Government of Western Australia

Productivity Commission Inquiry On First Home Ownership

Submission by the Western Australian Government

October 2003

CONTENTS

EXECUTIVE SUMMARY

The total stock of housing in Western Australia is sufficient to meet the underlying demand from both home owners and renters. However, housing markets are complex, and are affected by a variety of factors. Supply and demand conditions can vary between markets in different regions and within sections of a regional housing market. Accordingly, conditions in the Western Australian housing market can and do differ from other parts of Australia.

On balance, housing affordability is not a major issue in Western Australia compared to other States, although the future supply of housing will need to be carefully managed to ensure affordability remains within acceptable bounds.

The Western Australian Government recognises that affordability and accessibility of housing will always be an issue for low income earners and disadvantaged members of the community. Nevertheless, Government assistance through the provision of public housing and rental assistance, which accounts for an important, albeit small proportion of the housing market, plays an important role in ensuring the provision of adequate housing to all Western Australians. This aspect of the housing market warrants close attention in the Commission's considerations.

While affordability for home buyers in Western Australia has declined in recent years, most measures indicate that it remains within historical bounds and that housing is relatively more affordable to buy in Perth than in most other capital cities in Australia. In the rental sector, vacancy rates in Perth are currently at a high level and the median level of rent has fallen in real terms, which has boosted affordability.

The recent decline in affordability for home buyers (including first home buyers) in Western Australia has been driven by rapid growth in house prices. The strength of house price growth has more than counteracted the otherwise beneficial impact on affordability of low interest rates (and low associated mortgage repayments) and relatively strong income growth. Interestingly, it has been suggested that favourable movements in interest rates and income may have been capitalised as higher house prices.

House prices have been increasing in all major urban regions of Australia, and indeed, in many developed countries. When viewed in this broader national and international context, the increase in house prices in Perth and regional areas of Western Australia has been relatively low.

The Western Australian Planning Commission (WAPC) has responsibility for ensuring that an adequate supply of land is available to meet demand for new housing across the state. In fulfilling this role, it works in close consultation with the community, developers, major infrastructure providers and local government.

Over the five years to 2006-07, projected total lot production in the Perth urban region is expected to exceed total lot production in the previous five years by around 26%. In aggregate, the Perth metropolitan area has a residential land bank of about 25-30 years (land currently zoned for residential use in regional and local government planning schemes). There will, however, inevitably be short term periods where a demand spurt may place pressure on the supply of housing in both Perth and regional areas of Western Australia. Furthermore, some regional and remote areas of Western Australia may face relatively high housing costs due to land supply shortages or high costs of construction.

As is the case for other Australian States, the taxation of property is an important component of the narrow range of taxation sources which are available to Western Australia to assist in the funding of essential services in areas such as education, health, law and order and the environment. These taxes include stamp duty on property conveyances and land tax.

While there have been calls from the Commonwealth and the housing industry for the States to reduce stamp duty, States are constrained in their capacity to do this by the narrow nature of their tax base, the strong community demand for enhanced services (especially in health services) and the fact that their share of total taxation revenue (even after incorporating the GST) is projected to decline. This reflects stronger growth in taxation revenue at the Commonwealth level than at the State level. Western Australia's capacity to reduce its reliance on existing property taxes is further restricted by the fiscal equalisation system and the financial disadvantages which this system imposes on Western Australia. Overall, Western Australia's revenue as a share of GSP is projected to decline on current policy settings.

Notwithstanding that stamp duty raises a significant amount of revenue in aggregate, it nevertheless is a relatively minor component of the affordability of housing in Western Australia. Over the past three years, the median house price in Perth has increased by around $53,000, while the associated stamp duty cost has increased by a much smaller $3,500. Furthermore, there has not been any slowing in the rate of turnover of property sales in Western Australia in the past two years, notwithstanding increases in conveyance duty rates which have been introduced in response to the need to meet the funding pressures on Government.

The infrastructure charges which are levied on developers by the major utilities (water/sewerage and electricity) in Western Australia are based on the recovery of costs and also do not appear to have contributed to the strong growth in new house prices in Western Australia. Water/sewerage is the largest component of infrastructure charges by utilities and is based on recovering 40% of the costs of off-site infrastructure that is required to service a subdivision. Electricity charges are based on a full recovery of costs for the extension of the network within a new subdivision, with no element of charging for off-site infrastructure. Gas charges are relatively minor and usually only applied to developments which do not abut existing infrastructure.

Local government fees are also minor imposts which are based on recovering administrative costs. In Western Australia, developers' contributions to local government or other public authorities (such as for upgrading major roads or extending public transport) are relatively minor in comparison with arrangements in some other States and subject to WAPC guidelines. These guidelines do not permit local government to seek contributions from developers for the funding of general community amenities.

Taken together, State taxes (to fund general community services) and standard utilities charges for infrastructure (to pay for specific development costs) account for a small share (typically around 2.7%) of the total costs of land development. While the nature of costs will vary according to the region and type of housing, the major costs faced by land developers (inclusive of cost of house construction) relate to on-site infrastructure (such as site preparation, earthworks, minor roads, and landscaping). The major tax impost for housing is attributable to the GST, which directly applies to new houses and has a flow-on effect on prices in the established housing market.

The Western Australian Government has a number of effective programs in place to ensure an adequate supply of affordable housing and will continue to provide extensive support for first home buyers. The key existing programs in Western Australia that assist first home ownership are:

- a $500 stamp duty rebate for purchases of established homes of value up to $135,000 and for vacant land of value up to $52,000;
- a Keystart program to assist Western Australians who have difficulties meeting commercial lenders' deposit requirements;
- a New Living Program to renovate and sell public housing stock at modest prices to former tenants;
- a Goodstart scheme to enable public housing tenants to purchase equity in their current rental property;
- a Home Buyers Assistance Fund to provide a grant of up to $2,000 for the incidental expenses of first home buyers of low value properties; and
- the State Government also administers the First Home Owner Grant (FHOG) of $7,000 which was introduced as part of national tax reform. The cost of this scheme will be fully funded by Western Australia when budget balancing assistance from the Commonwealth is no longer required under the GST guarantee.

CHAPTER ONE

INTRODUCTION

For many Australians and their families, home ownership is a fundamental aspiration. The purchase of the first home is a major step toward achieving greater financial security and represents a key stage of family life.

The Western Australian Government supports the home ownership aspirations of Australians and welcomes the current inquiry by the Productivity Commission.

This inquiry provides a valuable opportunity to review and improve the understanding of the factors which drive the demand, supply and affordability of housing. It is the hope of the Western Australian Government that the current inquiry will help to establish a framework for a cooperative approach by State and Federal Governments in addressing affordability obstacles for first home buyers.

State Governments play the key role in planning for the availability of land supply, infrastructure and public housing. In certain areas, State taxation concessions can be offered to assist first home buyers. However, there is limited financial scope for Western Australia to reduce its reliance on existing State taxes, including those that impact on housing.

The Commonwealth has a major role in determining the affordability of housing. These factors include macroeconomic policy settings (which impact on interest rates and wage and earnings growth) and the income taxation and GST treatment of housing.

Given the public focus by housing and development industry representatives on the impact of taxation and Government charges on housing affordability, this submission seeks to clarify the actual impact of State taxation and charges relative to other major demand and cost factors operating in the housing market. In some areas, the Commission may wish to undertake further research to clarify the importance of the various factors which impact on housing affordability.

The following chapters of this submission are as follows:

- Chapter 2 provides an overview of the housing market and affordability in Western Australia;
- Chapter 3 addresses the drivers of housing demand in Western Australia;
- Chapter 4 addresses supply issues, including planning processes;
- Chapter 5 addresses the impact of taxation, infrastructure costs and local government fees on housing costs;
- Chapter 6 addresses the financial limitations on the States, including the impediments to Western Australia reducing its reliance on existing State taxes;
- Chapter 7 outlines the current range of State Government initiatives that assist home ownership in Western Australia; and

- Appendix 1 provides information on the level and nature of demand for public housing in Western Australia.

Western Australia will also be contributing to other submissions to the Productivity Commission through the Department of Housing and Work's involvement in the submission from the Australian Building Codes Board and the Housing Ministers' Advisory Committee on A National Affordable Housing Project.

CHAPTER TWO

THE WESTERN AUSTRALIAN HOUSING MARKET

While the Western Australian housing market has many characteristics that are similar to housing markets in other jurisdictions, for instance the relatively high proportion of home ownership, housing markets are affected by a large number of factors and conditions do vary in each market. Indeed, conditions within sub-markets, and even between suburbs can vary considerably. This chapter provides an overview of the Western Australian housing market, and recent trends in the market, while other chapters outline in more detail factors that influence the housing market.

Rising house prices have been a global phenomenon, coinciding with low interest rates and poor stock market returns. Strong price rises in Sydney, Melbourne and Brisbane have not been replicated to the same degree in Perth. While trends in regional house prices vary, prices in the largest regional centres in Western Australia have grown at a slower pace than in Perth and in other regions across Australia in recent years.

Reflecting this more moderate house price growth, affordability (as measured by the capacity of the average person to meet loan repayments for the median house) remains comparatively high in Western Australia, with Tasmania the only State more affordable in the June quarter 2003. While affordability at a national level has declined over the past two years, it is not excessively low compared to historical levels.

Rental prices have fallen in real terms in Western Australia over the past three years. This may reflect increases in supply of rental accommodation as a result of the increase in the proportion of homes purchased for investment purposes. In addition, demand for rental accommodation is likely to have been reduced as a result of first home owners purchasing homes earlier than they otherwise might in response to the extended FHOG (see discussion below). Reflecting the decline in real rents, the attractiveness of renting rather than buying has improved in financial terms, which may see some potential homebuyers elect to rent, at least in the short term.

The fact that rental prices remain low and vacancy rates have risen also suggests that the affordability of housing services (including rental accommodation) per se is not an issue.

HOME OWNERSHIP AND RENTAL MARKETS

According to the ABS Census, 70.7% of Western Australians either owned their home outright or were in the process of purchasing their home in August 2001. This is slightly higher than the national figure of 69.5% and represents a slight increase on the figure recorded in the 1996 census (69.6%).

In August 2001, 26.0% of Western Australian households were renting compared with 27.6% nationally. This was down from 27.7% in 1996.

Public housing rentals accounted for 4.4% of total housing, down from 5.1% in 1996, representing 17% of all rentals. Nationally, public housing rental accounted for 4.7% of households in 2001, or 17.1% of all rentals.

House Price Trends

Recent increases in house prices in Perth have been more modest than the robust rises recorded in most other capital cities. Over the past two years, house prices in Perth have increased by 10.8% per annum on average, well below the 17.2% increase nationally. Sydney and Brisbane recorded average annual growth of 19.3% and 19.1% respectively over the past two years.

House Price Increases (%)

	2001-02	*2002-03*	*2-year average*	*5-year average*
Sydney	17.4	21.2	19.3	13.0
Melbourne	21.8	11.7	16.6	13.5
Brisbane	13.7	24.7	19.1	10.5
Adelaide	14.5	21.6	18.0	11.9
Perth	**8.7**	**13.0**	**10.8**	**9.0**
Hobart	4.3	12.2	8.2	6.1
Darwin	2.7	6.9	4.8	2.9
Canberra	16.1	19.7	17.9	12.3
National*	**16.5**	**18.0**	**17.2**	**12.0**

*Weighted Average of 8 Capital Cities
Source: ABS

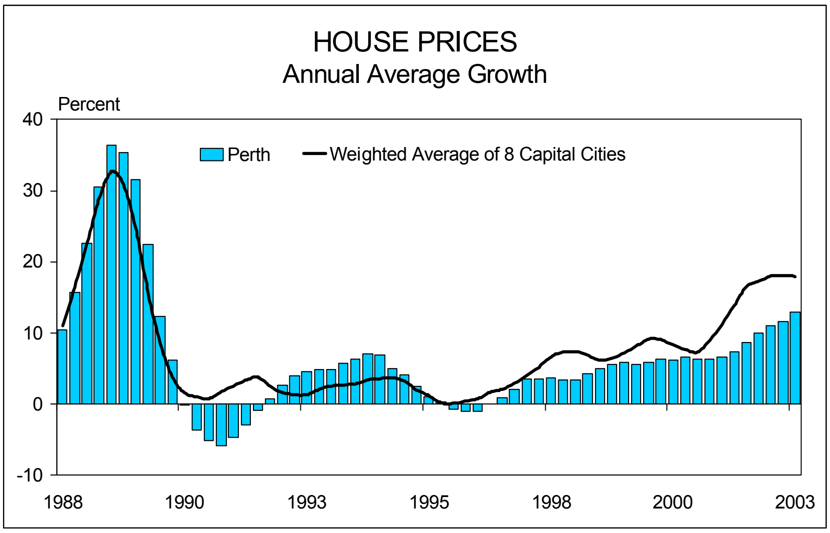
House prices in regional Western Australia have generally increased more moderately than Perth and regional centres in other States. Prices in major regional centres in Western Australia (Mandurah, Bunbury, Kalgoorlie/Boulder and Geraldton) have, on average, increased by 6.4% per annum over the past two years.

Mandurah, with advantages in its closeness to Perth, has experienced the strongest house price growth of the major regional centres, with prices rising by an average of 17.0% over the past two years. By comparison, average prices for similar cities in New South Wales - Wollongong and Newcastle - have risen by 26.2% and 29.7% respectively. This would appear to reflect their vicinity to Sydney.

Other exceptions are the fast growing tourist regions, such as Broome (21.8% per annum) and some relatively remote resource dependent towns in the North West of the State, such as Port Hedland (13.8%). Higher costs and house prices in the North West of the State also reflects the cost of cyclone-proofing homes, and in some areas native title constraints.

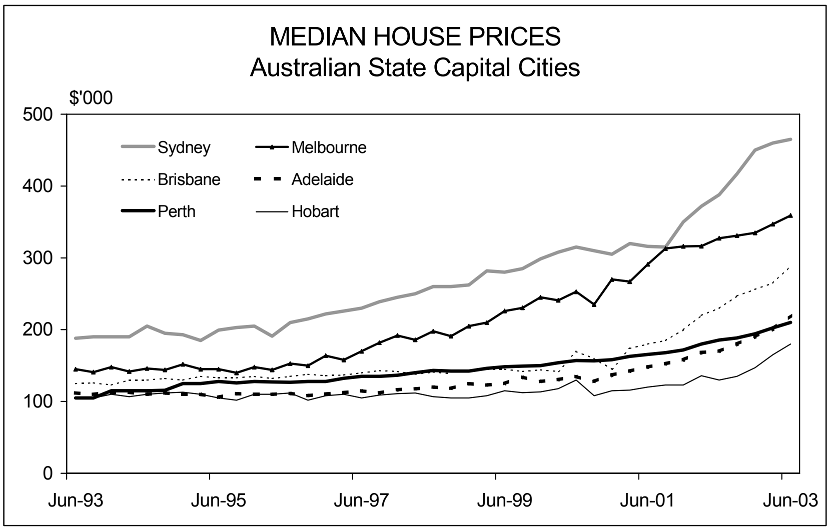
One feature of house price increases in Perth has been regional variations, with suburbs close to the ocean performing better over the past 10 years. Analysis of Real Estate Institute of Western Australia (REIWA) data shows that prices in a sample of coastal suburbs have increased by an average of 16.6% per annum over the past 10 years, compared with a sample of non-coastal suburbs, which grew by an average of 13.1% over the same time period.

The following chart also shows that the recent increase in house prices has been modest compared with the price rises in the late 1980s.



Source: ABS

The median house price in Perth remains lower than for most other capital cities. In the June quarter 2003, the median house price in Perth rose to $210,200. By comparison, the median house price in Sydney is now $465,000 (2.2 times higher than Perth), $359,000 in Melbourne (1.7 times higher than Perth) and $289,000 in Brisbane (1.4 times the Perth prices). The ratios for Sydney and Brisbane against Perth prices reached all time highs in the December quarter 2002.



Source: REIA

FHOG data indicates that first homebuyers have been purchasing homes in a range of suburbs across Perth, and often buy homes at the lower end of the price range (particularly in inner suburbs). In this regard, the median house price purchased by first home buyers in Perth was on average around 15% lower than the median price of all homes, although in more expensive suburbs, the price of homes purchased by first home buyers was often significantly lower than the median price for the suburb. The State-wide median price of homes purchased by first home buyers was $156,000 in 2002-03.

Not surprisingly, median house prices in regional Western Australia are usually lower than prices in Perth, with the exception of popular tourist/lifestyle regions such as Broome and Augusta-Margaret River. Prices are also substantially less than most regional centres on the eastern seaboard. In the June quarter 2003, REIWA found that median house prices in Geraldton were less than half those of Wollongong ($325,000), the Gold Coast ($295,000), Newcastle ($269,300) and Geelong ($260,000).

Western Australian Median House Prices
$'000

	June Quarter 2003	*Annual Growth (%) since June Quarter 2001*
Perth	210.2	12.6
Mandurah	185.6	17.5
Bunbury	147.8	7.0
Kalgoorlie/Boulder	150.9	2.6
Geraldton	117.8	3.2
Broome	310.8	21.8
Roebourne/Karratha	196.1	na
Port Hedland	183.5	13.8

Source: REIA, REIWA

The trend of rising house prices has been a worldwide one. Key reasons for this boom appear to be low interest rates around the world and recent poor stock market returns. *The Economist* published international house price comparisons in May 2003, and these data confirm that in many countries, house prices have been rising rapidly. House prices in Australia recorded the sixth highest increase in the survey, rising by 53% in real terms from 1995 to 2002. Ireland recorded the largest house price increases, with prices rising by 152% over the period. Sydney recorded the largest increase for Australia, to be 68% higher in real terms.

Global House Price Increases (%)

	1995-2002		
	Nominal	*Real*[1]	*2002*[2]
Ireland	219	152	6.0
Britain	125	89	21.8
Netherlands	121	83	1.4
Spain	95	58	13.0
Sweden	68	56	6.9
Australia	**83**	**53**	**15.0**
France	45	31	6.9
US	51	27	4.6
Canada	18	2	2.8
Germany	-5	-13	-4.4
Japan	-20	-19	-4.2
Global Index	**35**	**18**	**4.2**

[1] Adjusted for consumer-price inflation
[2] Real
Source: A Survey of Property, The Economist, 31 May 2003

HOUSING AFFORDABILITY

While there are a variety of interpretations of the term affordability, generally housing affordability can be taken to refer to the capacity to enter and maintain a position in the home ownership market and is a major issue for potential first home owners.

