



# Review of Productivity Commission's 'In need of repair' report

CHIA

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# 1. Overview

The Productivity Commission published a comprehensive review of national housing assistance policy in August 2022. It argues that Australia's challenges with rental stress, homelessness and receding access to homeownership are in large part due to inefficiencies in market supply of housing brought about by poorly designed planning regulations. According to the Commission, rectifying these inefficiencies and providing improved income support for low and moderate income earners otherwise in rental stress should be the key pillars of a revamped national housing assistance framework. This would see a winding back of home ownership support in favour of more investment in homelessness services. Social and affordable housing providers would perform a safety net function in the housing system, providing accommodation to those unable to access market offerings because of discrimination and complex support needs.

An alternative framing would have seen social and affordable housing cast in an essential infrastructure role, leading to a significantly different set of policy recommendations.

## 1.1 Background

The Productivity Commission's report, *'In need of repair: The National Housing and Homelessness Agreement'* released in August 2022 following a commissioning reference from the then Treasurer Josh Frydenberg in December 2021, is the first comprehensive review of national housing assistance policy in almost 30 years.

The report calls for a complete overhaul of the National Housing and Homelessness Agreement (NHHA) under which the Commonwealth transfers approximately \$1.6 billion each year to the States and Territories for the delivery of housing assistance programs, principally the supply of social housing and homelessness services.

The key moves proposed by the Commission include:

- Expanding the scope of the NHHA to cover all housing related assistance in which the Commonwealth is involved, including Rent Assistance paid to low and moderate income earners and various programs aimed at supporting access to home ownership
- Working with the States and Territories to radically reshape planning regulations to enable more responsive housing supply from the private sector, thereby putting downward pressure on prices and rents and creating opportunities for low and moderate income earners both directly and through vacancy chain and downward filtering effects

- Better targeting Commonwealth Rent Assistance (CRA), lifting its sufficiency in the hands of recipients and extending it to tenants of social housing in lieu of income related rents, so that these households are better able to find housing solutions which suit them best, whether in the private market or in social housing
- Withdrawing home ownership grants and tax breaks, other than for households who face structural barriers, such as discrimination, in accessing this tenure, and diverting the savings into homelessness programs

Under this reform prescription, social housing providers would perform a safety net role in the housing system, providing assistance for households that cannot secure opportunities in a well-functioning market because of crisis, complex needs or discrimination. Implicitly, the viability of these providers will be underpinned by receipt of market related rents made possible by improved Commonwealth income support for tenants, though the details of this arrangement are not set out by the Commission.

Social housing providers would therefore be placed on a more 'commercial' footing and tenants would no longer have incentives to remain in these dwellings when their circumstances or preferences change.

The size of the social housing sector under this set of policies is indeterminate. Both in its report and in subsequent public briefings, the Commission has been reluctant to put a figure on how much social housing Australia needs. Presumably, in the Commission's view, investment in social housing should be regarded as a residual, contingent on the efficiency of private housing supply. The more responsive market housing supply, the less investment required in social housing.

## 1.2 Economic framing

In terms of economic framing, the Commission sees the housing assistance challenge before Australia as the outworking of *regulatory failure*, rather than *market failure*. That is, the capacity of land and housing markets to respond to both background increases and periodic surges of demand in areas well located to jobs and opportunities has been so compromised by ill-directed planning restrictions that the country has been left with major housing shortages in these areas. These shortages have pushed down vacancy rates and driven up rents to the considerable detriment of low and moderate income households.

Looking at housing assistance through the Commission's conceptual lens, much of the problem would be resolved if two conditions are met. Firstly, the market is given a chance to work efficiently, by removing barriers to entry, clearing out regulations which cannot be shown to deliver a net community benefit and addressing incidental market failures which may inhibit housing supply, such as threshold infrastructure requirements or lot fragmentation. Secondly, income support is provided to those who cannot otherwise participate in an efficiently operating market.

This approach is reminiscent of that which was strongly advocated during the early days of National Competition Policy in Australia in the late 1980s. The then equivalent of the NHHA, the Commonwealth State Housing Agreement (CSHA), came under close scrutiny on the premise that poor housing outcomes for Australians 'was not a housing problem but an income problem'. Tying assistance to occupancy of a state-owned dwelling was considered to be inefficient in principle because those being assisted had no agency.

