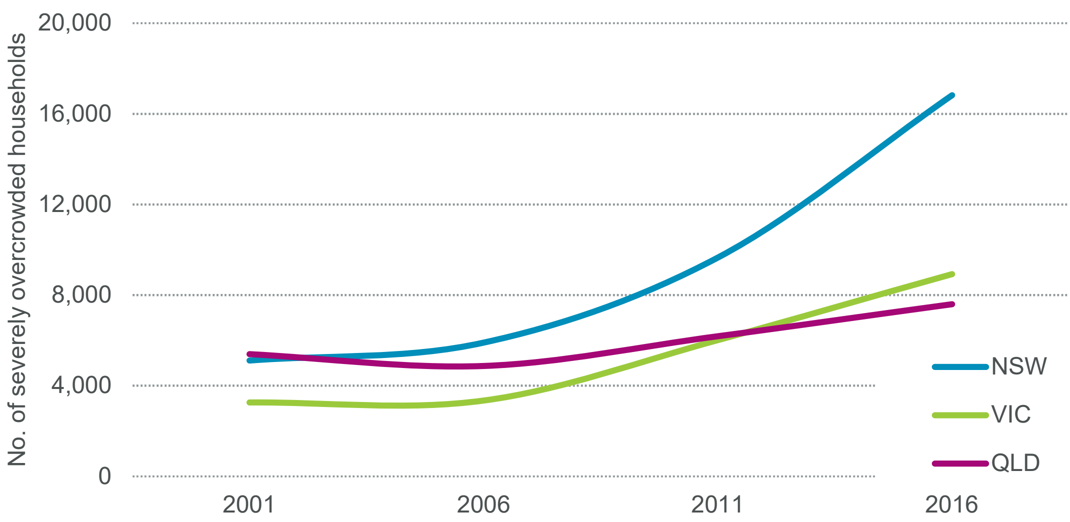
Figure 7: Sydney residents are being squeezed



Source: ABS 2016 Census.

This will continue to worsen severe overcrowding in Sydney compared to other capital cities. Already the number of severely overcrowded dwellings in New South Wales was double that of Victoria and Queensland in 2016 and increasing at a higher rate (see Figure 8).[10]

Figure 8: NSW households are increasingly sacrificing living standards

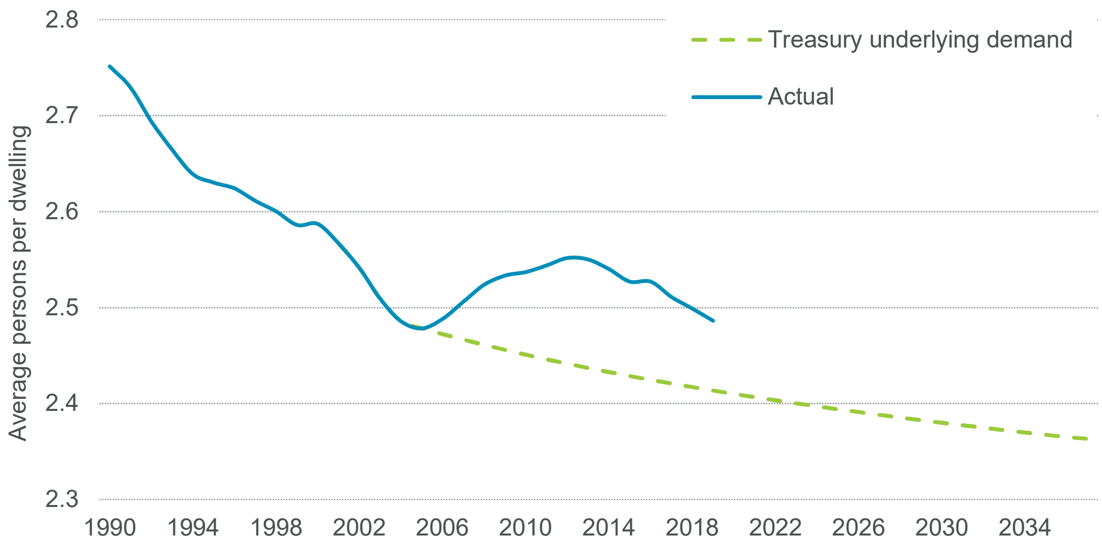


Source: ABS 2016 Census.