This section provides an overview of issues relating to affordability in the Western Australian housing market and suggests that, while affordability is considered to have fallen somewhat recently, it is within the range of historical values. In addition, recent declines seem likely to be a result of cyclical movements rather than evidence of an ongoing structural problem in the housing market.

Affordability trends in Australia are highly regional, with affordability in Sydney and Melbourne particularly low. While affordability in Perth has fallen recently, it remains relatively high compared with capital cities on the east coast.

What Determines Housing Affordability?

Housing affordability is determined by both the capacity to raise a sufficient deposit to enter the market as well as the ability to meet ongoing interest and principal payments on a housing loan.

The ability to raise a deposit for an individual can depend on: the person's level of disposable income; the level of house prices; the deposit required by the person's financial institution; and/or the amount by which the person wishes to gear against the deposit or whether he/she is willing to pay mortgage insurance to offset a lower deposit.[1]

The ability to service a housing loan depends on; the person's level of disposable income, the level of house prices, the size of the initial deposit; and interest rates and other costs of the individual or the "community" (e.g. insurance).

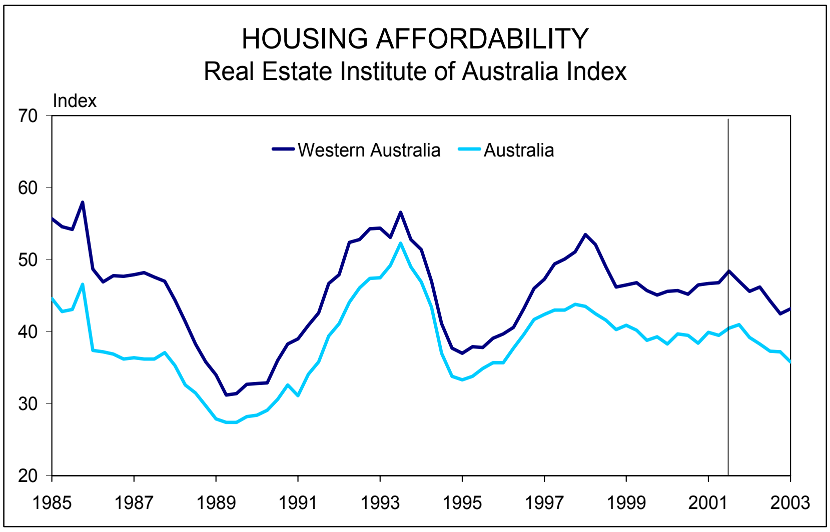
Most measures of housing affordability assume a certain level of income, which assumes that the "typical" person in the index is employed. The indices do not capture the change in aggregate affordability arising from changes in employment status.

Median Affordability

The chart below shows the REIA housing affordability index over the past 12 years.[2] This is considered the most comprehensive publicly available index of housing affordability in Australia. The Housing Industry Association's (HIA) housing affordability index is also often quoted, and recently showed housing affordability at its lowest level in 13 years. It should be noted, however, that the HIA index is constructed only from Commonwealth Bank loan approvals and so might not be a representative measure.

[1] Mortgage insurance is usually required for deposits less than 20%, with a maximum loan of 95%.

[2] This index compares the level of repayments for the median priced house at current interest rates compared with median family income. A higher figure means that housing is more affordable. It does not include additional costs such as insurance and purchasing costs.



Source: REIA

According to the REIA index, affordability at both the national level and Western Australian level has deteriorated recently, but remains well within the range of historical values. In particular, current affordability rates in Western Australia remain well above recent lows reached in 1989 and 1995.

While house prices have risen considerably, these increases have been largely offset by a fall in interest rates and growth in income over the period. According to the ANZ bank, the borrowing capacity of Australian households[3] rose by nearly 175% over the past 12 years, which it claimed was able to explain the increase in national house prices over the period. Indeed, the ANZ noted that any favourable movements in interest rates and incomes are, in a strong market, likely to be capitalised into higher housing prices[4].

As can be seen in the following chart, housing in Western Australia is more affordable than all States except Tasmania. Affordability in New South Wales remains substantially below all other States. These State differences are mainly attributable to differences in house prices (and hence repayments) rather than differential income levels in each region.

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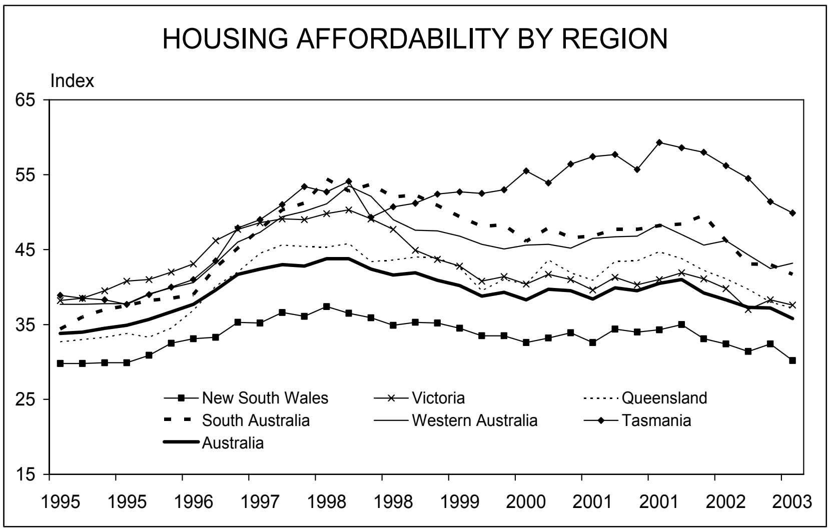
[3] As measured by the mortgage loan obtainable by a couple earning average weekly male and female earnings, with repayments capped at 25% of gross income.

[4] Saul Eslake, ANZ Bank, "Is the Australian Property Market in Bubble Trouble?", Presentation to the Urban Development Institute of Australia (Queensland), 4 September 2003.



Source: REIA

Housing accessibility is likely to have decreased most significantly for first home buyers in capital cities such as Sydney, Melbourne and Brisbane, as house price increases have far exceeded income gains. This is particularly pertinent in Sydney, where a 20% deposit on a median house is $92,000. It is noted that the "deposit gap"[5] is an issue that must be considered in this inquiry, nevertheless, there is little evidence of this being a substantial problem in Perth.

First Home Owner Affordability

Australians have always had a strong culture of home ownership, although characteristics of first homeowners have changed over time. While there is no typical first home owner, people in this category are older than in the past as these people are typically staying in education longer, residing in the family home until they are older, are more likely to live alone, and are getting married later in life.

In addition, those people who do live with partners are more likely to have two incomes than previously. While the lack of data makes it hard to draw any firm conclusions, it is likely these shifts have had an impact on both when people are buying their first home and the type of housing they are demanding.

Specific data on affordability for first home buyers are not available to the same level of detail as median affordability. However, some indication can be gained from examining partial data.

Data published by the REIA and the ABS suggests that affordability for first home owners moved in a similar fashion to the overall market. REIA data for houses in the lower quartile of price ranges, shown in the table below, indicate that prices in the lower part of each capital city market moved reasonably similarly to the median price over the past five years.[6]

[5] The difference between the purchase price and the amount able to be borrowed.
[6] A comprehensive time series for "down market" units/townhouses was not available.

	Median House		Lower Quartile House	
	March 1998	*March 2003*	*March 1998*	*March 2003*
Sydney	260.0	465.0 (78.8%)	193.0	337.0 (74.6%)
Melbourne	186.0	359.0 (93.0%)	138.5	260.0 (87.7%)
Brisbane	138.0	289.0 (109.4%)	116.5	234.0 (100.9%)
Adelaide	117.6	220.0 (87.1%)	85.0	164.0 (92.9%)
Perth	142.5	210.2 (47.5%)	106.1	157.0 (48.0%)
Hobart	112.0	180.0 (60.7%)	83.5	125.0 (49.7%)

Note: Change over period in parenthesis
Source: REIA

As illustrated in the following table, the average loan size indicates that first home owners are taking out similar sized loans to those taken out by non-first home buyers in many markets. However, it is likely that the average value of houses purchased by non-first home buyers is greater than that purchased by first home owners, as tertiary buyers are able to contribute the equity in their existing homes to their subsequent purchases.

From ABS data (see following table), the size of first home buyer loans has generally grown by more than those of non-first home buyers over the past five years and loan sizes are now broadly comparable. This may indicate that, if first home buyers do earn less income on average, then they will be spending more of their income on mortgage repayments and this may make them more vulnerable to interest rates rises.

There has also been some anecdotal evidence that greater HECSs debts could be delaying or reducing the ability of young people to enter the market. Again, while there are no data to support this statement, higher HECS debts reduce disposable income and therefore impact negatively on housing affordability, which is not captured by the indices referred to earlier.

		Size of Loan	
		Average Value ($'000)	Growth since three months to July 1998 (%)
New South Wales	First Home Owners	221.7	62.8
	Other	220.4	51.5
Victoria	First Home Owners	179.4	72.6
	Other	179.5	66.1
Queensland	First Home Owners	157.4	47.2
	Other	170.4	53.3
South Australia	First Home Owners	130.6	66.3
	Other	129.8	50.1
Western Australia	First Home Owners	141.5	51.8
	Other	148.1	45.5
Tasmania	First Home Owners	87.6	2.7
	Other	104.5	30.9

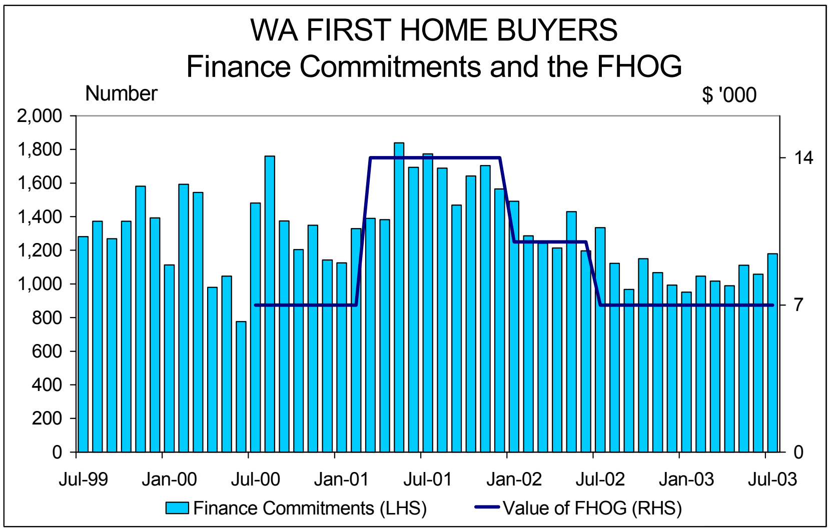
Source: ABS

TRENDS IN FIRST HOME OWNERSHIP

The extended-First Home Owner Grant (FHOG), introduced in March 2001, encouraged a large number of first home owners into the market, and the number of first home owners reached record (for Australia), or near record (for Western Australia), levels in the second half of 2001. The number of first home buyers nationally and in Western Australia has fallen from the FHOG-induced highs reached in 2001. This decline appears to have been exacerbated by demographic trends (discussed in the following chapter).

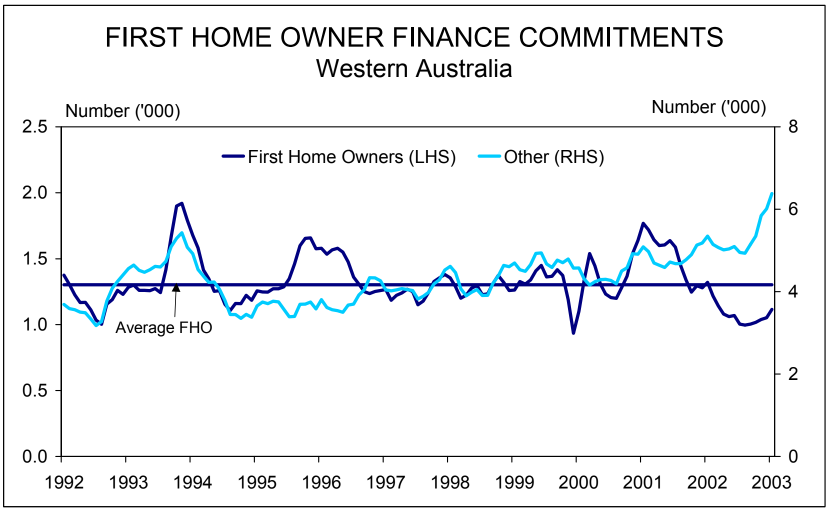
First home ownership data from the ABS relate to housing finance commitments and so the information captures all finance applications for new or established dwellings and excludes finance for alterations or additions. The data show that the number of first home buyers in Western Australia has declined over the past two years, although the level has stabilised in recent months. By contrast, the total number of commitments has accelerated, in both Western Australia and Australia as a whole. This has resulted in a reduction in the proportion of first home owners in the market to its lowest levels since the current data series began in July 1991.

The number of finance commitments for first home buyers in Western Australia has fluctuated around a steady mean over the past decade. Fluctuations since 2000 can be traced to movements in the FHOG. In particular, there was a large rise in commitments after February 2001, with the introduction of the $7,000 extension of the FHOG in March 2001. Commitments remained strong until the $3,000 extension was removed, reflecting a large pull-forward in activity over this time. The impact of the FHOG has had on the market for first home owners is evident in the following chart.



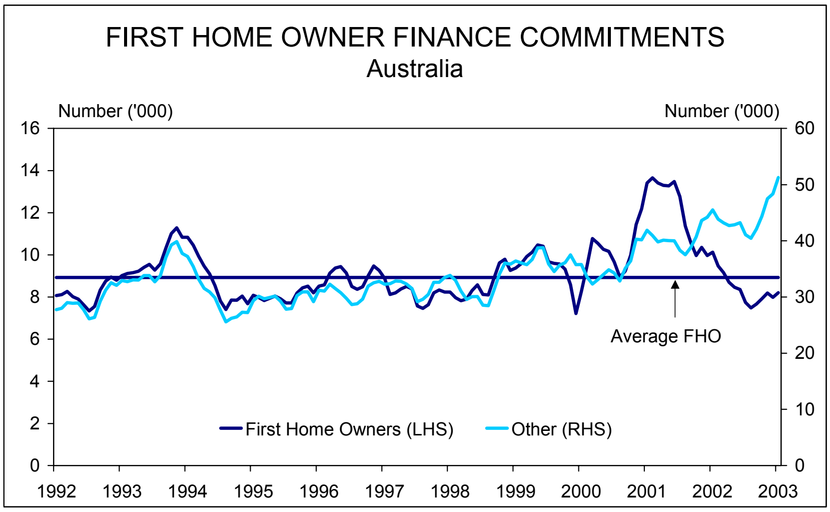
Source: ABS

Reflecting the pull-forward of activity while the extended FHOG was in place, the number of commitments by first home owners has eased since the extended FHOG ceased. The number of commitments by first home owners bottomed in the three months to February 2003, but has subsequently increased. Despite the recovery in the number of first home owner commitments, the share of total commitments has declined, reflecting the strong growth in non-first home owners commitments.



Source: ABS

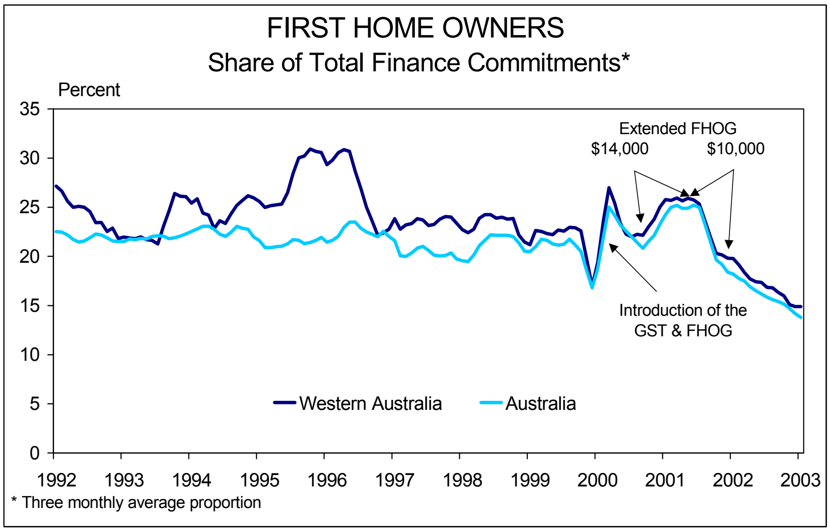
Trends in first home owner activity nationally are similar to those in Western Australia, with first home owner activity influenced significantly by extensions to the FHOG. A key difference between Western Australia and nationally is that the number of first home buyers entering the market, largely in response to the FHOG, reached a record high nationally. While the number also rose significantly in Western Australia during the period, the record number of first home entrants in Western Australia occurred in 1994.



Source: ABS

As a result of these trends, the proportion of first home buyers in the market has declined markedly over 2003 in both Western Australia and nationally. Over the three months to July, first home buyers accounted for 14.9% of the total market in Western Australia and 13.8% nationally. Western Australia has historically had a higher proportion of first home buyers in the dwelling market than nationally (around 24% in the 1990s, compared with 21% nationally), but this gap has narrowed in recent years (mainly since 1999).

Trends in the proportion of first home buyers in the market are shown in the following chart. In particular, the chart shows the distortions from the GST and subsequent FHOG changes.