Acting on the same premise, other jurisdictions, most notably New Zealand and the UK, pursued policies of divestment in social housing in favour of improved income support for households requiring assistance. These were fairly quickly rolled back when governments were confronted with steeping outlays occasioned by inelastic private supply of housing at affordable rents.

The re-run of this approach advanced in the *'In need of repair'* report applies a more sophisticated formulation with a strong focus on fixing supply inelasticity. Accordingly, the Commission's reform agenda for planning regulation is, perhaps, the keystone of its policy prescription and deserves due examination of conceptual coherence, evidence base and real world practicality.

While the Commission has sought to be comprehensive in its review of Government programs impacting housing assistance, it is noteworthy that at least one major omission remains. More than three decades ago Flood and Yates (1987) showed that the biggest single subsidy delivered in the Australian housing system is the non-taxation of imputed rent for home owners<sup>1</sup>. Reform towards tenure neutrality in the tax system is clearly a fraught topic. Nevertheless, it warrants discussion here, and in any analysis which adopts the Commission's thesis, because such tax distortions in favour of home ownership will fuel anti-development sentiment in many communities.

### **1.3 An alternative framing**

An alternative economic framing of the national housing assistance challenge would apply an *infrastructure* lens rather than a regulatory failure / welfare choice lens.

This would propose that all suburbs and neighbourhoods require a permanent stock of housing that is affordable to low and moderate income households. Aside from providing protection from poverty for the relevant households (which can be considered a generic requirement of any housing assistance strategy), this permanent local stock of affordable housing would deliver two place or region specific benefits.

Firstly, it would support access to low and moderate income workers needed by local businesses and institutions. This would boost the productivity of these enterprises, other things equal, by reducing staff training and turnover costs.

Secondly, it would support more liveable, or higher amenity, neighbourhoods. In part, this would be due to better access to local services, supported by the abovementioned low and moderate paid workers, and in part through the maintenance of a more diverse and inclusive community.

These are external benefits; they flow to the wider community as a spillover of providing assistance to households requiring affordable housing. As recognised by the Commission, poverty mitigation also brings major external benefits for the wider community in terms of savings or productivity gains in health, education and workforce participation. But these are not necessarily place specific.

Assuming that communities recognise and value the place specific externalities of affordable housing, an efficiently operating market free of barriers to entry and restrictive development regulations could not be relied upon to deliver a welfare optimising stock of local affordable housing. This is because, as with other forms of infrastructure, the value of the externalities in question do not figure in the

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<sup>1</sup> <https://catalogue.nla.gov.au/Record/1816120>

accounts of developers and other agents transacting in the market. There is no commercial incentive for the market to provide a local, enduring, stock of housing which is affordable to low and moderate income households. To the extent that regular market development delivers housing which is affordable to this group of households, it is generally via the vacancy chain and filtering effects described by the Commission. But these offer no certainty that all communities will ultimately have a *local* stock of affordable housing sufficient to deliver the two place specific externalities described above. Indeed, vacancy chains are likely to distribute affordable housing to concentrated locations which are generally remote from jobs and opportunities.

Infrastructure is characterised by one or more of three features – natural monopoly, non-excludability and significant externalities. The presence of any one (or more) of these will mean that an otherwise efficient market will not produce a welfare optimising allocation of resources. This is why Governments step in to either directly provide, regulate the market to provide or subsidise the market to provide the infrastructure in question. This happens with public transport, roads, education, child care and health facilities to name a few. Local affordable housing infrastructure bears the same warrant on economic grounds.

This alternative framing, relying on the infrastructure role of social and affordable housing, is a mainstream one. Under the heading *“Social infrastructure is economic infrastructure too”* Infrastructure Australia in its 2021 Plan explains that ... *“investment in safe and adequate social housing generates positive wellbeing, health and productivity outcomes for individuals and contributes to the effective functioning of society”*<sup>2</sup>. Meanwhile, Infrastructure Victoria regards social housing as a key infrastructure priority for the State<sup>3</sup>. Nygaard (2022) has demonstrated the strong business case for investment in social housing with reference to the extensive economic benefits generated for the wider community<sup>4</sup>. Housing All Australians (HAA), a consortium of private sector organisations, is campaigning for increased investment in affordable housing based on its role as ‘economic infrastructure’. Planning strategies at the regional, municipal and local level routinely refer to the formation of diverse and inclusive communities with affordable housing for key workers.