[10] A severely overcrowded dwelling is defined as one that requires four or more additional bedrooms to meet the Canadian National Occupancy Standard (a benchmark for how many bedrooms are required for particular living arrangements).

NSW Treasury analysis projected household sizes to decrease from 2006 if housing supply was adequate (see Figure 9). This was derived from long-standing demographic trends continuing (for example, more individuals and couples without children). The sharp increase in household sizes after 2006 indicates a large pent-up demand for housing.

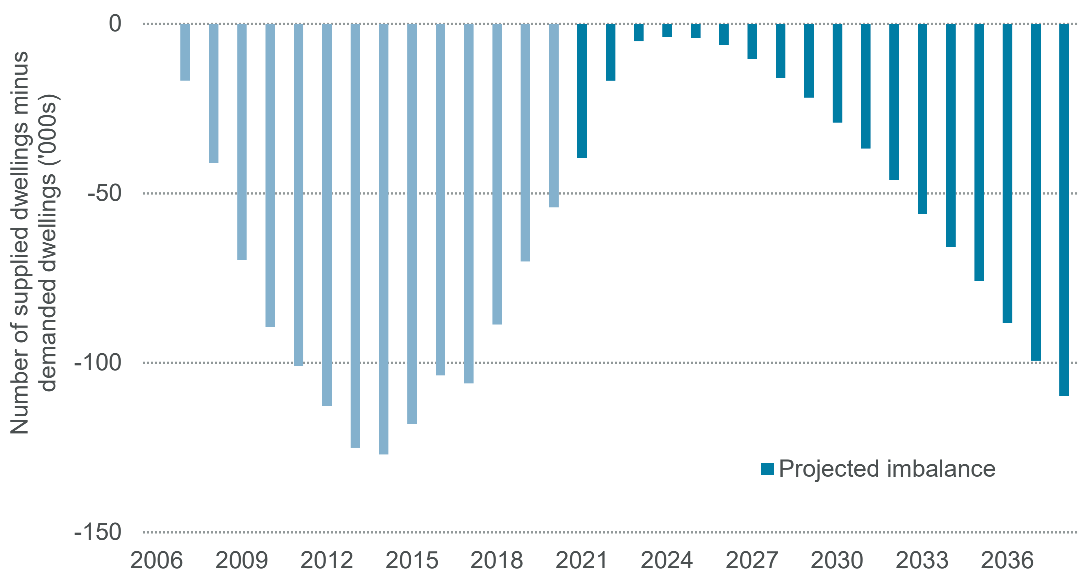
Figure 9: There is strong demand for more housing in NSW



Source: NSW Treasury estimate assuming trends in households' living arrangements had continued.

This housing demand is expected to ease in the short term due to current border closures constraining population growth. However, demand is expected to lift after international travel restrictions are eased. The NSW Productivity Commission has projected that under current arrangements, a substantial 'undersupply' will again develop (Figure 10).

Figure 10: Current policy settings will not meet this housing demand



Source: NSW Productivity Commission 2021 White Paper.

There are clear options to boost housing supply in the right locations

In addition to the evidence that constrained supply leads to higher rents and prices, there is evidence that increasing supply in the right locations can significantly reduce average housing prices further. NSW Treasury found a 50 per cent increase in density in the right locations (i.e. inner Sydney suburbs) would lower rents by 18 per cent. It would also increase household disposable income by about 5 per cent.[11] The significant benefits of increasing density in inner suburbs (as opposed to on the outskirts of the city) demonstrate that households want well-located housing with easy access to well-paid jobs.