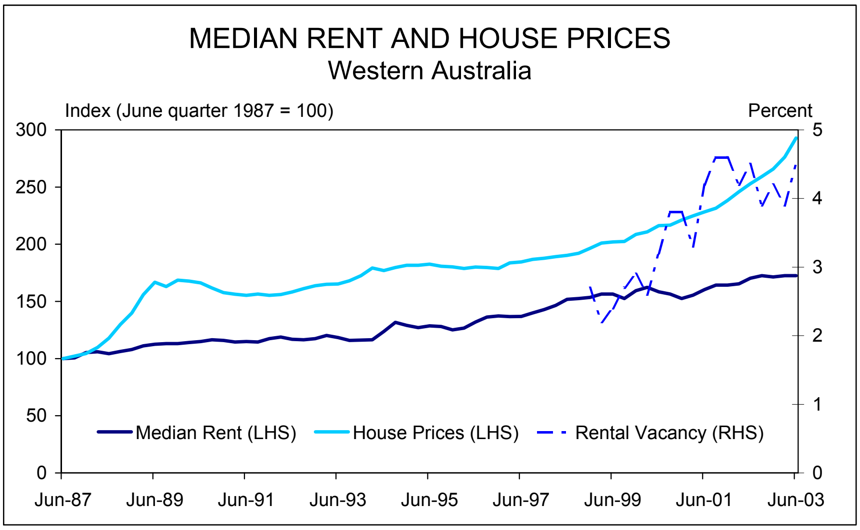


Source: ABS

THE RENTAL MARKET

As the main alternative form of housing services for prospective first home buyers, the rental market can play an important role in managing the peaks and troughs of the housing cycle. While house prices in Western Australia have experienced strong growth over the past few years, the same cannot be said for rental price growth. This indicates a strong increase in the affordability of rental accommodation in recent years, especially considering the gains in employment growth and average earnings over this period. This may have led to potential first home owners deciding to rent rather than buy in the current market.

A rise in rents indicates that there is excess demand for housing, signalling that more building needs to take place, while a decline in the rental market is often the first sign that there is an excess housing supply. Over the three years to 2002-03, the median weekly rent in Western Australia rose by a subdued 2.6% per annum, implying of real decline of 1.4% per annum.



Source: REIWA

In historical terms, the availability of rental properties in Western Australia is relatively high. In the June quarter 2003, the average vacancy rate in Western Australia stood at 4.5%. This compares to the long-term average (5 years) of 3.6%.

CHAPTER THREE

DEMAND SIDE FACTORS

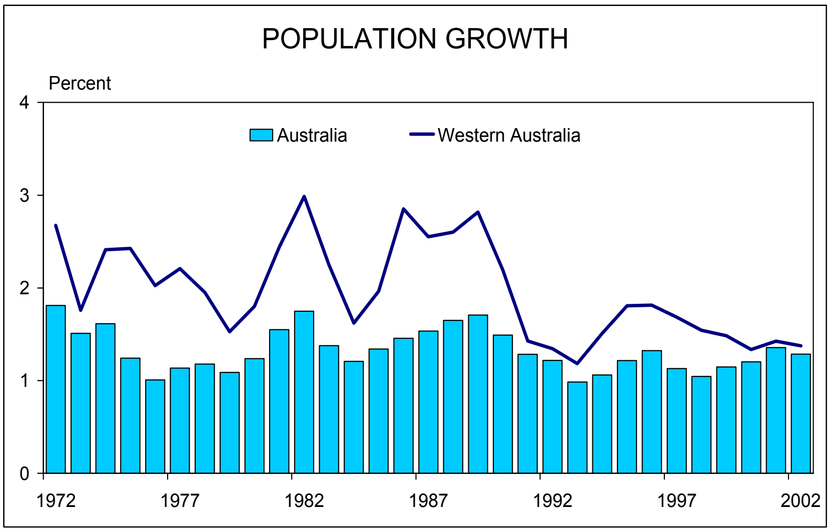
While the number and share of property transactions by first home purchasers has fallen, this is not necessarily indicative of a problem with housing affordability for first home owners.

Changing demographic and social trends have influenced the number of first home owners entering the market, while a range of macroeconomic factors have influenced housing demand. This chapter reviews demographic trends impacting on first home ownership levels, and outlines macroeconomic developments, including investor activity.

DEMOGRAPHIC AND SOCIAL TRENDS

Population in household formation age bracket

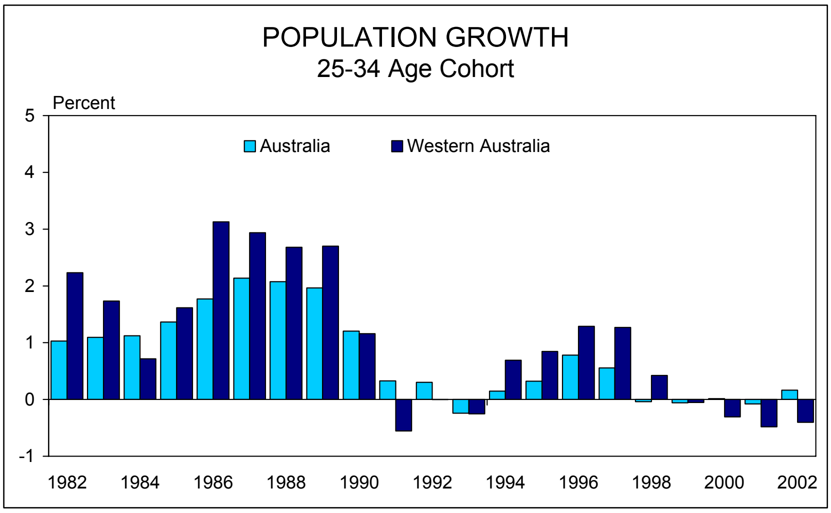
While Western Australia's population has historically grown at a faster rate than nationally, the rate of population growth in Western Australia has slowed in recent years, and is now only marginally above the national rate.



Source: ABS

Historically, the household formation bracket (25-34 year olds[7]) has also grown faster in Western Australia than nationally. However, growth both in Western Australia and nationally has slowed significantly over the past decade and, in Western Australia, the number of people in this household formation bracket has declined over the past four years. The recent fall in population for this age group suggests that without inducements for first home owners, the number entering the market would have otherwise fallen over the past four years.

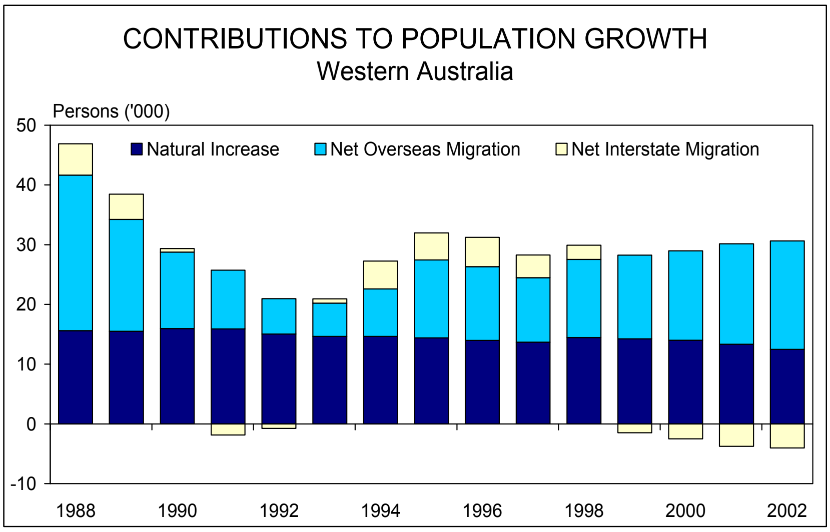
[7] In reality, first homeowners consist of a much wider range of age groups (see the Productivity Commission's Issue Paper *First Home Ownership*, September 2003). However, for simplicity, focus here is on the 24-34 year age group, which accounts for 61% of all first home owners.



Source: ABS

Reflecting the decline in the number of people in the household formation bracket, the share of people in this bracket as a proportion of total population has declined for both Western Australia and Australia. However, the decline for Western Australia has been slightly greater than experienced nationally. In Western Australia, 25-34 year olds as a share of population fell from 17.2% in 1990 to 14.8% in 2002. This compares with a fall from 16.5% to 14.6% nationally.

The reduction of people in this age group would appear to be partly related to declines in interstate immigration to Western Australia. Net interstate migration for Western Australia has been negative in recent years and, while no data are available for individual age cohorts, this does correlate with falls in population in the 25-34 year old age bracket over the past four years. Anecdotal evidence suggests that this fall may be due, in part, to the fact that young people have a greater propensity to shift States to pursue career opportunities.



Source: ABS

ABS labour force data also shows that the 25-34 year old cohort in Western Australia has declined as a share of total labour force over the past 10 years, and the decline has been greater than experienced nationally. Over the past 10 years, the share of 25-34 year olds in the labour force has fallen by 3.2 percentage points, from 25.9% to 22.7%. Nationally, the share has fallen by just 1.8 percentage points to 20.1%. While there are a number of possible factors, such as a propensity to stay in education longer and a declining population share, the decline is likely to be at least partly due to negative interstate migration – particularly given the larger than national fall.

This larger fall in both population and labour force contribution for Western Australia goes some way to explaining the larger decline in the share of first home owners over the decade.

Demographic changes

Changes in home ownership and living arrangement patterns have also had a significant impact on the housing market. The 1999 ABS survey of Australian Social Trends in Housing found that young Australians have become less likely to embrace home ownership. The survey compared data from 1988 and 1996-97 and found that young people were less likely to purchase a home. Over the study period, home ownership rates among income units[8] in which the age of the reference person was 25-34 declined from 42% to 32%.

This trend may be related to changing patterns of family formation among young people. In particular, other ABS surveys of Social Trends have found that young people are living at home longer, staying in education longer, delaying marriage and having their first child later in life. Consistent with these changes, young people have been delaying buying their first home with the median age of first home buyers increasing from 30.2 years to 31.8 years between 1988 and 1996-97.

While no data are available to show current patterns, it is likely that these demographic trends have continued since 1996-97.

Tastes and expectations

The type of new housing and residential lots demanded in Western Australia is changing, reflecting shifts in the demographic landscape. The ageing of the population and emergence of smaller family sizes has seen a reduction in household sizes, with an increase in one and two person households. With the continued 'greying' of the population, this is likely to continue.

Reflecting these trends, there has been evidence of greater demand for smaller lot sizes in some market sectors. The Subiaco and East Perth Redevelopments provide examples of successful moves to higher density living that may become more popular in the future.

[8] Income units are defined as single persons, or groups of related persons within a household whose income is assumed to be shared. Income sharing is assumed to take place within couples and between parents and children.

While there is still demand for large blocks in outer suburbs, demand for units and townhouses appears to have increased in recent years. The proportion of approvals for detached or semi-detached (clustered) buildings has increased from 11.4% in 1996-97 to 15.2% in 2002-03.

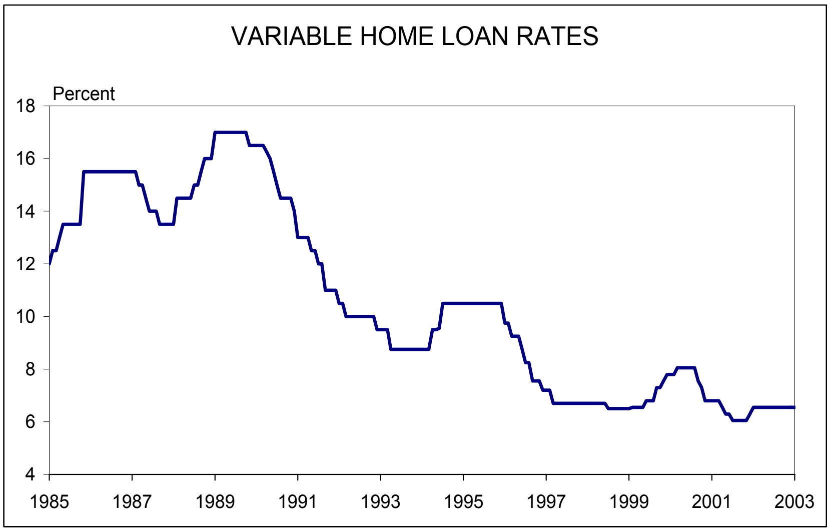
Between 1998-99 and 2001-02, clustered dwelling approvals comprised 48% or more of total dwellings approved for 22% of Perth suburbs. There were four notable suburb groups (Scarborough and Innaloo; Tuart Hill; South Perth and Como; and Hilton and Hamilton Hill), which were all in established residential areas. This suggests that there is an increase in urban infill occurring across the Perth metropolitan area. These have generally been popular suburbs for first home owners, which indicates a trend towards higher density housing for at least some sections of the first home owner market.

MACROECONOMIC FACTORS

Macroeconomic factors have played a large role in the growth of housing prices both locally and internationally. Nationally, low nominal interest rates, low unemployment, rising incomes, declining equity market returns, and Commonwealth taxation policies are all factors that are believed to have contributed significantly to heightened investment demand.

Finance Markets

Nominal variable home loan interest rates have roughly halved over the past decade. This reflects the general decline in interest rates that has occurred over this period, and increased competition in the home mortgage market.



Source: RBA

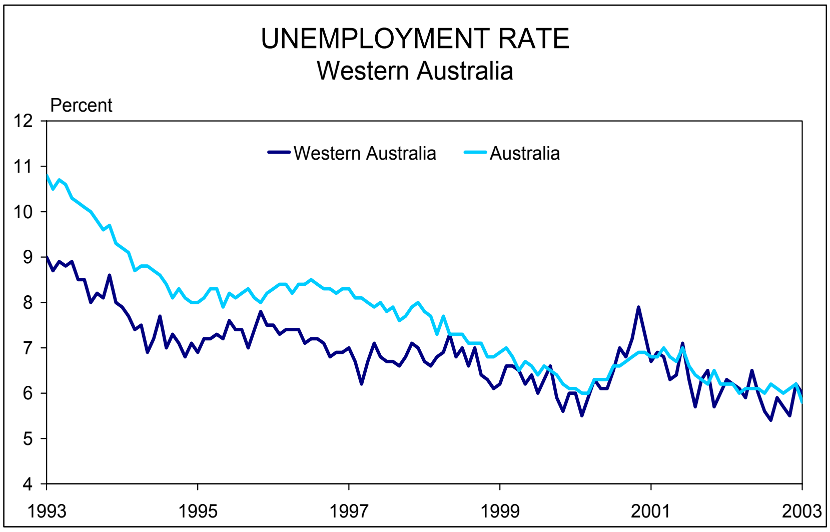
Income

Incomes have also grown strongly over the period. Individuals' nominal incomes (as measured by average weekly earnings) increased by almost 40% between 1992-93 and 2002-03. It is likely that the proportion of households with two (dual) incomes has increased over the period, which would increase household incomes to an even greater extent.

However, there are important differences in income between regions that could impact upon the real estate market in each State. In this regard, New South Wales is home to almost 45% of the workers in the high employment and highly paid finance and insurance industry, compared with its total employment share of 33%. This is more likely to influence prices at the upper end of the market than in other regions.

The affordability indices presented in the previous chapter assume that the household obtains the median level of income for each region, which in turn assumes that one or more people in the household are employed. If employment is strong (and unemployment low), then more people are in a position to afford a home, and aggregate affordability is improved.

The chart below shows that the Western Australian and national unemployment rates trended downwards during the 1990s. This improvement in the labour market is likely to have had a positive impact on the housing market, particularly benefiting first home buyers, who might be more prone to unemployment than older workers. Conversely, however, anecdotal evidence suggests a move towards less secure employment than in the past, which (other things equal) would reduce the ability to secure housing finance.

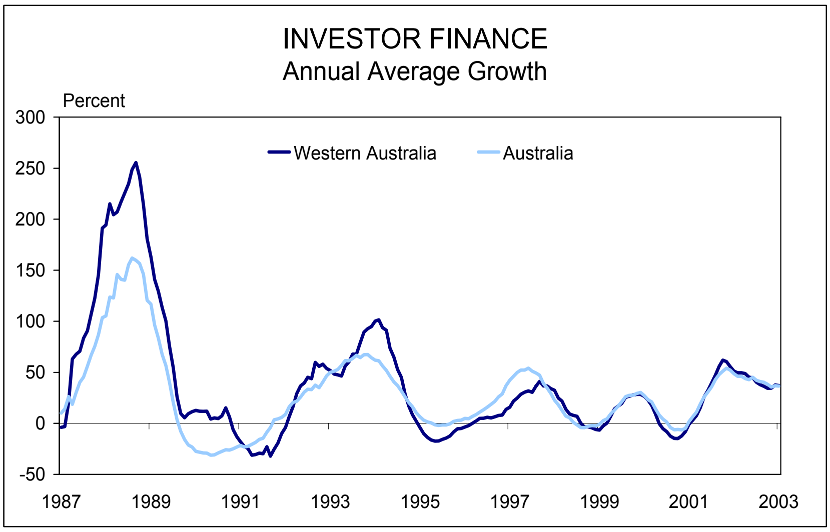


Source: ABS

Investor Demand

Investors have become increasingly important participants in Western Australia's residential property market. This additional demand may be one contributing factor to the State's rising house prices.

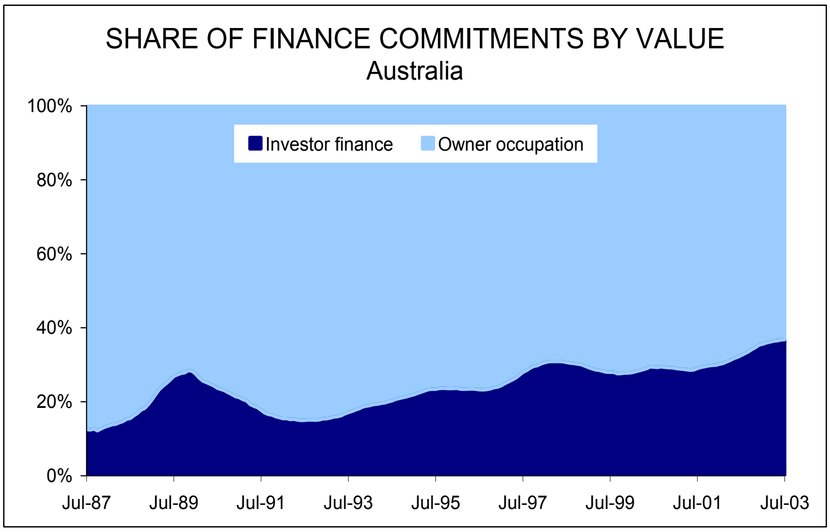
Over the past two years, annual growth in investor finance across Western Australia has averaged 43.9%, which is significantly above long-term average growth of 23.9%. A similar trend has been experienced nationally.



Source: ABS

While current growth rates in investor finance are high, there is a strong cyclical element in these data and the current peak is well below that experienced in the late 1980s when financial deregulation led the reintroduction of negative gearing.

While this indicates that the current level of growth in investor finance is not excessive in historical terms, there has, nevertheless, been a gradual upward trend in the proportion of investors in the housing market. Over the last decade, the share of investors in the Australian housing market has more than doubled, as illustrated in the chart below.