Taking an infrastructure perspective on the national housing assistance challenge does not negate the Commission’s reform agenda. It remains important to optimise the efficiency of housing supply. Redirecting home ownership support funds to improve homelessness services is also well justified.

However, understanding social and affordable housing as essential infrastructure for successful communities suggests that the Commission’s analysis and prescription is incomplete. As with any other infrastructure program, governments must lead and ensure that all communities have the investment in local affordable housing that they need.

There are many ways of achieving this including direct government procurement, leveraging private capital through tax breaks or grants and regulatory measures such as inclusionary zoning. These are summarily dismissed by the Commission because its approach is captive to a conceptual framework

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<sup>2</sup> <https://www.infrastructureaustralia.gov.au/2021-australian-infrastructure-plan-implementation-and-progress/recommendation-8.3>

<sup>3</sup> [https://www.infrastructurevictoria.com.au/wp-content/uploads/2019/03/IV\\_30\\_Year\\_Strategy\\_WEB\\_V2.pdf](https://www.infrastructurevictoria.com.au/wp-content/uploads/2019/03/IV_30_Year_Strategy_WEB_V2.pdf)

<sup>4</sup> <https://www.communityhousing.com.au/wp-content/uploads/2022/05/CHIA-Everyones-Home-Wider-Benefits-Analysis-31.3.2022.pdf?x91874>

which would see a freed up market solving most of the problem, rendering innovative or government driven supply redundant. However, application of an infrastructure framework would call on government to set targets for adequate supply of social and affordable housing (which the Commission eschewed) and identify an optimal mix of delivery strategies which balance the competing objectives of long run cost effectiveness and the need to assist as many household in need as possible in the short term. Unsurprisingly, the Commission is silent on these matters.



## 2. A risky strategy with no ‘Plan B’

The Productivity Commission’s advice continues the unspoken dominant theme in Australian policy for the past 3 decades that Australia’s housing affordability problem can be solved through better income support to needy households, and allowing them to make choices which suit them best in the private market. This approach has demonstrably failed to date. The new contribution from *‘In Need of Repair’*, is a push to radically expand housing supply through planning deregulation, so that the market might respond more readily to household choices. It is not clear that this radical shift in market supply can be achieved, and no discussion of how policy should respond if the anticipated benefits of deregulation do not eventuate.

### 2.1 Empowering clients of housing assistance

In the Commission’s view the recipients of housing assistance should be at the centre of the reform process. Ideally, they would have agency and choice in resolving their housing requirements rather than be dependent on the business models and unrelated motivations of assistance providers, such as social and community housing organisations<sup>5</sup>.

The idea of ‘portable rental assistance’ looms large in this vision.

*“Portable rental assistance involves a shift away from providing assistance according to whether a person lives in public, community or private housing towards a system of financial assistance that can be accessed regardless of the type of housing a person lives in. It allows households to choose where they live based on their preferences, rather than the type of financial assistance available for different types of housing”. p 270*

This idea is embedded in the Commission’s advocacy of three principles – sufficiency, fairness and effectiveness – to underpin the next National Housing and Homelessness Agreement (see Figure 1). Of note is that these principles do not encompass external benefits for neighbourhoods and the wider community that might flow from the provision of subsidies for housing, whereas such externalities would figure prominently in the provision of, say, subsidies for education or child care.