The NSW Productivity Commission's 2021 *White Paper, Rebooting the Economy* recommended changing planning controls to enable more housing and business activity within transport service catchments on under-utilised corridors. Identifying spare capacity along existing corridors—particularly rail—in Greater Sydney and increasing density would deliver three benefits:

- reduce average housing costs (as highlighted by NSW Treasury's Technical Research Paper to the 2021 Intergenerational Report)
- shorten commuting times to the Global Economic Corridors and other highly productive centres of economic activity
- maximise the use of existing infrastructure, reducing the need to embark upon new major projects in an increasingly constrained fiscal environment.

The potential for supply to moderate dwelling prices must be kept in context

Action by all levels of government is therefore required to ensure planning regulations and incentives for public sector agencies do not unduly limit housing supply. As discussed below, there is also considerable scope for taxation and expenditure reform to increase supply and ensure best use of the existing housing stock.

Concerted action should ensure cost of living pressures from high residential rents are moderated. As all Australian residents are consumers of housing services, this will generally lift living standards. More supply and better housing utilisation should also put downward pressure on dwelling prices.

Taxation and regulatory reform, therefore, have great potential to moderate the cost of housing, particularly for tenants. Sharper incentives for state and local government through the federation to deliver more housing supply would also help affordability.

More and better allocated housing would also put downward pressure on dwelling prices (or dwelling price growth). But it's important to bear in mind dwellings are subject to asset pricing fundamentals, particularly the monetary policy stance of the Reserve Bank of

[11] NSW Treasury (2021) *Sensitivity analysis on Sydney's urban structure and house prices for the 2021 Intergenerational Report*. 2021 NSW Intergenerational Report Treasury Technical Research Paper Series. TTRP 21-04. January 2021.

Australia (RBA). And the RBA continues its expansionary policy initially adopted in response to the 2008-09 Global Financial Crisis. This has been accentuated by COVID-19 response, which has seen the policy interest rate reduced to its effective lower bound of 0.1 per cent.

2. The impact of Commonwealth, state, and local government taxes, charges, and regulations on housing supply

Transaction taxes impede an efficient allocation of housing supply

All states and territories impose property transaction taxes, the largest being transfer duty (also known as 'stamp duty') on the transfer of real property. Stamp duty is paid by the purchaser of the property on the sale price, which includes land and improvements on the property.

Generally, property transactions generate an increase in economic welfare because property ownership is transferred to people who value it highest. By raising the cost of transacting, stamp duty discourages property transfers, which means dwellings are not necessarily allocated to those that most value them. This economic distortion is particularly inequitable for those whose circumstances require them to move more frequently.[12]

Stamp duty imposes costs on people at all stages of life. For first home buyers, it increases the time required to save the deposit for a first purchase. For people who change their place of employment, households may live further from work or not take up job offers. Growing families that desire to be closer to schools may face significant costs. Older Australians who own their home are less likely to downsize to more suitable housing.

It is estimated that for a full-time worker who earns the NSW average annual earnings and saves 15 per cent of their income, stamp duty adds 2.5 years to the time required to save a deposit of 20 per cent of the average NSW property.[13]

Reduced turnover of existing properties because of stamp duties has been examined in at least 15 empirical studies across global jurisdictions. They have typically found that a 100 basis point increase in stamp duty reduces transaction volumes by about 10 per cent.[14] This has material consequences for affordability by reducing the effective supply of housing and placing upward pressure on prices.

Stamp duty also has implications for property investment, as it taxes the market value of property, including improvements to the land. Investment decisions are based on the post-tax rate of return from the sale of property. Therefore, stamp duty reduces the incentive to

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[12] Malakellis M and Warlters M (2021) *The economic costs of transfer duty: a literature review*, Treasury Technical Research Paper Series, June 2021, p2