Source: ABS

An increase in real incomes may be one explanation for this trend, however, given that average earnings tend to rise with age, the State's demographic structure could also be a factor stimulating investor activity. That is, there are more people with higher incomes seeking appropriate avenues of investment, giving rise to the possibility that those in the "baby boomer" generation seeking investment opportunities may be squeezing first home buyers from the housing market.

The increase in popularity of home equity loans over the last decade also supports an increase in investor demand for housing. According to the RBA, home equity loans[9] have increased in popularity since the early 1990s with a low-inflation and low-interest rate environment creating a conducive investment environment, which coincided with the entry of number of new products into the housing finance market. Recent increases in house prices enhance the capacity of households to withdraw equity using home equity loans or by refinancing their mortgage, since access to these products depends on net equity in the home being above a minimum level. In addition, by using home equity, investors do not need to save money for a cash deposit in order to invest. This has meant that the increased equity in people's homes has become more accessible as a means of financing (amongst other things), investment properties and has led to a rapid expansion of credit over the past five or so years.

It is worth noting that, if investors are targeting lower priced homes, first (occupier) home owners are at a considerable disadvantage. First home owners must save some form of deposit, while investors can use existing home equity as collateral. If prices are being set by a surge in purchases from investors who could not previously raise a deposit, then saving for a first home deposit will have become considerably more difficult.

The decline in equity market returns over the past three years may be another reason behind higher investor interest in the housing market. In 2002-03, the ASX 200 fell by 9.9% in annual average terms, after a modest gain of just 1.0% in 2001-02. In the three years to 2002-03, the ASX 200 contracted by an average of 0.3% per annum. More significant declines have occurred in the United States, with the S&P 500 index falling by an average 13.7% per annum over the past three years.

Commonwealth Government taxation policies also provide an additional incentive for investors in the State's housing market. For instance, the negative gearing provisions in Commonwealth income tax legislation allow for the loss on investment properties to be deducted from assessable income.[10] In addition, in 1999, the Commonwealth Government introduced measures that effectively halved the capital gains tax payable on assets held over one year. This is likely to have been rapidly capitalised into house prices, as investors would be able to pay a higher upfront price and still meet their required rate of return.

DEMAND FOR HOUSING LOTS

The discussion in the previous sections illustrates the large number of, and recent trends in, factors that interact to influence the demand for housing. Some of this demand will be for established housing, and some for new housing. Demand for new housing inevitably has flow-on impacts for the demand for land.

[9] A loan secured by a primary residence or second home to the extent of the excess of fair market value over the debt incurred in the purchase, or a loan guaranteed by the home owner's equity (usually the estimated value of the home minus the amount still owed to a bank or other lender).

[10] While this concession is also available for other forms of investment, current lending practices enable borrowers to leverage to a much greater degree for residential property than for other types of investments.

The extent to which the demand for new housing translates into demand for land lots will depend on the extent to which new houses are constructed on sites where homes have previously been demolished and the extent to which multi-unit buildings are built on single lots. Reflecting this, the number of new dwellings demanded will exceed the demand for new lots of land.

The most recent projections suggest that over the period 2002-03 to 2006-07, around 65,000 new dwellings will have to be created in Western Australia. Over the same period it is estimated that an additional 60,330 lots will be approved, yielding approximately 59,500 single dwelling units and 6,325 group dwelling units.

Details of factors influencing the supply of land are outlined in the following chapter.

CHAPTER FOUR

SUPPLY ISSUES

The Western Australian Government places a high priority on planning for a sufficient supply of land to meet projected growth in the demand for housing. This is a challenging task, as it requires the Government to resolve complex, multifaceted planning problems involving issues in the areas of sustainability, environment, land ownership, local communities and the coordination of the provision of the infrastructure to planned new developments.

This Chapter provides an outline of the processes governing the supply of land in Western Australia, as well as providing an overview of current supply conditions.

Planning and Land Supply

Western Australia has a centralised planning system which facilitates the development of land by making a single authority, the Western Australian Planning Commission (WAPC), responsible for land planning and development approvals. The WAPC monitors and forecasts the availability of land across the State to ensure sufficient supply of newly sub-divided land to meet the needs for residential and commercial development. It also plans and coordinates the provision of essential and social infrastructure.

The WAPC uses Land Release Plans to achieve this goal. Land Release Plans have two objectives:

- to identify and monitor past, current and projected residential-type land development activity and the provision of associated services and infrastructure requirements within a five year time horizon; and

- to provide information to government and the public for land planning purposes.

The WAPC prepares:

- an Urban Land Release Plan (ULRP) for the Perth Metropolitan Region and adjoining Mandurah and Murray local government areas annually. This includes a five year outlook for land release and associated infrastructure provision. The current ULRP covers the period from 2002-03 to 2006-07; and

- Land Release Plans for 13 major regional centres at two to three year intervals. These plans also have a five year outlook.

Land Release Plans are prepared in consultation with local government agencies, State government agencies, services providers and the building and development industry. They include:

- a detailed analysis of the historic and current state of residential land supply, demand and development; and

- a five year outlook for the supply and demand of residential land, and associated human services, facilities, physical services and infrastructure.

In addition, Land Release Plans include an analysis of housing affordability, urban capacity, a number of differing residential land demand projections and the provision of detailed demand profiles for residential land and associated infrastructure and services.

The WAPC uses the Land Release Plans as a means of matching land supply with projected demand. In this regard, the WAPC uses the regular information prepared by the Housing Industry Forecasting Group (comprising Government and industry representatives) as a guide to future demand for land.

The table below shows the number of lots released in the Perth region from 1997-98 to 2001-02 and ULRP projections (shaded) for the period 2002-03 to 2006-07.

Year	Lots produced (number)
1997-98	7,708
1998-99	10,209
1999-00	11,239
2000-01	8,328
2001-02	10,222
2002-03	10,386
2003-04	11,669
2004-05	11,741
2005-06	11,406
2006-07	10,691
Year unspecified	4,437
Total in 1997-98 to 2001-02	47,706
Total in 2002-03 to 2006-07	60,330

Source: Urban Land Release Plan, 2003

As shown in the table, projected total lot production for the period 2002-03 to 2006-07 of 60,330 is expected to exceed total lot production for the period 1996-97 to 2001-02 of 47,706 by around 12,624 (or 26%).

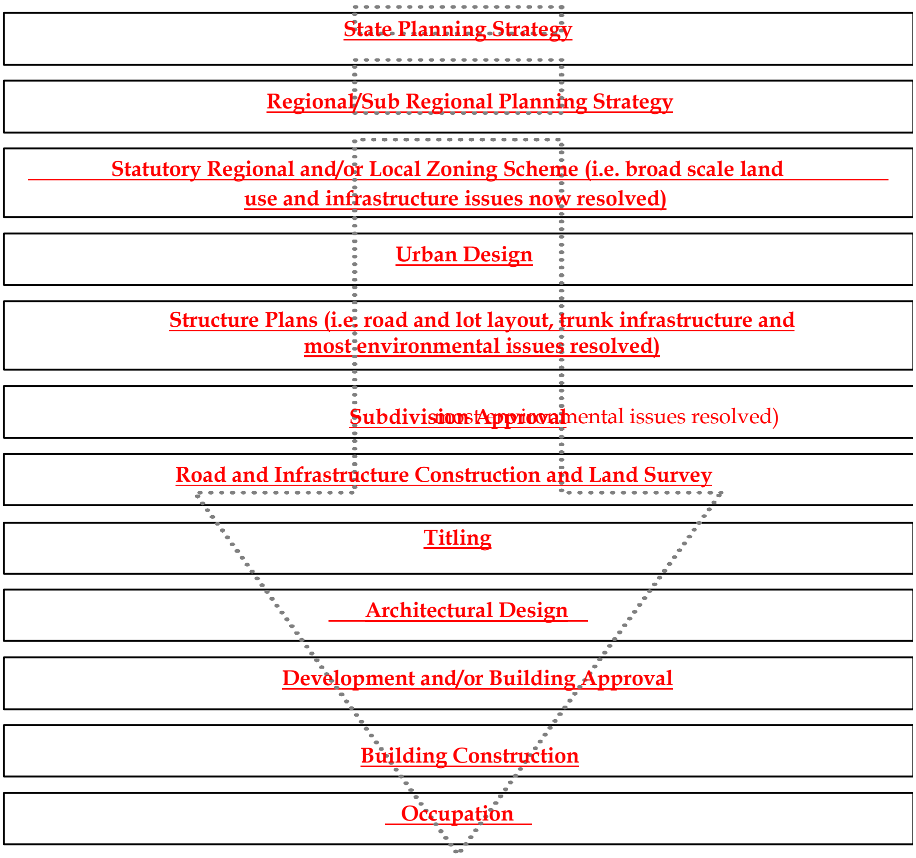
The projected annual average lot production of 12,066 for the period 2002-03 to 2006-07 is consistent with the WAPC's projections that 12,000 new lots will be required in each year to meet the projected underlying growth in housing demand (based on demographic projections and expected income growth). Indeed, the WAPC has indicated that there is sufficient residential land bank (land supply to accommodate the long term demand for new housing for the next 30 years.

Based on comparisons of actual residential lot approvals (all lots) and ULRP projections (which do not include new developments of less than five lots[11]), there has not been any reduction in the rate of land release (either at the urban fringe or in in-fill areas) in the Perth metropolitan region and it is not evident that government land release policies are constraining the availability of land for development.

[11] Developments of less than five lots account for around 20% of all lots approved for development.

However, it is important to note that the planning process contains relatively little flexibility to respond to short term fluctuations in demand. The planning process is designed to be responsive to environmental, infrastructure and community building concerns and to manage the complexity of the interplay within and between these issues in a way which results in a quality built environment that is developable at a profit to the private parties involved. Significant effort is being made at State and national levels to improve these systems but the complexity of issues and the sensitivities attaching to land and the environment are unlikely to change.

The system in Western Australia in outline is:



Source: Department of Planning and Infrastructure

Under existing planning processes in Western Australia, the typical lead time for the planning and development of new land and housing in the Perth metropolitan region is three to five years. There is little practical scope to have sub-divided land supply "on call" and ready for sale (i.e. with infrastructure installed) to meet sudden surges in demand (to do so, would require land developers to be willing to incur the relevant holding costs).

This inflexibility is highlighted when demand for housing is driven by factors which are external to the underlying (i.e. largely demographic) factors. For example, the surge in investor interest in residential housing following the share market downturn in late 2001/early 2002, and the strong bring forward of first home buyers in response to the extension of the FHOG by the Commonwealth Government.

In addition, more than half (329 out of 576) of the land release areas earmarked for the next five years have what the WAPC describes as "noteworthy issues" which may effect the progress of their development. The most commonly identified issues are planning for provision of sewerage and water utilities as well as adequate access to education and transport services. However, advice to the WAPC from the infrastructure utilities is that these can be realistically resolved within a five year timeframe.

The WAPC is actively responding to concern from the development industry and broader community regarding the future supply of land by establishing a "Land Development Pipeline" monitoring system. This system will feature an integrated assessment of short to long-term land supply across the State. A significant part of this project involves bringing together existing datasets from a number of State Government agencies (including the WAPC, Department of Planning and Infrastructure, Department of Land Information, Valuer General's Office and Water Corporation) into a comprehensive information system.

While this project is still in its development phase, the following table indicates an initial assessment of the land supply pipeline in Perth.

Residential Lot Potential at each Stage of the Development Pipeline

Development Pipeline

	Number of Residential Lots	No. of Years' Supply (based on Vacant Lot Sales for 2002/03)	Years to Get to Marketable Lots (typical)	Comments
Potential Number of Residential Lots in:-				
MRS Urban Deferred areas	41,656	4.2	5-10	Requires MRS amendment with associated environmental clearances
MRS Urban areas	51,360	5.2	3-7	Requires TPS amendments
Partially Developed: -				
TPS Residential areas (already MRS Urban)	14,866	1.5	1-20	Includes infill redevelopment potential in established areas
R-Coded areas (already TPS Residential and MRS Urban)	96,888	9.8	1-20	Includes infill redevelopment potential in established areas within existing R-codes
Vacant: -				
TPS Residential areas (already MRS Urban)	100,490	10.1	2-7	May require 'R-coding' (not mandatory)
R-Coded areas (already TPS Residential and MRS Urban)	96,675	9.7	1-5	May require structure planning, infrastructure servicing and/or subdivision approval
Five-Year Intended Lot Development (from Urban Land Release Plan 2003/04 to 2007/08): -				
Unspecified Year				
Subdivision of 5 lots or more	5,960	0.6	1-5	Developers' Intentions Survey 2003 + WAPC data
Subdivision of less than 5 lots	540	0.1	1-5	Estimate from past trends
2007/08				
Subdivision of 5 lots or more	7,450	0.8	5	Developers' Intentions Survey 2003 + WAPC data
Subdivision of less than 5 lots	2,392	0.2	5	Estimate from past trends
2006/07				
Subdivision of 5 lots or more	10,342	1.0	4	Developers' Intentions Survey 2003 + WAPC data
Subdivision of less than 5 lots	2,292	0.2	4	Estimate from past trends
2005/06				
Subdivision of 5 lots or more	11,793	1.2	3	Developers' Intentions Survey 2003 + WAPC data
Subdivision of less than 5 lots	2,092	0.2	3	Estimate from past trends
2004/05				
Subdivision of 5 lots or more	12,171	1.2	2	Developers' Intentions Survey 2003 + WAPC data
Subdivision of less than 5 lots	2,242	0.2	2	Estimate from past trends
2003/04				
Subdivision of 5 lots or more	12,181	1.2	1	Developers' Intentions Survey 2003 + WAPC data
Subdivision of less than 5 lots	2,392	0.2	1	Estimate from past trends
Number of Lots in the Land Approval System: -				
Number of Residential Lots in Pending Subdivision Applications (as at 30 June 2003)	12,726	1.3	0.25 (90 days)	Requires determination by WAPC
Preliminary Approvals given in 2002/03	14,104	1.4	-	
Residential Lots with Preliminary Approval as at 30 June 2003	19,604	2.0	0-3	Requires clearance of subdivision conditions (preliminary approvals are valid for 3 years)
Final Approvals Given in 2002/03	11,675	1.2	-	
Market Activity/Demand:-				
Vacant Land Sales in 2002/03	9,922	**1.0**	-	VGO 'SalesTrack' data
Dwelling Approvals in 2002/03 (no. of dwelling units)	15,992	1.6	-	Includes group dwellings and replacements of demolished stocks

Notes:-

Shading Indicates *Stocks of Residential Lots*

MRS - Perth Metropolitan Region Scheme

R-code - Residential Design Codes (including density/lot size limits)

TPS - Town Planning Scheme

VGO - Valuer General's Office

WAPC - Western Australian Planning Commission

Source: Department for Planning and Infrastructure, 2003 (Unpublished data based on information from Development Industry, WAPC, DLI, VGO and ABS)

The WAPC (as well as Landcorp, the Department of Housing and Works and private developers) is actively seeking to increase the choice and diversity of housing supply by providing for smaller than standard housing (detached and semi-detached) as part of the mixture of housing on offer in new developments. Smaller housing better suits the needs of single home buyers, low income earners and persons seeking to downsize from family homes. Greater diversity of housing will promote increased density and expand the total supply of housing from any given area.

In this regard, the WAPC estimates that around 28% more land than is necessary has been used to construct the existing housing stock in the metropolitan region (based on a comparison of zoned "R-Codes" (i.e. residential density ratings) with actual population densities). This provides an indication of the substantial increase in the utilisation of land supply which could result from implementing strategies which promote greater diversity of housing types.

Efforts are currently being made by developers to go beyond the standard four bedroom (or more) detached dwellings in new developments. These approaches include offering smaller semi-detached two-bedroom housing (on smaller blocks) and incorporating environmentally efficient designs. The housing supply provided by government programs (such as Keystart) also tends to be smaller and more affordable than the standard dwelling in fringe areas and new developments in existing urban areas.

However, obstacles are often encountered in efforts to increase density and variety of housing types of in-fill programs, reflecting a general preference by local communities for existing densities and forms of housing. Alterations to the choice and mixture of dwelling types are common sources of delays in the approval process for in-fill developments.

A proposal to establish an "urban growth boundary" as part of the *State Sustainability Strategy* may have significant implications for long term land supply and population density in the Perth metropolitan region. There is a view in the community that a boundary should be established, mainly on environmental grounds and to reduce the costs associated with servicing the urban sprawl. However, any restriction on access to urban fringe areas for land supply would need to be balanced by an increase in population density of existing urban areas, or seeking to develop alternative regional centres.

In this regard, research by the Department of Planning and Infrastructure (DPI) illustrates the cost to the State government of urban sprawl from supporting new infrastructure including transport, health and education services. These costs include:

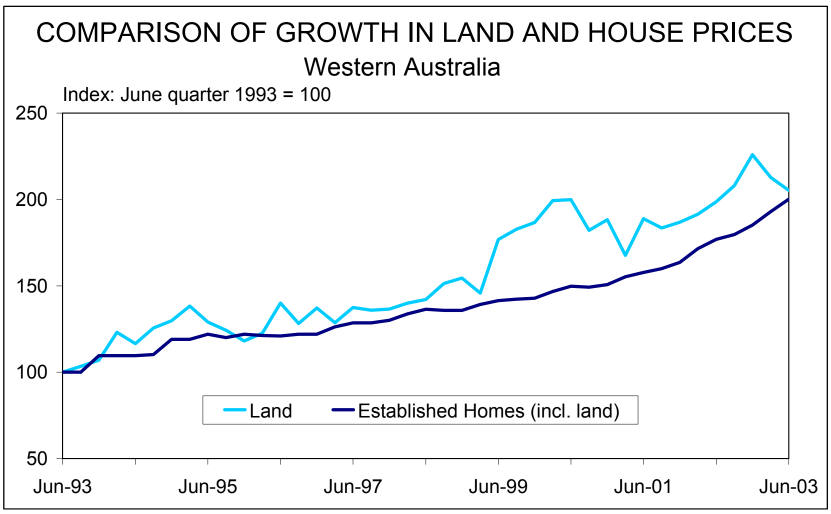
- "brownfield" redevelopment in existing areas – no or minimal cost;
- development on the urban development "front" - $30,000 per block; and
- development off the urban development front - $66,000 per block.