Following these principles, the Commission urges that ... *“(i)n the next Agreement, the outcomes could be improved by shifting the focus away from systems to improving outcomes for people across tenure types (including homelessness, social housing and the private rental market). For example, rather than having outcomes focused on an effective homelessness service system and a well-functioning social*

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<sup>5</sup> The Commission overlooks opportunities to boost client agency within a social housing context. In submissions to the PC’s Review of Human Services, CHIA has noted how the social and affordable housing system could provide more user choice - even in the constrained environment that exists at present. For example, users could be more involved in designing reforms of social housing delivery and regulation. This includes the opportunity to trial Choice Based Letting which, based on overseas evaluations, looks able to improve tenant satisfaction and system efficiency.

housing system, they could focus more directly on improving outcomes for people experiencing or at risk of homelessness and people in social housing. The outcomes should also cover improved outcomes for people in the private rental market.” p 154

**FIGURE 1: PRINCIPLES FOR HOUSING ASSISTANCE (AS NOMINATED BY PRODUCTIVITY COMMISSION)**

Sufficient	Fair	Effective
 <p>People receiving assistance can access housing that meets their needs</p>	 <p>Assistance is targeted to people most in need</p>	 <p>Assistance is flexible and tailored to individual circumstances</p>
 <p>Household incomes after paying for housing costs are sufficient to cover other essential items (such as food, clothing and health care)</p>	 <p>People in the same circumstances are treated in the same way</p>	 <p>Assistance is delivered in a timely way</p>
		 <p>Assistance responds to changes in need over time</p>
		 <p>Assistance supports social and economic participation</p>
		 <p>Assistance delivers the best use of taxpayers' dollars</p>

Source: Figure 7 in the Commission’s report (p 15)

## 2.2 A safety net role for social housing

An inevitable outworking of these principles is that social housing must play a residual, safety net, role, pending expanded choices for eligible households in private housing markets.

*“Building more social housing will increase the supply of housing affordable for low-income households, but social housing is relatively costly and can only be a partial solution to affordability. Social housing should be targeted to people most at risk of long-term homelessness and people who are unable to access and sustain affordable and appropriate housing in the private market. For most low-income households, the focus should be on improving housing affordability in the private rental market.” p 231*

*“Social housing is a safety net for people on low incomes (mostly people who receive income support) who cannot access appropriate or adequate housing in the private market”. p 232*

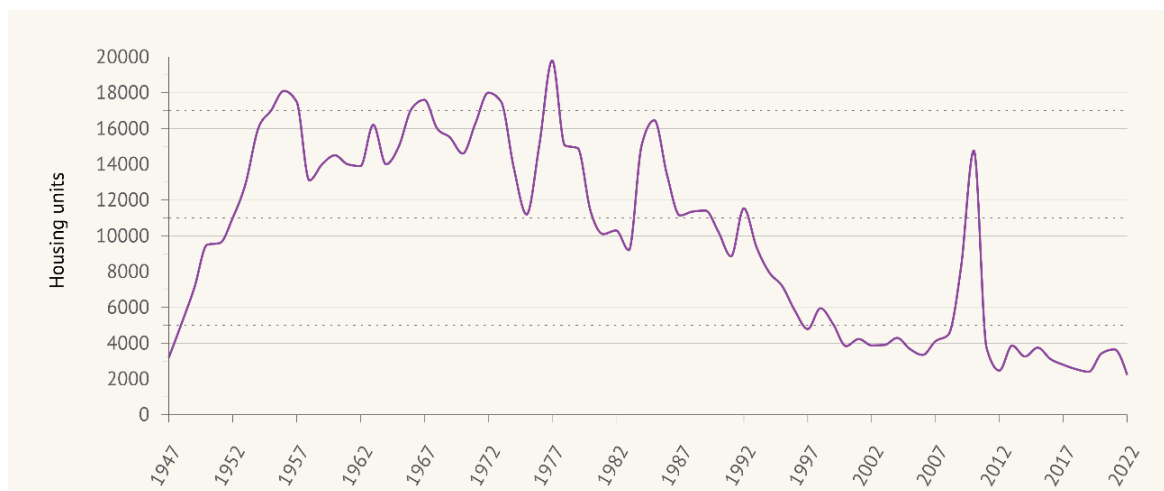
Conceptualising the housing assistance challenge as one of lack of income and choices for low and moderate income households is not new. In fact, it has been the dominant paradigm in housing assistance policy for the better part of 4 decades. The 1980s saw a clear shift away from ‘social housing as infrastructure’ policies which had characterised the Commonwealth State Housing Agreements since 1945, towards models which implicitly relied on income support and private supply.