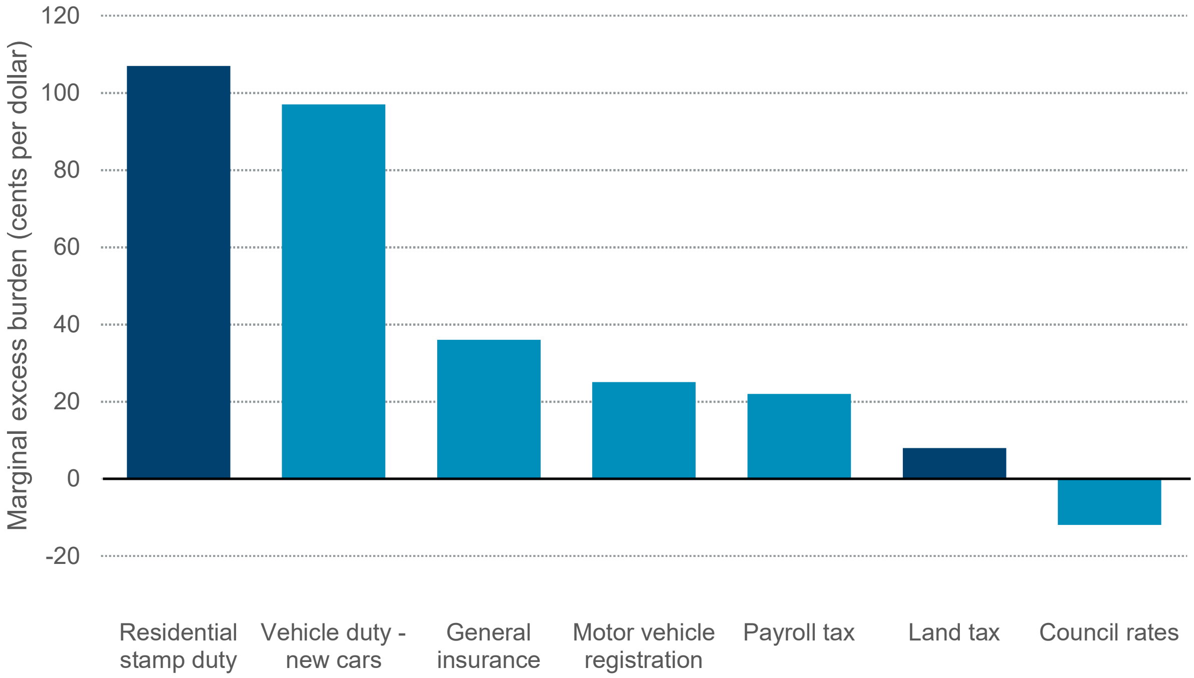
[13] Calculation based on data from CoreLogic, Australian Bureau of Statistics and NSW Treasury.

[14] Malakellis M and Warlters M (2021) *The economic costs of transfer duty: a literature review*, Treasury Technical Research Paper Series, June 2021. p12.

deliver new supply and improve the quality of existing properties. The result is lower quality housing supply and further upward pressure on prices.[15]

Across the State's major revenue sources, stamp duty on property is widely considered the most inefficient tax. That is, it imposes the largest economic cost of all existing taxes (Figure 11). In contrast, a broad-based land tax on the unimproved value of land—such as local government rates—is the most efficient tax available to the states. Switching, therefore, from transfer duty to a broad-based land tax would enhance economic efficiency in the housing market and support a more equitable distribution of the tax burden. It would also provide a stable and sustainable revenue source to fund government services.[16]

Figure 11: Property stamp duty is the most economically inefficient tax imposed by the states and territories



Source: Nassios et al (2019) *The economic impact and efficiency of state and federal taxes in Australia*, Centre of Policy Studies/IMPACT Centre Working Papers, p197.

The NSW Government has proposed a transition from the existing stamp duty and land tax to a broad-based annual property tax based on unimproved land values. The proposal would boost home ownership and help people live where they would most like to. A more efficient allocation of our housing stock will improve affordability. But, as noted in the NSW Productivity Commission's 2021 White Paper, the transition is complex. States and territories will need to consult widely with the community through implementation of this reform.