The current planning strategy in Western Australia already incorporates a redirection of growth to brownfield developments. A brownfield development imposes minimal additional infrastructure costs on Government when there is a degree of spare capacity in existing social infrastructure which will service the subdivision. For example, a brownfield development may not require any additional capital spending on schools or augmentation of the public transport system. Five key brownfield projects are operating in the Perth metropolitan region are East Perth, Subiaco, Midland, Armadale and Hope-Valley Wattleup.

In regard to regional housing in Western Australia, the WAPC works closely with relevant regional and local councils in developing land release strategies. Land supply is generally sufficient in the larger regional centres. However, in the more remote parts of the State, there is no private housing market as investors are not attracted to such places. In particular, the State's north-west can come under pressure from high demand and/or land supply constraints (e.g. from native title claims). The shortage of affordable housing in these areas is a significant problem in attracting and enabling skilled workers, such as teachers, doctors and nurses, to provide essential services. In areas where large resource development projects are occurring, such as Karratha, there is a "boom and bust" cycle that affects the local housing market. For example, there can be a large temporary workforce in such places because construction workers are brought in from elsewhere and work from temporary camps.

The previously mentioned Land Development Pipeline will also cover information on supply pressures at a regional/local government level. In addition, the WAPC is undertaking a State Infrastructure Study which will provide an "early warning system" for demand spikes that arise from major development and investment projects (such as resource development projects).

Notwithstanding that land release plans are used to match demand for land, there has been a steady increase in land prices over the past decade. Indeed, as the following chart illustrates, land prices have almost doubled between the June quarter 1993 and the June quarter 2003. This is broadly similar to growth in established house prices over the same period.

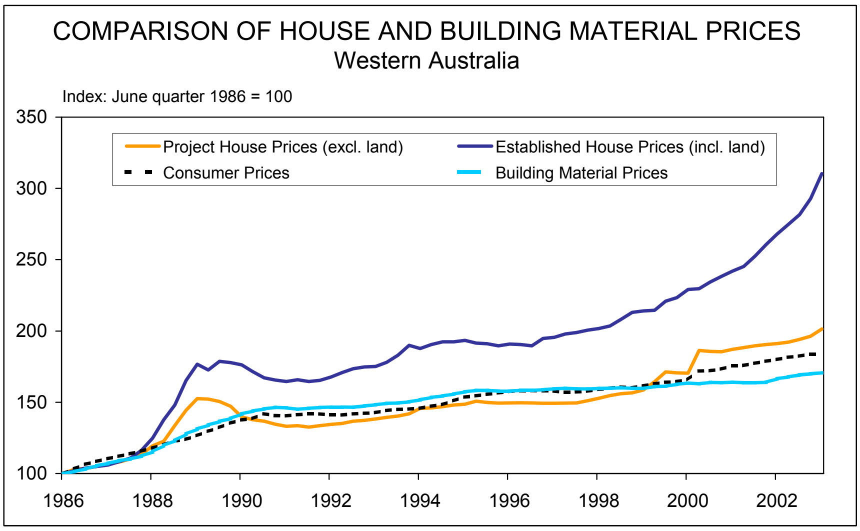


Source: UDIA, ABS

The following Chapter considers a variety of issues related to the cost of housing, and highlights that increases in the on-site costs of producing land (including earthworks, landscaping, minor road works) have been a major contributor to higher land development costs.

BUILDING INDUSTRY AND LAND DEVELOPMENT OPERATIONS

As the following chart illustrates, the escalation of housing prices in Western Australia does not appear to be driven by building costs.



Source: ABS

While there are relatively few large land developers in Western Australia, this is consistent with the small size of the market. There is no evidence that land developers have unduly withheld land supply in order to bolster prices (although, of course, it is the prerogative of land developers to plan to release land at a time which potentially maximises their commercial returns). Rather, the public nature of the ULRP process places a degree of pressure on developers to follow-through with their stated intentions of land releases over the next five years.

Past experience would suggest there are no impregnable barriers to entry to the land development industry in Western Australia. Numerous small developers closely monitor the market strategies of the larger developers and are adept at quickly taking advantage of any market gaps.

CHAPTER FIVE

IMPACT OF TAXES, INFRASTRUCTURE COSTS AND LOCAL GOVERNMENT FEES

The terms of reference of the inquiry into first home ownership require the Productivity Commission to pay particular attention to the impact of, amongst other things, taxes, levies and charges, and the provision of basic infrastructure on the cost of housing. At the same time, the Commonwealth Government has highlighted stamp duty as a cost for first home buyers.[12] Developers have also expressed concern that their contributions to the cost of infrastructure (both direct and indirect) are not transparent and increasingly appear to be a form of revenue raising by the State and local government for the provision of community services.[13]

The housing and land development industry is also concerned that taxes, infrastructure costs and local government fees are becoming a significant proportion of the total cost of purchasing a home. These factors include State taxes (mainly stamp duty), the GST on new houses, infrastructure charges by major utilities and various fees and charges levied by local government.

The analysis in this Chapter indicates that for Western Australia:

- State taxes are not a significant contributor to movements in the affordability of housing. House price increases have far exceeded the growth in State taxes on housing;
  - since mid-1993, the median house price for a first home buyer has increased by around $78,000, while the amount of stamp duty payable has increased by $4,520 (after allowing for the stamp duty rebate for first home buyers);
  - the average amount of stamp duty payable by the home buyer remains a small proportion of the total house price, while the main tax impost for new housing is the GST;
- while infrastructure costs represent a substantial proportion of total costs for land developers, the charging practices of major utilities (water/sewerage, power and gas) are based on cost recovery and applied in a transparent manner;
  - moreover, the major infrastructure costs for developers are incurred "on-site" (i.e. minor water/sewerage works, roads, footpaths, landscaping etc.). These on-site costs do not involve charges by major utilities; and
  - to a certain extent, these types of infrastructure costs reflect community preferences and expectations for increased quality and amenity in land developments, such as road quality and landscaping;

[12] For example, see transcript of the Prime Minister's interview with Alan Jones on 4 August 2003 (www.pm.gov.au).

[13] For example, see Housing Industry Association's paper entitled "Restoring Housing Affordability", July 2003.

- where developers are required to make special contributions for infrastructure (such as to local government), these are limited to circumstances where the subdivision is considered by the WAPC to contribute to the need for the particular infrastructure or facility for which the contribution is being sought (i.e. such as a need to upgrade a road which is not actually located on the subdivision, but will carry increased traffic to and from a subdivision);
  - the amount and nature of these contributions by developers are subject to approval by the WAPC, which also requires local government to spend the funds within a reasonable period of time;
  - importantly, under WAPC guidelines, developers' contributions to local government do not extend to the funding of general community services (such as libraries), as developers claim is occurring in some other States; and
- local government fees (i.e. planning fees, subdivision approvals) are minor administrative charges levied on a user-pays basis.

STATE TAXES

The major State taxes which impact on the residential property sector are stamp duty on conveyances and land tax. Stamp duty on property conveyances (also known as conveyance duty) is the largest duty payable by the home purchaser. While land tax is not generally payable by owner-occupiers, it may be incurred by land developers as a holding cost for land being held for development or unsold sub-divided land.

Conveyance duty rates

Conveyance duty is payable by the purchaser or "transferee" of real property such as land, buildings (including fixtures) and business goodwill. The current rates of duty (applying from 1 July 2003) are as follows:

Property Value	Rate of Duty
$0 to $80,000	$2.30 per $100 or part thereof
$80,001 to $100,000	$1,840 and $3.45 per $100 above $80,000
$100,001 to $250,000	$2,530 and $4.75 per $100 above $100,000
$250,001 to $500,000	$9,655and $5.90 per $100 above $250,000
Above $500,000	$24,405 and $6.30 per $100 above $500,000

Recent changes to the rates of stamp duty on conveyances are as follows:

Value $'000	Marginal Tax Rates % From 1 Nov 1983	From 1 July 1998	From 1 July 2002	From 1 July 2003
less than 80	1.75	1.95	2.00	2.30
80 – 100	2.50	2.85	3.00	3.45
100 – 250	3.25	3.70	4.15	4.75
250 – 500	4.00	4.55	5.15	5.90
above 500	4.25	4.85	5.50	6.30

Land tax rates

Land tax is an annual tax based on the ownership and use of land at 30 June immediately preceding the financial year to which the assessment applies. Taxable land includes vacant land (including land held by land developers), rental properties and commercial properties. Major exemptions include residential owner-occupiers and land used in primary production.

Land tax is levied upon the unimproved value of taxable land held as at 30 June and the current rates are as follows:

Land Tax Scale for 2003-04

Unimproved Value of Land $'000	Land Tax Payable
0 – 50	Nil
50 – 190	$75.00+0.15c per $1 above $50,000
190 – 550	$285.00+0.45c per $1 above $190,000
550 – 2,000	$1,905+1.76c per $1 above $550,000
2,000 – 5,000	$27,425+2.30c per $1 above $2,000,000
Over 5,000	$96,425+2.50c per $1 above $5,000,000

Direct Impact of Stamp Duty on Affordability

Recent media reports, the housing industry and even the Federal Government have highlighted stamp revenue "windfalls" for the States arising from the strong activity in property markets in recent years. Land tax has attracted less attention, reflecting that owner-occupiers of residential property are generally exempt from this tax.

In view of a rapid rise in house prices, the Federal Government and the housing industry have suggested the States consider reducing stamp duty to assist home buyers.[14]

[14] For example, see transcript of interview between Federal Treasurer and Tim Lester, 7.30 Report, 30 July 2003 (www.treasurer.gov.au).

An objective reading of the data indicates that stamp duty is not making a significant contribution to the decline in housing affordability, or that reductions in stamp duty would be an effective means of assisting home buyers. In this regard, it is important the Productivity Commission takes into account the following factors in its assessment of this issue:

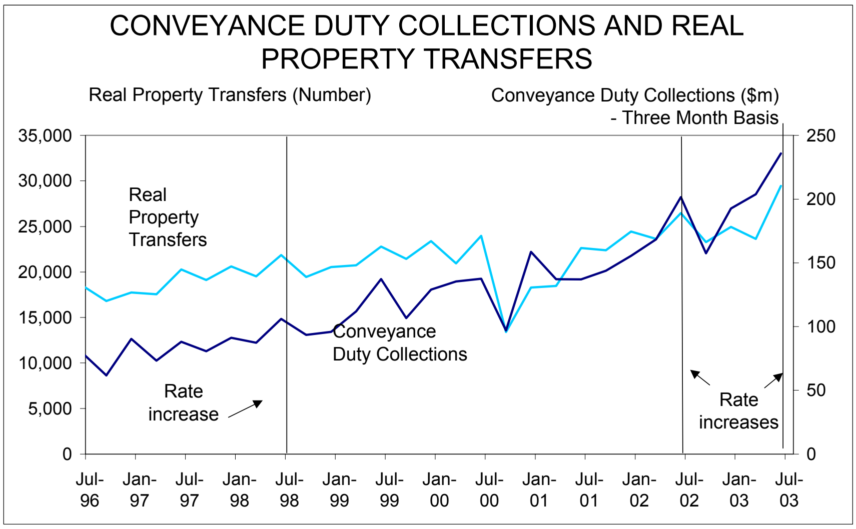
- stamp duty payable on a median priced house ($156,000) for a first home buyer represents just 3.3% of the price. This is substantially less than other cost components such as infrastructure and the GST;

- house prices have increased by substantially more than stamp duty in recent years;

  - the increase in stamp duty payable on a median-priced home is around $3,500 over the last three years, compared to a $53,000 increase in the median house price;

  - since mid-1993, the median house price has increased by around $105,000, while the amount of stamp duty payable has increased by $5,700 (after allowing for the stamp duty rebate for first home buyers);

  - as shown in the chart below, property transfers have remained strong in Western Australia, notwithstanding increases in conveyance duty rates in the past two years; and



Source: Department of Treasury and Finance

- it is unlikely that stamp duty reductions would be an effective means of improving affordability for home buyers;

  - indeed, it has been suggested by at least one private sector commentator that in an environment of strong demand for housing, a reduction in stamp duty may simply lead home buyers to increase the (pre-stamp duty) amount which they are willing to pay for a property, with no net impact on affordability.[15]

[15] Saul Eslake, ANZ Bank, "Is the Australian Property Market in Bubble Trouble?", Presentation to the Urban Development Institute of Australia (Queensland), 4 September 2003.

INFRASTRUCTURE COSTS

A general principle that applies to funding of the infrastructure needs of a new subdivision is that the cost should largely be met by the party that builds on developed land and thereby gains from future capital gains.

It is useful to distinguish two categories of infrastructure costs for land developers in Western Australia. These are:

- the charges paid to major utilities (water/sewerage, power and gas) for connection to, and/or the major works undertaken for the extension of existing networks; and

- other infrastructure costs, including special developers' contributions and the "on-site" costs incurred by developers on minor works for water/sewerage and power, roads, footpaths, landscaping etc.

Water/Sewerage

Water/sewerage headworks charges are generally the largest charges levied on developers by the major utilities in Western Australia.

The Water Corporation of Western Australia currently levies "headworks" charges on the basis that land developers should meet 40% of the cost of building the water/sewerage infrastructure that is required to service a subdivision.

- The remaining 60% is recovered from householders as a component of annual service charges.

- Importantly, there is no "tax" element to the headwork charges, although there may be some dispute as to how much should be recovered through up-front fees (payable by the developer) and how much through the annual service charges (payable by the home owner).

Under this arrangement, the Water Corporation treats the following "off-site" items as headwork infrastructure:

- for water supply – dams, catchments, bores, water treatment plants, distribution mains and reservoirs;

- for sewerage – treatment plants, pumping stations, rising mains and main sewers; and

- for drainage – main drains and compensation basins.

A specific complication for headworks charges is the issue of how to attribute the impact of a new development on the demand for infrastructure (such as dams, catchments and treatment plants) which is substantially constructed in advance (sometimes by many years) of expected demand.

- In this regard, the Water Corporation's underlying approach is to derive a total value for all existing headworks infrastructure and divide this value by the total number of residential units serviced by its network.

- This average existing cost is then assumed to apply to each new residential lot in a subdivision.
- For a standard residential lot, water/sewerage headwork charges currently amount to around $4,390 (comprising $2,600 for water and $1,790 for sewerage/drainage).

Where developments occur beyond the existing servicing frontier for water and sewerage services, additional headworks contributions may be applied by the implementation of Special Developer Contribution Areas (SDCAs), or alternatively the developer may pre-fund all of the cost of the required headworks infrastructure. This approach reflects the principle that developers should accept the risk and cost of advancing the timing of the provision of infrastructure.

- Currently in the Perth metropolitan region, there are two main SDCA's (in the North West and North East Sectors), involving additional headwork charges of around $3,000 per lot.
- Where developers pre-fund all of the cost of any required headworks infrastructure, the Water Corporation will refund the cost to the developer after an agreed period (which is generally a maximum of 10 years).

Power

Western Power's development charges are based on recovery of costs for the extension of the existing network within a new subdivision. As there is no "headworks component" (such as a contribution to the additional cost (if any) for power generating stations, major transmission lines), the charging process is much more straightforward than the water/sewerage payments to the Water Corporation.

The developer's contribution to Western Power for a typical residential lot is $2,500 for the full capital cost of the electrical infrastructure within a typical metropolitan residential subdivision with blocks around 600 square meters. This cost includes the high voltage infrastructure (i.e. transformers), low voltage infrastructure and street lighting. It does not include any cabling within the lot boundaries, which form part of minor works provided directly by the developer (see below).

Gas

As a general rule, the major gas utility in Western Australia (Alinta) seeks to avoid charging developers, partly reflecting the relatively low cost of gas infrastructure and a policy of encouraging developers to include the provision of gas in a subdivision at an early planning stage (in Western Australia, gas is not classified as an essential service that must be included in subdivisions).

However, if a new subdivision does not abut existing gas infrastructure, then headworks contributions may be required by Alinta. The amount of these charges is negotiated on a case-by-case basis and adjusted to suit the individual circumstance of each subdivision.

Other Infrastructure Costs

In addition to the charges levied by major utilities, developers typically directly provide and fund all other infrastructure within a subdivision, such as roads, footpaths, landscaping, minor works for water/sewerage and power (i.e. reticulation from mainlines to, and within, individual lots) and drainage. Although the cost of these types of infrastructure will vary according to topography and the intended market for the development (e.g. home buyers may place a premium on the landscaping of a subdivision), the total cost for developers is usually substantially higher than the infrastructure payments to major utilities (see section below – Relative Contributions to Housing Costs of Taxes, Infrastructure and Local Government Fees).

Also, under the *Town Planning and Development Act 1928*, special infrastructure payments may be required from developers to meet an increased need for various offsite infrastructure, such as a need for a local council to upgrade an arterial road to meet increased traffic or a requirement to extend the public transport system to developments beyond the existing urban frontier.

- The nature of these contributions will vary according to individual circumstances and are subject to approval by the WAPC.

- Under the principles applied by the WAPC, local governments are not able to seek contributions from developers for the purpose of funding general community services (such as libraries), as developers claim is occurring in some other States. Local government infrastructure charges in Western Australia are modest and substantially lower than charges (reportedly up to $64,000 per lot) in Sydney.

LOCAL GOVERNMENT FEES

The local government fees and charges paid by developers are administrative in nature and calculated on the basis of the cost of services provided. These fees are relatively minor. An indicative schedule of the fees and charges is provided below, although there will be some minor variations in the fees between the various local governments.

Local Government Fees

Description of Planning Services	Indicative Fees
Development applications	
where the development cost is:	
$50,000 or less	$100
$50,000 to $500,000	0.23% of cost of development
$500,000 to $2.5m	$1,150 + 0.18% of excess
$2.5m to $5.0m	$4,750 + 0.15% of excess
$5.0m to $21.5m	$8,500 + 0.1% of excess
more than 21.5m	$25,000
Sub-division clearance	
up to 5 lots	$50 per lot
5 to 195 lots	$250 plus $25 per lot in excess
more than 195 lots	$5,000
Scheme amendments	
minor text	$1,820
major text	$2,100
(estimated using maximum fees set out in Regulations)	
Building applications	
buildings/alterations	$40
Building licence applications	
single dwelling or additions	$600

Source: WAPC

RELATIVE CONTRIBUTIONS TO HOUSING COSTS OF TAXES, INFRASTRUCTURE AND LOCAL GOVERNMENT FEES

The tables below show the relative impact of State taxes, infrastructure costs and local government fees on the cost of housing in the context of all the factors (including the GST) which contribute to the final purchase price for the buyer of a new home. These data are based on indicative costings provided to the Western Australian Government for a typical urban in-fill subdivision and green-field subdivision in the Perth metropolitan region, adjusted by the Department of Treasury and Finance to represent a house/land package (with a house construction value of $110,000).