This is evident in the respective trajectories of social housing investment and Commonwealth Rent Assistance since 1985. Aside from a dramatic but short lived peak in social housing investment initiated in 2009 as part of the Commonwealth’s response to the Global Financial Crisis, building of new social housing has declined sharply over the past 30 years, and comprised only around 2,000 units in 2021/22.

This contrasts with the period between 1955 and 1985 when construction of public housing ran at a rate of more than 14,000 units per year, during a time when Australia’s population was much smaller.

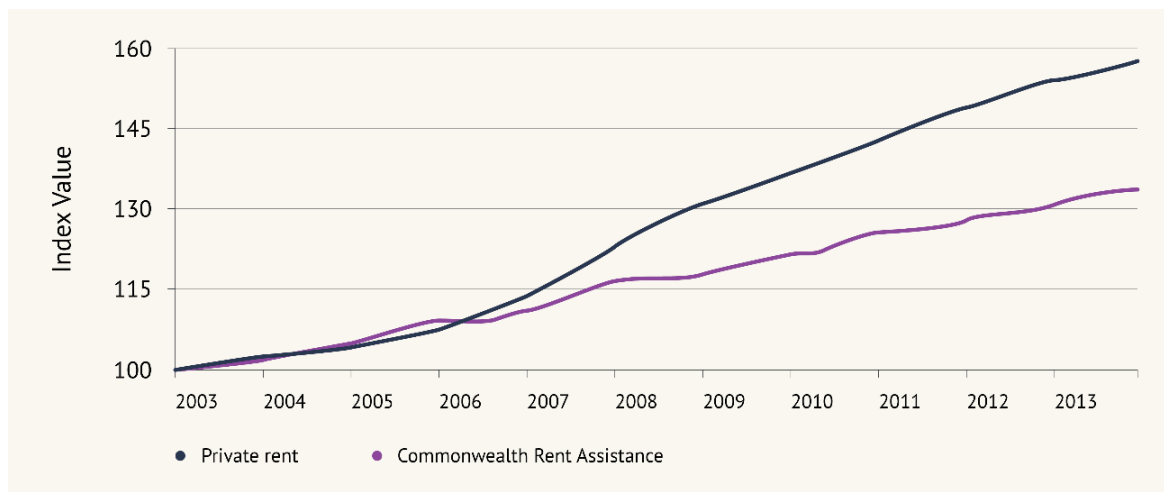
Meanwhile, some 1.49 million Australian households were in receipt of Commonwealth Rent Assistance in 2021. More than 27,000 households per year on average had become part of this group over the previous 8 years<sup>6</sup>. Unfortunately, the sufficiency of CRA declined steadily over this period, as the growth in the value of these payments fell behind that of private rents (Figure 3).

**FIGURE 2: DWELLING CONSTRUCTION APPROVALS – PUBLIC SECTOR**



Source: ABS Building Approvals data, SGS calculations

**FIGURE 3: GROWTH IN CRA VERSUS PRIVATE RENTS**



Source: Productivity Commission, 2015<sup>7</sup>

<sup>6</sup> <https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia/data>

<sup>7</sup> Productivity Commission, 2015, ‘Housing Assistance and Employment in Australia Research Paper Volume 2’, <https://www.pc.gov.au/research/completed/housing-employment/housing-employment-volume2.pdf>

While a focus on income support and client agency is an implicit characteristic of Australian housing assistance policy, what is new in the 2022 Commission review is its assertive stance on liberalising private housing supply so that it can, indeed, respond efficiently to the choices of eligible household empowered by ‘portable rental assistance’. As discussed further below, the Commission’s report dedicates considerable space to the hypothesis that planning restrictions, in particular, are hobbling the supply of affordable housing. The Commission opines that ... *“Housing that is affordable for people on low incomes does not need to be social housing. When housing supply is responsive to changes in price, new supply improves affordability in all parts of the housing market. .... new supply in the higher-cost segments of the housing spectrum flows through to improve housing affordability in lower-cost segments.”* (p 273).