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[15] Malakellis M and Warlters M (2021) *The economic costs of transfer duty: a literature review*, Treasury Technical Research Paper Series, June 2021 p6.

[16] These include: 2021 NSW Productivity Commission White Paper, 2020 NSW Review of Federal Financial Relations, 2017 Commonwealth Productivity Commission 'Shifting the Dial' Review, 2010 Henry Review (Australia's Future Tax System), 2001 Harvey Report (Review of State Business Taxes).

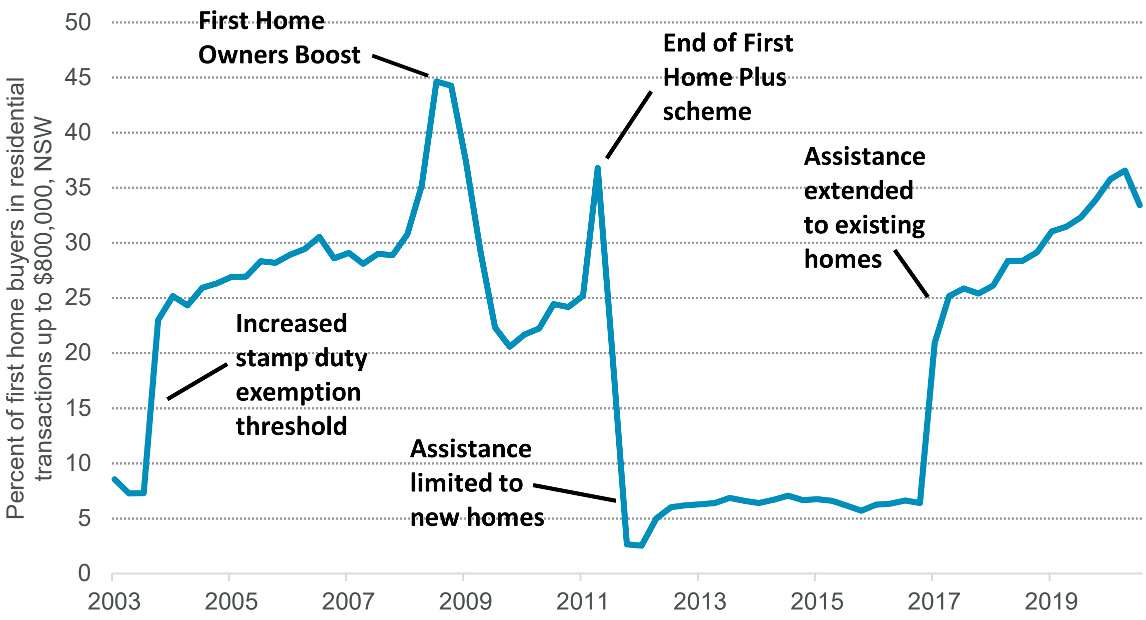
Further details on this reform are included on the NSW Property Tax Reform website: https://www.nsw.gov.au/initiative/property-tax-reform.

First home buyer grants and concessions inflate prices

All Australian jurisdictions provide support to first home buyers. The NSW Government currently provides a stamp duty concession and a lump sum grant, subject to eligibility.[17] In 2020-21, over 48,000 NSW first home buyers were provided with full or partial stamp duty exemptions, at a cost of about $750 million. Over the same period, the grant scheme has supported around 7,700 first home buyers, totalling around $78 million.

These concessions benefit first home buyers by increasing their purchasing power relative to other buyers. After assistance was extended to existing dwellings in June 2017, first home buyers as a share of residential transactions up to $800,000 increased from 6.5 per cent in the June 2016 quarter to 21.2 per cent in the September 2017 quarter (Figure 12).

Figure 12: First home buyer assistance programs have a strong influence on the housing market



Source: NSW Treasury.