Suburban Greenfield Development

(Middle Sector, Perth Metropolitan Region)

	$ per lot	% of total price (including GST)
Price of a vacant block of land	**15,561**	6.1%
Developer's infrastructure costs	**51,127**	20.2%
Charges by utilities	6,890	2.7%
Water Corporation (for water, sewerage and drainage headworks)	4,390	1.7%
Western Power (electricity connection)	2,500	1.0%
On-site infrastructure costs (non-government)	44,237	17.5%
Site preparation (earthworks, levelling, retaining walls, etc.)	14,393	5.7%
Other infrastructure contributions (landscaping, drainage, roads, etc.)	20,782	8.2%
Water and sewerage reticulation and minor works	2,404	0.9%
Electrical reticulation and minor works	1,391	0.5%
Consultant fees	5,267	2.1%
Government taxes, fees and charges paid by the developer	**3,604**	1.4%
Stamp duty on land purchase paid by the developer	925	0.4%
Land taxes (holding cost, if applicable)	1,693	0.7%
Local government clearance fees and charges	123	0.0%
Local government rates (holding cost, if applicable)	863	0.3%
Net GST (on land purchase and development costs)	-	-
Developer's management and finance costs	**9,204**	3.6%
Selling costs and other professional fees	**16,261**	6.4%
Advertising, agent's commisions, legal and settlement costs	16,261	
Developer's margin	**24,553**	9.7%
Total land value (excluding GST)	**120,310**	47.5%
House construction (excluding GST)	**110,000**	43.4%
Total house and land value (excluding GST)	**230,310**	90.9%
GST paid by home buyer	**23,031**	9.1%
Total house and land price (including GST)	**253,341**	100.0%
Stamp duty paid by a home buyer (for house/land package)	*9,814*	*3.9%*

Source: Department of Treasury and Finance

Urban Infill Development

(Single Residential Lots of Approximately 500 sq m)

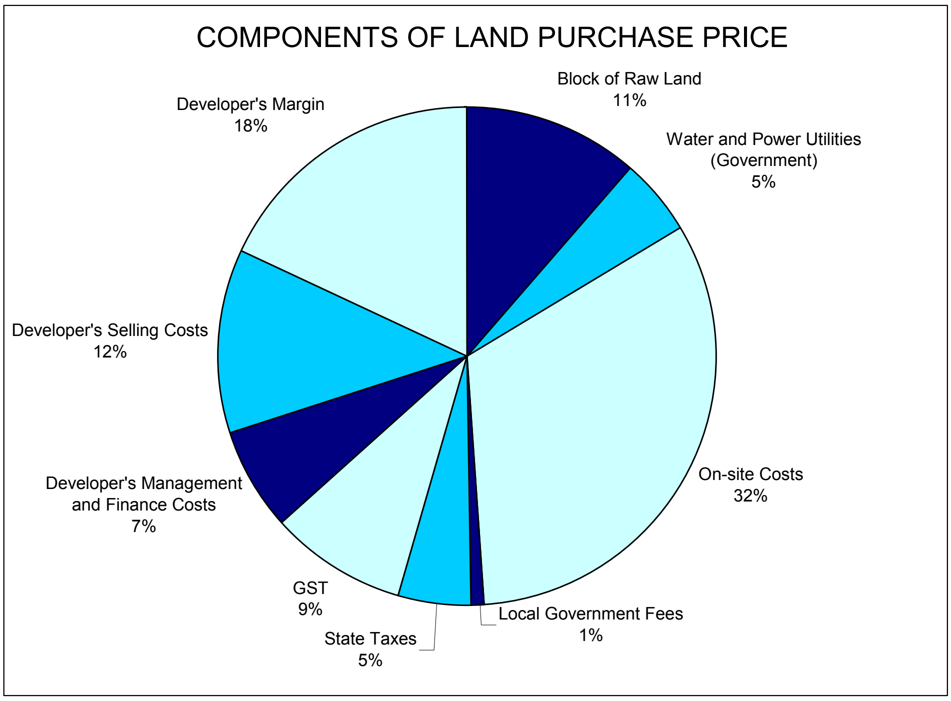
	$ per lot	% of total price (including GST)
Price of a vacant block of land	**109,524**	33.5%
Developer's infrastructure costs	**39,252**	12.0%
Charges by utilities	6,890	2.1%
Water Corporation (for water, sewerage and drainage headworks)	4,390	1.3%
Western Power (electricity connection)	2,500	0.8%
On-site infrastructure costs (non-government)	32,362	9.9%
Site preparation (earthworks, levelling, retaining walls, etc.)	12,100	3.7%
Other infrastructure contributions (landscaping, drainage, roads, etc.)	13,044	4.0%
Water and sewerage reticulation and minor works	3,000	0.9%
Electrical reticulation and minor works	1,310	0.4%
Consultant fees	2,908	0.9%
Government taxes, fees and charges paid by the developer	**9,803**	3.0%
Stamp duty on land purchase paid by the developer	6,816	2.1%
Land taxes (holding cost, if applicable)	2,283	0.7%
Local government clearance fees and charges	105	0.0%
Local government rates (holding cost, if applicable)	600	0.2%
Net GST (on land purchase and development costs)	-	-
Developer's management and finance costs	**12,176**	3.7%
Selling costs and other professional fees	**5,603**	1.7%
Advertising, agent's commisions, legal and settlement costs	5,603	
Developer's margin	**10,849**	3.3%
Total land value (excluding GST)	**187,206**	57.3%
House construction (excluding GST)	**110,000**	33.6%
Total house and land value (excluding GST)	**297,206**	90.9%
GST paid by home buyer	**29,721**	
Total house and land price (including GST)	**326,927**	100.0%
Stamp duty paid by a home buyer (for house/land package)	*14,784*	*4.5%*

Source: Department of Treasury and Finance

The tables highlight that the major taxation impact is from the GST (accounting for around 9% of the cost), although this would be partly offset by the $7,000 First Home Owner Grant if the property were purchased by a first home owner. Stamp duty accounts for 3.9% of an urban in-fill subdivision and 4.5% of a suburban greenfield subdivision. This further supports the preceding observation that stamp duty is not a significant cost factor in the affordability of housing.

In regard to the non-taxation factors, the major costs for developers are those associated with "other infrastructure", rather than payments to major utilities for water/sewerage and power. Moreover, a major contribution to long term increases in the cost of new housing has come from "other infrastructure" (a recent survey by the Urban Development Institute of Australia suggested that, as a proportion of total housing costs, other infrastructure costs have increased from 27% in 1992 to around 31% in 2002). This partly reflects the trend toward greater amenity and quality in property development (such as landscaping and road quality) in the preferences of new home buyers, including first home buyers.

The pie chart below summarises the various contributions to the final selling price of the land (i.e. excluding the house) component of the middle sector subdivision represented in the table above.



Source: Department of Treasury and Finance

Again, the pie chart illustrates that total State taxes are a minor component of total costs (5%), with the major cost contributions arising from the GST (9%), on-site infrastructure which is funded by the developer (32%) and the developer's margin (18%, although this component would be significantly influenced by demand conditions at the time of marketing a subdivision and would vary greatly between developers and the type/location of the subdivision).

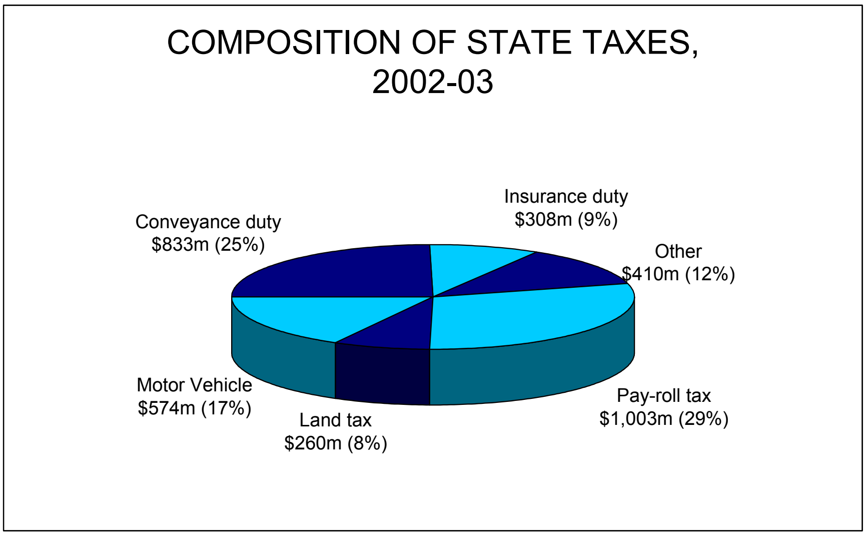
The relative magnitude of the cost components of land and housing would vary across the metropolitan, regional and remote areas of Western Australia. While detailed data are not available, as a general rule the cost of the provision of infrastructure and housing construction would be higher in remote and regional regions, particularly in the north-west of the State.

CHAPTER SIX

LIMITATIONS ON STATE REVENUE SOURCES AND NEED FOR REFORM OF COMMONWEALTH-STATE FINANCIAL ARRANGEMENTS

As discussed in Chapter Five, stamp duties and land tax are the main forms of State taxes which impact on the cost of housing. Chapter Five also indicated that State taxes only account for a small proportion of the cost of housing. However, it is also noted that the Federal Government and the housing industry have suggested that the States consider reducing stamp duty.

Reflecting the importance of conveyance duty and land tax, conveyance duty raised $833 million or 25% of Western Australia's total taxation revenue in 2002-03. Land tax raised $260 million or around 8% of total taxation revenue.



Source: 2002-03 Final Budget Outcome, Department of Treasury and Finance

On current policy settings, Western Australia's total revenue is projected to decline from 14.25% of GSP in 2002-03 to 12.25% in 2006-07.

Because of the States' limited tax bases, declining share of national revenues and, particularly in Western Australia's case, the effects of the Commonwealth Grants Commission (CGC) process, any reduced reliance on property taxes would need to take place in the context of reform to Commonwealth-State financial relations.

NEED FOR REFORM OF COMMONWEALTH-STATE FINANCIAL ARRANGEMENTS

Limited State Tax Bases

Notwithstanding the size and recent growth in revenues from property related stamp duties, there is limited scope for Western Australia to reduce its reliance on existing taxes (such as stamp duties) and continue to meet the growth in demand for community services and capital infrastructure.

In this regard, any significant reduction in stamp duty revenue would need to be offset by an increase in revenue from other taxation sources (such as pay-roll tax) which may have other adverse implications for economic efficiency and activity. The Productivity Commission acknowledged this difficulty for the States in its 1993 report on Taxation and Financial Policy Impacts on Urban Settlement, when it advocated "less emphasis" on the use of stamp duty by the States and suggested that a possible revenue offset could be achieved by broadening the land tax base (e.g. removing major land tax exemptions, such as for own-occupiers and primary production). This highlights the very limited revenue raising options available to the States to offset any reduction in stamp duty.

The current Commonwealth-State financial arrangements also provide very limited scope for the States, and Western Australia in particular, to have a reduced reliance on stamp duty.

The Commonwealth Government has almost exclusive powers to levy taxes on the Federation's largest tax bases - income and the production and consumption of goods. This is a result of:

- the Commonwealth takeover of State income taxes during World War II, initially as a temporary wartime Commonwealth revenue raising measure; and

- restrictive High Court interpretations that have limited States' Constitutional powers to tax the production and consumption of goods.

As a consequence of the Commonwealth's domination of these tax bases, the States are relatively constrained in their revenue raising powers. In this regard:

- because the remaining tax bases available to the States are relatively narrow and inefficient there are limits to the amount of revenue that can be collected from these bases; and

- the States are heavily reliant on grants from the Commonwealth Government (which raises more revenue than it needs to cover its direct expenditure responsibilities). In 2002-03, around 45% of Western Australian State Government revenue was sourced from Commonwealth grants.

This structural imbalance between the taxation and expenditure responsibilities of the Commonwealth and the States was substantially increased by national tax reform in 2000-01. Under the GST arrangements, the States receive all the proceeds of the Commonwealth's GST revenue which is collected by the Commonwealth and distributed on the basis of allocations recommended by the CGC. In return, the States agreed to:

- forego a number of sources of revenue including financial assistance grants and revenue replacement payments from the Commonwealth, a range of State taxes and to reduce gambling tax rates; and

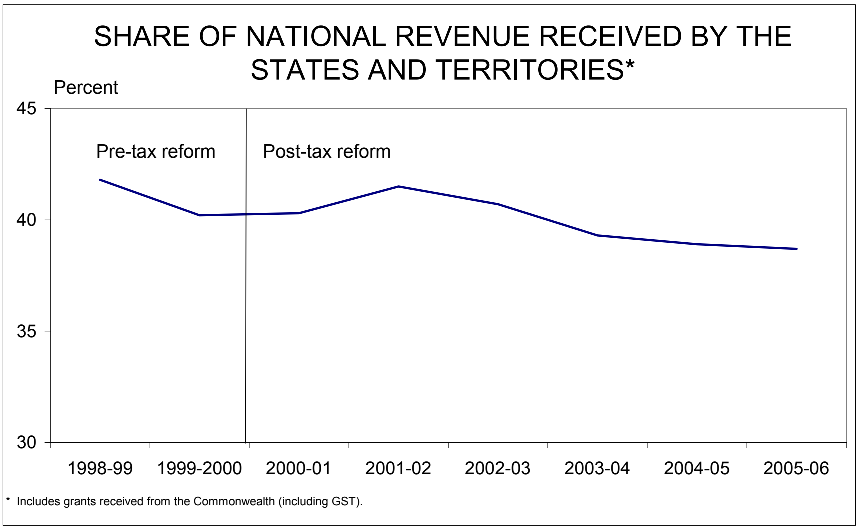
- take on additional expenditure responsibilities, such as the cost of the First Home Owners Grant Scheme and the costs associated with the administration of the GST by the Australian Taxation Office.

These tax reforms increased substantially the States' reliance on the Commonwealth for revenues to fund the services for which they are constitutionally responsible. As part of the arrangements, the Commonwealth undertook to ensure the States would not be worse off by providing budget balancing assistance (BBA). This assistance meets the difference between GST receipts and the revenue collections the States would otherwise had received if the reforms had not occurred.

Contrary to claims commonly made by the Commonwealth Government, States are yet to receive a significant financial benefit from the GST-related reforms. In 2002-03 most States received BBA and on current projections Western Australia is not expected to be permanently off BBA until 2006-07. Furthermore, changes made unilaterally by the Commonwealth to the calculation of BBA have reduced States' BBA entitlements. Accordingly, States may be off BBA and still not be receiving a net financial benefit from the GST-related reforms.

The States' Falling Share of National Revenue

Projected trends in State and Commonwealth revenue highlight the continuing funding pressures faced by State Governments, which restricts the capacity to reduce existing State taxes.



Source: 2003-04 Northern Territory Budget papers

The chart above, based on analysis prepared by the Northern Territory in May 2003 with input from all States and Territories, illustrates that the States' share of national revenues (raised by Commonwealth and State governments) is projected to decline, from around 41.5% in 2001-02 to 38.7% in 2005-06.

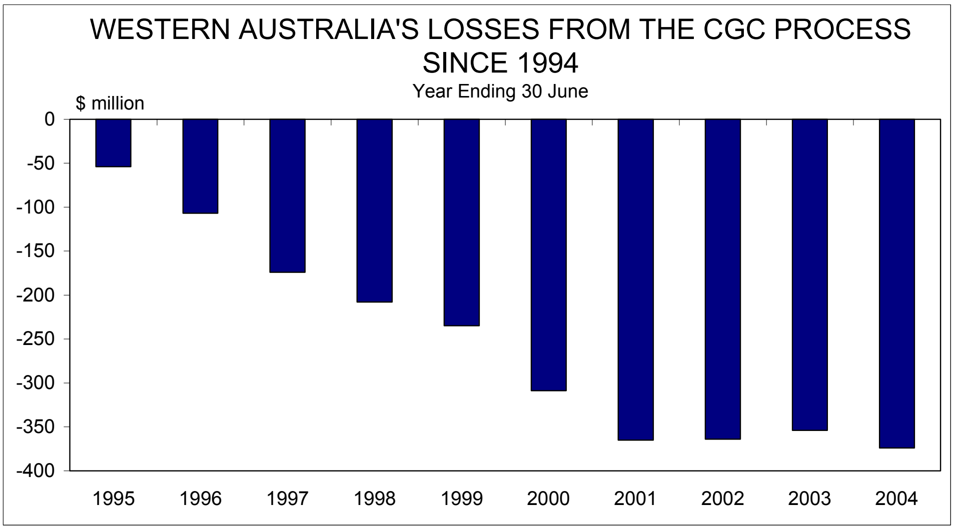
The decline reflects that:

- Commonwealth revenues (excluding the GST) are forecast to grow much faster than total own source revenue for the States (including the GST). Projected growth in Commonwealth revenues of 5.0% per annum between 2001-02 and 2005-06 is substantially more than projected growth of States' own source revenues of 3.5% over the same period; and
- grants "to" the States (excluding the GST) are projected to decline from 12.5% of Commonwealth revenues in 2001-02 to 10.0% of Commonwealth revenues in 2005-06.

These projections illustrate that the States have little capacity to reduce their reliance on conveyance duty. They also illustrate that the Commonwealth has greater capacity to assist the housing market, if required, given the relatively strong projected growth in its revenues.

The CGC Process

Western Australia is further disadvantaged under current Commonwealth-State financial arrangements through the methodology used by the CGC to distribute GST revenues amongst the States.



Source: Western Australia 2003-04 Budget papers

Over the last ten years, the CGC has successively reduced Western Australia's share of grants, with the cumulative impact of these cuts now totalling $374 million per year[16] (see figure below).

These cuts reflect Western Australia's strong growth in mining and petroleum royalties from resource developments (particularly from the North West Shelf project), which has led the CGC to redistribute Western Australia's grants to other States with weaker revenue growth.