The problem with first home buyer assistance is that it can significantly increase housing demand without necessarily increasing supply. Moreover, the incentives bring forward purchases that may have happened anyway, as well as bring people into the market who would not have otherwise been there.[18] Without a commensurate supply response, this places upward pressure on prices and reduces housing affordability.[19]

[17] For information on the NSW first home buyer concessions, see the Revenue NSW website: https://www.revenue.nsw.gov.au/grants-schemes/first-home-buyer.
[18] Grattan Institute (2018) *Housing Affordability – Reimagining the Australian Dream.*
[19] Agarwal et al (2021) 'Who gains from housing market stimulus? Evidence from homeowner grants with threshold prices', draft as of February 26 2021.

Agarwal et al (2021) analysed the impact of home buyer assistance on new homes in Sydney valued up to $600,000 between July 2010 and June 2012.[20] They found the policy distorted the market by encouraging purchases just below the $600,000 threshold. Buyers adjusted their willingness to pay and some new entrants were attracted into to the market. Overall, most of the financial benefit of assistance payments flows to vendors, not buyers.

Inappropriate planning regulations limit supply and reduce affordability

As discussed earlier, an unresponsive planning system imposes significant costs.

The NSW planning system applies an array of regulations to control where and how much new housing can be built. Where market failures exist, there is strong justification for government intervention in regulating housing supply. When applied too prescriptively, beyond the role of addressing market failure, these regulations impose unnecessary costs on development and reduce project feasibility. This reduces supply and affordability.

It is essential, therefore, for planning regulations to be subject to clear evaluation to ensure they deliver net economic benefits to the community. This will ensure, where supply is restricted, there are tangible benefits to the community that outweigh the foregone benefits more housing offers.

3. Commonwealth, state, and local government reform to improve affordability

Recommendation 1: The Commonwealth should remove disincentives for states to remove stamp duty from grants distribution methodologies

A substantive barrier to states pursuing tax reform is the horizontal fiscal equalisation system administered by the Commonwealth Grants Commission (CGC). The current methodology for distribution of Goods and Services Tax (GST) revenue among states aims of offset differences in revenue-raising capacity and varying costs of delivering services. An unintended consequence, however, is that it also disadvantages states that undertake productivity-enhancing tax reform.

The Commonwealth Productivity Commission found any state that replaced stamp duty with a broad-based land tax would lose GST revenue.[21] This finding is supported by NSW Treasury analysis, which estimates a loss of up to $1 billion in GST distribution per year were the NSW Government to proceed with its proposed tax reform under current arrangements.

In 2021, the CGC's Occasional Paper No. 2 acknowledged state-initiated tax reform can negatively affect grants distribution outcomes. It identified the need to address material impacts on GST relativities of states through its assessment methods. The NSW Government has engaged with the Council on Federal Financial Relations and continues to

[20] Ibid.
[21] Commonwealth Productivity Commission (2018) *Review of Horizontal Fiscal Equalisation* (May 2018), p13-14 and NSW Treasury (2020) *NSW Review of Federal Financial Relations Final Report* (August 2020) p54.

work with Commonwealth Treasury to address this issue. It is hoped productive engagement will provide upfront surety to the NSW Government when deciding whether to pursue its proposed property tax reform.

Recommendation 2: The Commonwealth should establish a 'Productivity Fund' to incentivise state-based reform

The cost of housing is affected by a wide range of tax and regulatory arrangements across all levels of government. There is great potential for reform efforts to be coordinated and incentivised. NSW Treasury has previously advocated the Commonwealth establish a 'Productivity Fund'. This would provide financial inducements for the states to undertake taxation and regulatory reform that will improve development feasibility and encourage up-zoning of land. This could include financial support for the states to phase out stamp duty.

Such a system could be considered a 'payoff' for benefits of state-based reform that are shared across levels of government. Higher economic output and productivity would strengthen the Commonwealth finances in the medium term. This would be received through higher income and company tax receipts while containing the need for welfare outlays. Eligibility for payments could be based on reforms identified by the Commonwealth Productivity Commission in its five-yearly Shifting the Dial report.

Recommendation 3: First home buyer concessions should be reformed

Consideration should be given to reforming first home buyer concessions to reduce and/or eliminate their unintended consequence for housing affordability. One option for reforming existing first home buyer concessions provided to all purchases of new and existing homes would be to limit their application to newly constructed dwellings. This may in part offset the impact that the concessions have on increasing house prices by stimulating the construction of new dwellings. To ensure genuine additional supply is created, the measures would need to be accompanied by measures to ease overall supply constraints.

Recommendation 4: Commonwealth grants to local government should incentivise housing supply

In May 2021, the NSW Productivity Commission released its White Paper *Rebooting the Economy*. Among its 60 recommendations were for development of housing supply targets in the right locations that were:

- **transparent** and **evidence-based**
- sufficiently **forward looking** to help communities plan for growth and facilitate planning for supporting infrastructure delivery
- supported by **strong governance** and **accountability** for its delivery.

Recommendations to improve NSW housing supply policy include[22]:

[22] See Recommendation 7.1 in the NSW Productivity Commission's 2021 White Paper for more information.

- better monitoring and reporting on unmet demand and capacity for growth
- establishing a housing supply council to advise on housing targets
- identifying and reporting on 5-, 10-, and 20-year targets by local government area
- incentivising local governments on the delivery of approved housing targets.

In 2021-22, the Commonwealth Government will provide $2.7 billion in financial assistance grants to local government through the states, including $835 million to NSW councils.[23] Significant economic and fiscal benefits could accrue to all levels of government were these grants contingent on the delivery of new housing supply. Rigorous monitoring and reporting against progress should accompany these incentives.

Recommendation 5: Other states should consider adopting New South Wales' principles-based approach to developer contributions

In March 2021, the NSW Government accepted all 29 recommendations of the NSW Productivity Commissioner's review of the infrastructure contributions system (the Review).[24] The Review was in response to the NSW Government's commitment to fixing the uncertainty of developer contributions to boost investment in the State. The package of reforms aims to deliver a system that is defined by the following principles:

- **certain** and predictable application of contributions
- **cost reflective** market signals to guide efficient development
- **simple** to understand with minimum administration costs
- **transparent,** open, and accountable collection and expenditure of funds
- **consistent** contributions based on the impactor and beneficiary pays principles developed by Commonwealth Productivity Commission.

A principles-based contributions system better supports housing supply and growth by:

- **delivering infrastructure** in a timely and coordinated way
- encouraging **efficient development**
- raising **adequate revenue** to fund growth enabling infrastructure
- building **community confidence** in the planning system.

Central to applying the **impactor and beneficiary pays principles** to infrastructure cost recovery mechanisms were the following:

- *For local infrastructure*, industry should be charged for costs that are contingent on their developments proceeding—**development-contingent** costs—no more, no less. **General costs** arising from population growth and any increase in community expectations for

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[23] Department of Infrastructure, Transport, Regional Development and Communications (2021) *Financial Assistance Grant to Local Government.*
[24] NSW Productivity Commission (2020) *Review of Infrastructure Contributions in New South Wales. Final Report.*

service delivery should be funded by other means. These include local government rates levied on the unimproved value of land, grants from other levels of government, and, where appropriate, user charges.

- *For State infrastructure*, industry should be charged for costs that have a strong relationship to growth—**development-associated** costs. Charges should be applied in multiple ways:
  - broad-based **per dwelling charges** on net additional development
  - additional broad-based per dwelling **charges on development delivered within the service catchments of major transport** investments.
  - cost-reflective **charges for biodiversity impacts**.

Modelling undertaken for the Review found substantial net economic benefits would be delivered by applying these principles. Benefits would come from increased housing supply and value for money services and public spaces.

The Review found **reform of the Local Government Rate Peg**—applied in New South Wales since 1976—was a necessary condition for reform. Other states have adopted rate pegging and should learn the lessons of New South Wales to ensure this policy does not involve unintended consequences.

Further information and contacts

For further information or clarification on issues raised in this submission, please contact:

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