However, while the CGC process shares the revenue benefits from these developments among the States through adjustments to grant shares, it does not similarly share many of the costs that States incur in supporting economic development, including providing infrastructure to service growing populations.

In this regard, Western Australia has noted for some time that the CGC provides little recognition for many of the State's development costs, such as common-use infrastructure for industrial developments, new or expanded social infrastructure to support population growth, and affordable access to energy and water services for communities in regional areas. However, the CGC effectively redistributes 90% of the royalties generated from resource projects in Western Australia to other States.

As a result, Western Australia believes that the CGC's funding shares significantly understates Western Australia's funding requirement to achieve parity with other States.

[16] The impact of cuts in earlier years increases over time due to the escalation of grants for inflation and population growth. These escalation impacts are not included in the $374 million cumulative cutback.

In these circumstances, the additional budget pressure in Western Australia would make it even harder than in other jurisdictions to offer property tax relief.

STATE GOVERNMENT INITIATIVES TO ASSIST HOME BUYERS AND PUBLIC HOUSING

The Western Australian Government has a number of effective programs and processes in place to ensure an adequate supply of affordable housing. Substantial assistance is provided to first home buyers through a number of programs, including stamp duty rebates, access to affordable finance, shared equity schemes for public housing tenants, Indigenous Australians and people with disabilities and grants. The Western Australian Government will continue to provide extensive support for first home buyers.

A State Housing Strategy is being developed by agencies for consideration by the Western Australian Government. The aim is to develop a strategy to ensure that housing remains affordable, particularly for low income and other groups in the community for whom the system may not deliver suitable outcomes and will have a dependence on public housing policies (Appendix 1 contains an outline of the level and nature of public housing in Western Australia).

The remainder of this Chapter outlines the various forms of assistance to home buyers provided by the Government.

STAMP DUTY REBATE

The Western Australian Government provides conveyance duty rebates to first home owners. In particular, it currently provides a $500 conveyance duty rebate to first home buyers for property purchases up to: $135,000 for established homes; $202,500 for established homes above the 26th parallel; and $52,000 for vacant land, upon which a residence is built by a first home buyer.

The Government has introduced legislation to increase property value eligibility thresholds for the $500 rebate at a cost to Government of around $2 million per annum. Thresholds will be raised to: $185,000 for established homes; $277,500 for established homes above the 26th parallel; and $72,000 for vacant land.

The increased thresholds will be quite generous.

- The revised threshold for established homes will be 19% above the 2002-03 median State-wide established house price for first homebuyers of $156,000.
- Latest estimates (based on 2002-03 data) suggest that currently, around 5,200 or 37% of first home buyers are eligible for the $500 conveyance duty rebate. With the increased thresholds, around 9,300 or 66% of first home buyers will be eligible.

ACCESS TO AFFORDABLE HOUSING

Keystart

The State's Keystart program provides access to home ownership for Western Australians who have difficulty meeting the deposit requirements of private sector institutions. Keystart has helped around 48,000 Western Australian households become homeowners since it began in 1989, representing over $3.8 billion of low deposit home loans.

Under Keystart:

- borrowers only require a low 2% or $2,000 deposit (whichever is the greater) or they may use the $7,000 First Home Owners Grant (FHOG) to cover the deposit and any loan fees if they do not have that amount already saved;
- borrowers can borrow up to a maximum of $225,000 to purchase a home for a maximum purchase price of $250,000;
- the maximum assessed income for eligibility is $85,000 per applicant;
- fee assistance is offered but there are no monthly fees and no mortgage insurance costs. Interest rates are competitive with commercial lending rates; and
- a safety net scheme is in place to help Keystart borrowers whose financial situation deteriorates after their loan is approved and who, without help, might lose their home.

Keystart currently accounts for approximately 21% of first home owner loan approvals, compared to around 37% in 1998-99 (see table below). This decline mainly reflects an increase in accessibility of private lending institution home loans to first home owners, driven by increased competition between lending institutions, lower deposit requirements, the introduction of the FHOG and low interest rates.

	Keystart First Home Owner Approvals		**Total Western Australian First Home Owner Approvals**		**Keystart Approvals as a % of Total Western Australian Approvals**	
	Approvals	*$m*	*Approvals*	*$m*	*% of Approvals*	*% of Value*
1998-99	5,617	544	15,200	1,552	37%	35%
1999-00	4,239	406	15,323	1,751	28%	23%
2000-01	3,728	345	17,070	1,898	22%	18%
2001-02	3,338	307	17,704	2,194	19%	14%
2002-03	2,656	282	12,807	1,683	21%	17%

Source: Department of Housing and Works

However, total loan approvals under Keystart are expected to increase over coming years, following implementation of a business model which will allow mortgage brokers to recommend Keystart home loans to customers.

The value of total loan approvals under Keystart is expected to increase to around $432 million in 2003-04 and $444 million in 2004-05, representing an estimated 5,000 approvals per annum. This compares to a total of 3,424 loans amounting to $373 million approved in 2002-03.

Additional information on Keystart is provided in Appendix 2.

New Living Program

The State undertakes an urban renewal program (the New Living Program) whereby old public housing stock is renovated and refurbished and then offered for sale at modest prices to former tenants and home owners. New rental homes are then provided in other areas to bring about a better spread of public housing. This reduces the concentration of public housing in a given area, producing a better social mix and reducing antisocial behaviour.

The New Living Program has transformed numerous marginalised areas across Perth and regional Western Australia into liveable, sought-after communities. There are now eight metropolitan projects covering 18 suburbs across Perth, plus eight country projects extending from Esperance to South Hedland. In 2003-04, it is projected that 485 living units will be sold and 400 refurbished under the New Living Program.

Since the initial projects commenced in the suburbs of Lockridge and Kwinana in 1995, New Living has won numerous awards, including the 1999 World Habitat Award.

SHARED EQUITY SCHEMES

GoodStart

The State's GoodStart Shared Equity Loan Scheme is designed to provide an affordable process for public housing tenants to purchase from 70% to 100% equity in their current rental property. Under the GoodStart scheme, the DHW retains equity rent-free in the portion of the property that the purchaser is unable to finance. Later the purchaser has the option of buying all or part of the Department's share.

1,146 families have been assisted since the Scheme's inception in 1997.

Under the GoodStart scheme:

- a minimum deposit of $2,000 or 2% is required (the $7,000 FHOG may be used towards the deposit);
- properties up to a value of $250,000 may be purchased; and
- although borrowings are dependent on the applicant's income, borrowings are capped at $225,000.

Applicants for the GoodStart scheme must:

- be a current Homeswest tenant, an applicant on the rental waiting list or eligible to apply for Homeswest rental accommodation;
- over 18 years of age;

- not have any debts owing to Homeswest or Keystart;
- have a satisfactory rental and credit history, including not being currently bankrupt or discharged from bankruptcy within 2 years of the date of the application;
- be able to demonstrate a capacity to meet the required repayments;
- not own or part-own another property or land in Australia; and
- not exceed set income limits.

Access Home Loans

Access Home Loans gives people with disabilities the opportunity to enter home ownership, to obtain funds to modify a house to better meet their disability needs, or to re-finance their home if they are no longer able to pay an existing loan due to a disability.

Since the Scheme's inception in 1995 it has assisted 463 families with $35.7 million.

Funds are made available for clients to purchase a minimum of 70% share of a property with the DHW owning the remaining share. Like the GoodStart Scheme the borrowers do not pay rent on the DHW's share of the property however the client is responsible for total cost associated with maintenance and rates on the property.

The loans are provided based on a $1,000 deposit over a maximum of 30 years. As most of the Scheme's borrowers are on low incomes, the loan is structured such that mortgage repayments and an allowance for the repayment of rates and insurance never take up more than 25% of the borrower's gross income.

Aboriginal Home Ownership Scheme

The Aboriginal Home Ownership Scheme is run by Aboriginal people to provide housing solutions specifically for people who are Aboriginal or Torres Strait Islanders.

The Scheme has assisted 395 families with $37.8 million in finance since its inception in 1994.

The Scheme comprises of a shared-equity arrangement assisting the client to purchase a minimum 70% share in a Homeswest or private sector property. The remaining 30% share can be purchased from the DHW when the borrowers' financial circumstances improve.

The loan is structured so the repayments never take up more that a total of 23% of the purchaser's gross (before tax) income.

The maximum property value that can be purchased is $160,000 throughout Western Australia with exceptions of Broome, Karratha, Kununurra and Port Hedland where the maximum is $190,000.

Grants

Home Buyers Assistance Fund

The Home Buyers Assistance Fund provides a grant of up to $2,000 for the incidental expenses of first home buyers when they purchase an established or partially built home through a licensed real estate agent.

The Real Estate and Business Agents Supervisory Board is responsible for the scheme, although it has a service contract in place with the Department of Consumer and Employment Protection to administer the scheme.

The Fund is established under the *Real Estate and Business Agents Act 1978*, which requires financial institutions to pay interest earned by real estate agents' trust accounts to the Board.

The grant can be used for stamp duty, registration fees, solicitor and/or conveyancing fees, valuation fees, inspection fees, establishment fees, mortgage insurance premiums and lending institution fees associated with lodging the application.

To be eligible for the grant the value of the property purchased must be less than:

- $95,000 in metropolitan and country areas;
- $140,000 in remote areas; and
- $160,000 any area north of the 26th parallel.

First Home Owners Grants (FHOG)

As part of the Intergovernmental Agreement on the reform of Commonwealth-State Financial Relations (IGA) signed in June 1999, the States and Territories have agreed to provide financial assistance to Australians who are buying their first home through the establishment of the FHOG.

Applicants are entitled to a one-off $7,000 grant providing they meet the Scheme's eligibility criteria (as agreed by the Commonwealth and the States and set out in the IGA).

Although the Commonwealth currently provides the States with funding for the FHOG Scheme, this is only a transitional arrangement. In this regard:

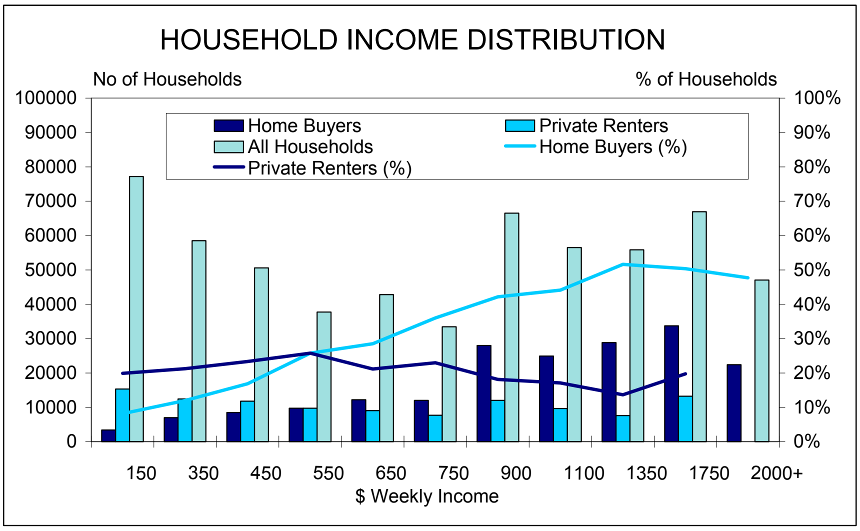
- under national tax reform, the States receive the GST collections in return for foregoing certain revenues and accepting additional expenditure responsibilities - including the FHOG Scheme;
- initially the GST revenues are insufficient to make up for the foregone revenues and increased expenditure responsibilities of the States, so the Commonwealth Government pays top up grants (which includes an allowance for FHOG) to ensure that the States are no worse off as a result of the tax reform arrangements;
- once the GST revenues exceed the revenues forgone and the increased expenditures there will not be a link between Commonwealth grants and FHOG expenditures. States will then have to fund the FHOG out of GST revenues.

APPENDIX ONE

THE LEVEL AND NATURE OF DEMAND FOR PUBLIC HOUSING IN WESTERN AUSTRALIA

If households cannot access home ownership because they are unable to save a sufficient deposit and/or have insufficient income to meet the necessary loan repayments then they will be forced to remain in alternative accommodation arrangements, including in rental accommodation. Increased demand in the private rental sector will lead to higher rents and may well lead to greater affordability problems for low income and other disadvantaged groups than currently exist. This will present a challenge for public housing policies, given the real decline in Commonwealth funding under the Commonwealth State Housing Agreement (CSHA) in recent years (discussed below).

The chart below shows household income distribution in Western Australia for home buyers, private renters and all households in 2001. The chart highlights the predominance of private rental households in the lower income ranges. The changeover point in the proportion of buyers and renters occurs in the $500-$599 income range, which captured the second income quintile of renters.



Source: Census 2001 data, ABS

The future demand for housing assistance in Western Australia will increase as a result of increasing proportions of:

- aged people with poor provision of retirement income;
- mentally and physically disabled people;
- low-income people as a result of persistent high rates of unemployment and under-employment (growth in part-time, casual, contract employment); and
- indigenous people (the indigenous population in Western Australia is growing at twice the rate of the population as a whole).

Public housing, as a percentage of the total occupied housing stock, has declined from 5.1% in 1996 to 4.5% in 2001. This relative decline in public housing provision is failing to keep pace with the population growth rate and has not been offset by an increase in the stock of low-cost private rental accommodation.

AFFORDABILITY AND HOUSING STRESS[17]

Analysis of 2001 Census data for Western Australia indicated that 11% of households buying their home in August 2001 spent more than 30% of their weekly household income on mortgage repayments. For home buyers in the lowest two income quintiles (income below $954 per week), the proportion of households committing greater than 30% of their household income to repayments was 28%. An estimated 3.5%, or about 25,000 Western Australian households, could be defined as experiencing some level of housing stress due to repayment costs, although households making accelerated repayments may have inflated this figure.

For private rental households, analysis of customised ABS Census data indicated that in 2001, 23% (24,500) of households spent more than 30% of their household income on rent. Broadly the analysis showed the following:

- 11% paid between 30% and 40% of income on rent;
- 8% committed 40-50% of household income to repayments; and
- 4% spent more than 50% of weekly household income on rent.

Of households in the lowest two income quintiles (<$539 per week), 60% were paying greater than 30% of income on rent. This suggests that in 2001 approximately 28,000 of Western Australia's households were experiencing some level of housing stress from rental costs.

Key points on rent affordability for Perth in 2001 were:

- private rental households increased 3% from 90,500 in 1996 to 93,200 in 2001;
- there is significant variability in median rent and income levels at a sub-regional level, ranging from $187 and $798 in the western suburbs to $137 and $555 in outer south eastern suburbs;
- 24% of private rental households paid more than 30% of household income on rent; and
- of private rental households in the lowest two income quintiles (<$539), 62% spent more than 30% of household income on rent.

In regional Western Australia, the key points from the 2001 Census were as follows:

- 23% of private rental households were located in regional Western Australia. The proportion of households renting privately varied from 9.9% in the Wheatbelt to 19.6% in the Goldfields with an average for regional Western Australia of 15.6%; and

[17] The definition of housing stress used is the generally accepted one of those households in the lowest 40% of the income distribution who were paying more than 30% of their income in housing costs.

- regional analysis indicated a high degree of income variability and rent levels and corresponding affordability for private renters. In 2001, approximately 52% of regional rental households in the lower two income quintiles were experiencing some level of housing stress.

Stock of Low Priced Accommodation

Analysis of low-priced private rental accommodation in Australia[18] found the following for Western Australia:

- the stock of low-priced rental dwellings in Western Australia declined by an estimated 39% between 1986 and 1996; and

- low-priced stock declined by 20% in Perth, and by 62% in the rest of the State.

This analysis has been updated with data from the 2001 Census. A comparison with 1996 shows that the decline in lower-priced private rental accommodation that was so evident in the ten-years up to 1996 continued in Perth in the five-years to 2001 but the rest of the State went against the trend. (In this analysis, rents for 2001 were indexed by the consumer price index[19] so that the low-cost rental of $100 per week rent in 1996 was equivalent to $111 in August 2001. The low to moderate rent range of $100 – 150 per week in 1996 was equivalent to $111-167 per week in 2001.)

Changes in Occupied Private Rental Housing in Western Australia

	Perth	Rest of State	Total State
Low Cost Rental			
1996	15,800	6,820	22,620
2001	14,879	7,948	22,827
% change	-5.8%	+16.5%	+1.0%
Low to Moderate Rental			
1996	47,802	12,498	60,300
2001	44,781	13,163	57,944
% change	-6.3%	+5.3%	-3.9%
Total Private Rental			
1996	90,873	25,330	116,203
2001	93,230	28,665	121,895
% change	+2.6%	+13.2%	+4.9%

Source: ABS Census 1996 and 2001

The stock of low-priced rental housing ($100 per week in 1996 dollars) fell by just under 6% in Perth in the five years but in the rest of the state there was a substantial increase of 16.5% in this type of stock. For the low-to-moderate priced rental stock ($100-150 per week in 1996 dollars), again there was a fall in Perth of 6% compared with an increase of just over 5% in non-metropolitan areas.

The total occupied stock of private rental housing increased by 2.6% in Perth, by 13.2% in non-metropolitan areas and by 4.9% for Western Australia as a whole.

[18] Maryann Wulff and Judy Yates, Low Rent Housing in Australia 1986 to 1996, Australian Housing Research Fund, Department of Family and Community Services, March 2001

[19]The All Groups CPI average for the eight capital cities was used to maintain consistency with the study by Maryann Wulff and Judy Yates.

These increases in private rental stock were lower than for total occupied dwellings, which increased by 10.2%, 11.5% and 10.5% respectively.

Interrogation of June 2002 Commonwealth Rent Assistance (CRA) data[20] for private renters in Western Australia, provides a number of other insights into those households vulnerable to housing stress in the private rental market:

- CRA supported at least half of Western Australia's private rental households and close to 10% of Western Australia's households (695,600) are dependent on CRA. This is in addition to the 5% of public and community housing tenants;
- singles or lone persons (50%) and single parents (27%) dominate CRA recipients with approximately a third of singles identified as single sharers living in a group housing arrangement;
- 69% of CRA recipients experienced pre CRA housing stress (>30% income on rent), which fell to 32% when CRA was taken into account; and
- effectively nearly half (47%) the singles were in post CRA housing stress.

DEMAND FOR PUBLIC HOUSING

The waiting list for public rental housing in Western Australia fell from 14,326 in 30 June 1999 to 12,981 as at 30 June 2003. The distribution of the waiting list by region and the change over the four-years to 30 June 2003 are shown in the table below.

Public Rental Housing Waiting List, as at 30 June 1999 and 2003

Region	30 June 1999	30 June 2003	% change
North Metro	5,452	4,355	-20.1%
South Metro	2,761	2,869	+3.9%
SE Metro	2,535	2,317	-8.6%
Southern	501	399	-20.4%
South West	875	786	-10.2%
Central	627	497	-20.7%
Midwest	466	437	-6.2%
Pilbara	455	371	-8.5%
Kimberley	654	950	+45.3%
State Total	**14,326**	**12,981**	**-9.4%**

Source: Department of Housing and Works

Despite the lower numbers on the waiting list, the average waiting time for housing has increased from 13.25 months in 1999-2000 to 15.84 months in 2002-03. Average waiting times in 2002-03 varied from a low of 9.7 months in the Great Southern to 24.3 months in South Metropolitan region. The waiting time in the Kimberley averaged 20.7 months.

[20]The data are created from a constructed unit record file obtained through the housing data repository maintained by the Australian Institute of Health and Welfare and may not be representative of, nor correspond with, official Commonwealth figures.

Priority waiting times in 2002-03 for applicants in urgent housing need, for example through homelessness, to avoid domestic violence or for medical reasons, varied from a low of 24 days in the Mid West up to 3.4 months in the north metropolitan region.

Special Group Needs

Over the last two decades, the demand on public housing assistance has been affected by increasing numbers of people with special housing needs, such as young people, seniors, people with a disability and Indigenous people. The increase in the numbers of homeless people in recent years is also having an impact on the housing responses demanded from social housing providers. For the development of the State Housing Strategy, the size of each group was determined and is shown in the table below.

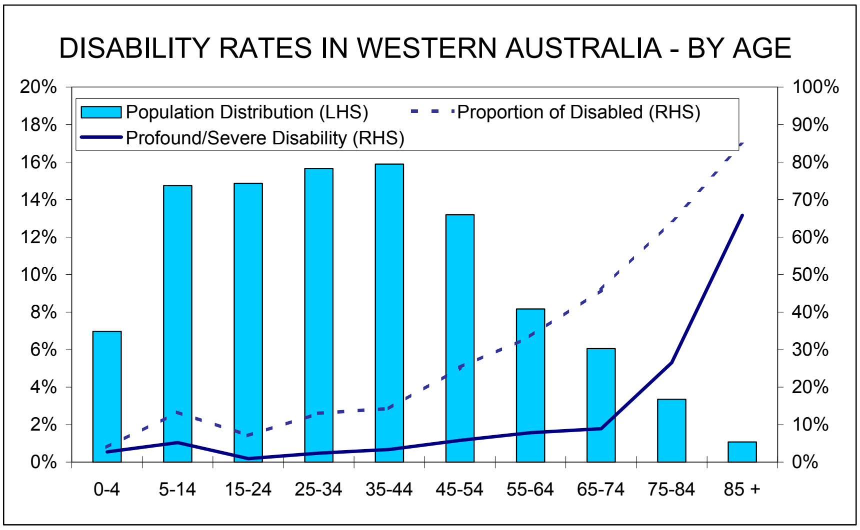
Size of Target Groups with Special Housing Needs – 2001, 2016 & 2031

	Population #		
	2001	**2016**	**2031**
Youth	271,600	317,000	354,000
Seniors	287,000	476,000	700,000
Disabilities	355,000*	512,000^	664,000^
Indigenous	66,000	+	+
Total Population	**1,901,159**	**+**	**+**

Source: Department of Housing and Works
Population figures are Estimated Resident Population (ERP) unless otherwise noted
*1998 ABS Disability, Ageing and Carers Survey
^ ABS projections from Disability Services Commission
+ ABS due to release experimental indigenous population projections March 2004

People With A Disability

The fact that we need to plan for an ageing population is by now well recognised. However, how this ageing will impact on the numbers of people with a profound or severe disability is not. The figure below shows the rates of disability and profound/severe disability in Western Australia according to age cohort in 1998 (latest available data).



Source: ABS.

The Western Australia Disability Services Commission has forecast that over the 30 years to 2031, demographic changes in Western Australia will be quite unlike the State's previous experience. Population growth will be greatest in the 65 years and over age group, which has the highest rate of disability, and will be lowest in the under 45 years age group, which has lower rates of disability. Effectively, therefore, "disability" will have a multiplier effect on population ageing, such that in 2031 the number of older persons with disability will be more than two and a half times that reported in 2001.

INDIGENOUS HOUSING NEED

Indigenous people experience significant housing disadvantage relative to non-Indigenous Australians. Disadvantages include:

- low levels of home ownership (in Western Australia 26% compared to 70% for the population as a whole)[21];
- high levels of dependence on public rental housing, with an estimated 20% of all Indigenous Western Australians currently housed in public housing;
- high levels of dependence on statutory benefits and housing programs;
- high levels of overcrowding, with 7% of Indigenous households Australia wide living in dwellings with 10 people or more, compared to 0.1% of non-Indigenous households;
- higher rates of homelessness and people living in improvised or sub-standard dwellings;
- higher rates of tenancy turnover;
- greater difficulty accessing affordable private rental housing options; and
- high levels of housing poverty, with 16.4% of all Indigenous households (Australia wide) determined to be in "after housing poverty" compared to 8.6% for non-Indigenous households.[22]

Indigenous people represent 3.2% of the total Western Australia population and 14.3% of Indigenous people in Australia. Population growth rates of Indigenous people are significantly higher than for the non-Indigenous population, with a 22% increase in the five-years to1996 and 15% between 1996 and 2001. In contrast the non-Indigenous Western Australia population grew by 7.6% and 5.6% respectively.

A significant back-log of housing need exists in the Indigenous community, particularly in rural and remote areas of Western Australia. To make significant in-roads into the backlog of need requires a significant increase in available funding and improved maintenance and sustainability strategies. A budget requirement for the five years from 2004-05 to 2008-09 has been estimated to total $538.5 million, of which $138.5 million is currently unfunded.

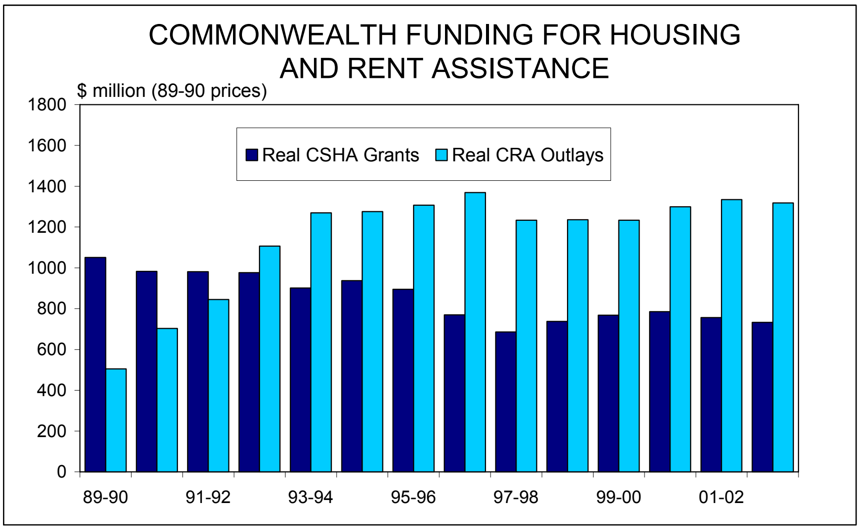
[21] ATSIC, 2002, Indigenous Home Ownership - Summary of ABS Census 2001data.

[22] Commonwealth Grants Commission, Report on Indigenous Funding 2001, pp149. The figure may be higher in Western Australia given the higher proportion of Indigenous people living in remoter communities where employment opportunities are limited.

FUNDING FOR PUBLIC HOUSING

The previous sections have demonstrated the increasing pressures on the demand for public housing assistance. The declining supply of low-priced rental accommodation in the private sector means that this sector will be unable to house those low-income households with only a housing affordability problem. This will be of particular importance if more households are forced to remain in the rental sector because of their inability to access home ownership.

The Commonwealth Government provides two major funding programs for housing: the Commonwealth State Housing Agreement (CSHA) and Commonwealth Rent Assistance (CRA). Funding for the latter two programs has been changing in different ways, with capital funding for the CSHA declining in nominal terms since 1996 and recurrent funding for CRA growing substantially over the same period.



Source: Housing Assistance Act Annual Reports and ABS (CPI).

In 2003-04, Commonwealth funds for public housing declined by a further $98 million in nominal terms, a result of the cessation of compensation for the impact of GST on public housing that was provided under the 1999 CSHA and the continued application of the so-called “1% efficiency dividend”.

In parallel with the decline in funding from the Commonwealth for public housing, the stock of dwellings in the sector has been declining. Over the last decade, most State Housing Authorities have been confronting a backlog of deteriorating public housing and community concern about the older public housing estates built in the 1960s and 1970s. The need to upgrade and refurbish this ageing housing stock has meant less money for new stock acquisition. Refurbishment of existing stock requires the transfer of the tenants into vacant stock while their homes are being refurbished. This has meant that over the last decade that Western Australia has had a lower number of homes to allocate to households on the waiting list for public housing assistance.

Additional cost pressures have been affecting public housing providers through the changing profile of public tenants. In the 1970s, significant numbers of public tenants were in work. Only 12% of public tenants were receiving a rebate on their rent. Also, a significant proportion of public tenants were two-parent families. A combination of the successful promotion of home ownership by the State Government and the move to increased targeting of public housing has resulted in an increased concentration of people with special needs in public housing.

There has been a large increase in public tenants with complex needs and falling household sizes. The increasing concentration of special needs clients in public housing has increased tenancy management costs, including a requirement to provide support for tenants. This can range from assisting unemployed tenants into work to teaching financial skills to prevent tenants being evicted.

As with the community at large, the size of households in public housing has been falling and the average rent paid by tenants has fallen because the household income is lower. This has meant that rent rebates, which are funded by housing authorities, have risen over time with an adverse impact on the financial bottom-line.

An ageing population also has implications for social housing with a mismatch between existing stock and the future profile of applicants. More older and single households will be demanding assistance, given that the average size of households has fallen steadily in recent years.

The squeeze on the financial viability of housing authorities, without a significant increase in government funding, means that public housing will be unable to meet any future increased demand from households unable to access home ownership.

APPENDIX TWO

FURTHER INFORMATION ON KEYSTART

Keystart is Western Australia's government backed home ownership scheme. Keystart's principal role is to provide access to home ownership for Western Australians who would generally have difficulty meeting the deposit requirements of private sector institutions.

Keystart is considered to be the best managed government home ownership scheme in Australia, helping 48,000 Western Australian households become home owners since it began in 1989, representing over $3.8 billion of low deposit home loans.

This paper provides an overview of Keystart's operations, a comparison between Keystart home loans and those of private sector lending institutions, recent financial performance and Keystart assistance to first home buyers and regional areas.

ADMINISTRATION OF KEYSTART

Keystart is a subsidiary of the State Housing Commission (SHC).

Keystart's Board of Directors is responsible for the operations of the scheme. The Directors include the Chairman of Commissioners of the SHC, the Director General of the DHW, the Chief Executive Officer of the Western Australian Treasury Corporation and other Directors with diversified financial institution and management experience.

The Board has engaged a private sector company, Scheme Managers Pty Ltd, to carry out the day-to-day activities of the scheme with loan originators appointed to refer loans to the scheme.

The SHC is obligated to Keystart in that it has given various representations and obligations to the effect that it will meet cash shortfalls from Keystart to investors or other creditors. However, Keystart has a number of protective measures in place to ensure its financial stability and minimise the risk to Government. In this regard:

- all Keystart borrowings are secured by mortgages over the borrower's property and with good capital appreciation over the past two years, this has further strengthened Keystart's security over the properties mortgaged. Furthermore, all properties have normal house insurance;
- the Scheme maintains an adequate provision for doubtful debts, which is reviewed each year by an actuary;
- Keystart has a capital adequacy level of 13%. This is above the Australian Prudential Regulatory Authority guidelines and is considered to be high compared to banks;
- Keystart's approach to financial risk management is one of risk mitigation. Keystart's treasury activities are positioned towards the conservative end of the risk profile and are consistent with the general practice of other financial institutions in Australia. Speculative transactions are prohibited and hedging transactions are only undertaken against an identified underlying exposure; and

- Keystart's policies ensure that the management of interest rate risk is performed in such a manner that Keystart obtains a balance between protection against adverse price movements and participation in favourable price movements. In this regard, external borrowings by the Scheme are being refinanced through the Western Australian Treasury Corporation, taking advantage of the Corporation's superior borrowing advantages and further reducing balance sheet risk.

Keystart's financial soundness continues to grow with the Scheme consistently making profits over the past five financial years and the net worth of the Trust increasing from $60.4 million in 1997-98 to $119.0 million at 30 June 2003.

INTERSTATE COMPARISONS

The following table shows that in the year ending 30 June 2002, government backed home purchase assistance in Western Australian accounted for 55% of total national government backed loan approvals and 63% of the value of those approvals.

HOME PURCHASE ASSISTANCE PROVIDED FOR THE YEAR ENDING 30 JUNE 2002

	Vic(a)	Qld	WA	SA	Tas	NT	Total
No. of Loan Approvals	70	96	3,998	2,650	204	247	7,265
Value of Approvals $,000	8,036	6,649	372,000	163,614	8,962	26,724	585,985

(a) New South Wales and the ACT do not provide direct lending assistance.
Source: Commonwealth-State Housing Agreement National Data Reports 2001-02

Keystart is the only government backed home purchase assistance scheme in Australia that provides all of the following services: direct lending; deposit assistance; interest rate assistance; home purchase and advisory counselling; and mortgage relief.

KEYSTART IN COMPARISON TO PRIVATE SECTOR LENDERS

Keystart home loans are not strictly for low to moderate income earners, (the maximum assessed income for eligibility is $85,000 per applicant). However, Keystart home loans have a number of features that make them particularly attractive in comparison to private sector home loans.

- Low deposit.
  - The most notable feature of Keystart loans is that borrowers only require a low 2% or $2,000 deposit (whichever is the greater).
  - This is compared to private sector lenders which will loan up to a maximum of 95% of the value of a property (i.e. 5% minimum deposit).
  - Borrowers with Keystart may use the FHOG to cover the deposit and any loan fees if they do not have the required deposit already saved.

- No mortgage insurance fees.
  - Mortgage insurance helps protect lenders and mortgage investors from severe financial losses in cases where loans are not repaid.
  - Most financial institutions charge mortgage insurance if the borrower has less than a 20% deposit.
  - Mortgage insurance fees can be a substantial up-front cost of establishing a home loan, running into thousands of dollars.
- Flexible income assessment.
  - Keystart is more flexible than traditional financial institutions when it comes to assessing income. Keystart takes into account all earnings including wages, salary, family tax benefits, Centrelink payments and child maintenance received.
  - Keystart allows loan repayments to be as much as 31% of the borrowers assessed income.
- No savings history required.
  - Keystart does not require its borrowers to have a savings history other than an ability to meet the $2,000 or 2% deposit requirement, which can be met through the FHOG.
  - Most financial institutions require borrowers to be able to demonstrate a strong savings history.
- Safety net scheme.
  - A safety net scheme is in place to help Keystart borrowers whose financial situation deteriorates after their loan is approved and who, without help, might lose their home.
  - Under the safety net, repayment amounts may be reduced for a period of three to six months.
  - The safety net scheme has proved effective and has assisted 650 borrowers over the last five years.
  - Relationship breakdowns and unemployment have been the main reasons for Keystart clients requiring this assistance.

Other features of Keystart home loans include:

- maximum borrowings of $225,000 to purchase a home for a maximum purchase price of $250,000;
- a competitive variable interest rate (currently 6.49% per annum); and
- a maximum term of 25 years.

KEYSTART'S HIGHLIGHTS IN 2002-03

During the 2002-03 financial year, Keystart recorded:

- 3,424 loans approved at a value of $372.5 million, of which:
  - $276.4 million was approved for the purchase of 2,758 established homes; and
  - $96.1 million was approved for new constructions representing 666 new building starts;
- a net surplus for the year of $11.7 million;
- net assets of the Scheme in excess of $119.0 million; and
- a loan book of $1.4 billion at 30 June 2003.

In 2002-03, Keystart also restructured its business operations to make its loans more accessible to potential borrowers, improved corporate governance and streamlined accounting and reporting. Achievements include:

- loan origination through central lending staff and mortgage originators;
- centralisation of loan approvals and credit decisions; and
- replacement and upgrading of information systems.

ASSISTANCE TO FIRST HOME BUYERS

Keystart currently accounts for approximately 21% of first home owner loan approvals in Western Australia. This compares to around 37% in 1998-99 (see table below).

The decline in Keystart's share of the first home owner market mainly reflects an increase in accessibility of private lending institution home loans to first home owners, driven by increased competition between lending institutions, lower deposit requirements, the introduction of the FHOG and low interest rates.

	Keystart First Home Owner Approvals		**Total Western Australian First Home Owner Approvals**		**Keystart Approvals as a % of Total Western Australian Approvals**	
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2000-01	3,728	345	17,070	1,898	22%	18%
2001-02	3,338	307	17,704	2,194	19%	14%
2002-03	2,656	282	12,807	1,683	21%	17%

Source: Department of Housing and Works

However, total loan approvals under Keystart are expected to increase over coming years, following implementation of a business model in 2002-03 which will allow mortgage brokers to recommend Keystart home loans to customers.

The value of total loan approvals under Keystart is expected to increase to around $432 million in 2003-04 and $444 million in 2004-05, representing an estimated 5,000 approvals per annum. This compares to a total of 3,424 loans amounting to $373 million approved in 2002-03.

REGIONAL ASSISTANCE

A significant portion of Keystart loans are directed to borrowers in regional areas, with 34% of the dollar value of Keystart's loan approvals and 42% of the number of its total loan approvals directed to regional areas in the six months to the end of August 2003.

This represents a marked increase in Keystart's lending to regional areas in recent times, from 22% of its loan approvals prior to 2002. This is attributed to Keystart's greater willingness to loan to people in regional areas compared to private lending institutions.