### **2.3 What if supply doesn’t respond as theorised?**

*In Need of Repair* goes on to make a raft of recommendations about how such liberalisation might proceed. We appraise these below. Of note at this point, however, is that the Commission does not contemplate a scenario where deregulation and other planning reforms fail to improve the price elasticity of housing supply sufficiently to enable indirect production of affordable housing opportunities through vacancy chain and downward filtering effects. This is problematic, because as we will show, the evidence base for the proposed planning reforms is not especially compelling. Moreover, even if the Commission’s hypothesis holds in theory, the radical changes it envisages, which would see levels of development in inner and middle ring metropolitan areas orders of magnitude greater than what has been experienced to date, may simply not be implementable.

The Commission is silent on what governments should be doing to mitigate the (moderate to high, in our view) chance that its primary policy prescription does not work as well as it expects it to. One such mitigation might have been to boost investment into social housing as a ‘no regrets’ addendum to the planning reform prescription, given that the Commission itself has demonstrated that access to such assistance is now extremely rationed. Instead, the Commission steadfastly eschews nominating an investment requirement for social housing, perhaps in fear that this might send a confusing message about the optimal way of dealing with Australia’s affordable housing challenge. This leaves communities and vulnerable people exposed to significant risk.

## 3. Planning and the supply of housing

The Productivity Commission imagines reforms where housing supply is drastically expanded in places close to jobs and opportunities, following deregulatory models recently launched in New Zealand. These models would destroy urban amenity at such an alarming rate that they are most likely impractical in an Australian setting. Housing supply could be improved by reforming the regulation of development rights, interventions to overcome fragmentation of developable land and better co-ordination of infrastructure. The Commission does not examine these opportunities.

### 3.1 Planning regulations as a handbrake on housing supply

*In Need of Repair* strongly asserts that price inelasticity of housing supply in Australia is substantially due to excessive planning restrictions. As discussed, the review report contends that this choking off of supply seriously dents the efficacy of income support designed to help private renters facing housing stress.

*Housing supply is heavily influenced by planning systems, which States and Territories are responsible for designing (and local governments for administering). CRA is intended to increase the ability of recipients to pay for housing, but its effectiveness in doing so depends on market rents, which are influenced by supply. Where housing supply is not responsive to increases in demand, rents are likely to increase and erode the purchasing power of CRA, reducing its effectiveness as a form of housing assistance. p 81*

The Commission paints a picture of a heavily regulated development sector where government dictates, rather than market signals, direct investment and overall supply outcomes.

*The release of development land is highly regulated by governments, usually through zoning, planning, and land use and development regulations. These regulations allow governments to manage the community wide impacts of land development such as urban sprawl, increased pollution and environmental impacts, and infrastructure costs. It also enables them to manage the growth of urban areas and coordinate the provision of infrastructure. But such regulation also dampens how much housing supply can respond to increases in demand. It leads to the supply and development of land being more responsive to government actions than to price, with substantial price increases needed to stimulate even small increases in land supply. For example, in many parts of Australia, there are zoning restrictions that limit higher density housing in certain areas and effectively cap the number of dwellings that can occupy that space. If these caps are binding (in other words, if developers would like to build more housing than the restrictions allow) prices increase and an inadequate amount of housing is supplied. p 467*

Notwithstanding this critique, the Commission says that it supports a certain amount of regulation in the public interest. It writes that “unrestricted supply may not be the best outcome for society - even

*though prices are lower and quantities higher, there are good reasons why housing supply should be restrained in some cases (p 475)*". However, it argues that the governance of planning regulations is no longer fit for purpose, if it ever was, with an increasing gulf emerging between the interests of local communities – wishing to preserve their amenity and asset values – and those of the wider community which wishes to see fairer access to affordable housing. In the Commission's view, these respective goals need to be rebalanced, with State and Territory Governments taking a stronger role in enabling housing development in currently restricted areas.

*"The costs and benefits of planning and zoning restrictions need to be assessed carefully to ensure the right balance between local community preferences and wider social benefits. Local governments will be more influenced by 'not in my backyard' sentiments than State and Territory Governments; States and Territories may need to take on more responsibilities for local planning and approvals to support the delivery of more housing". p 494*

The evidence base put forward by the Commission to back this diagnosis is sketchy. In large part, the Commission relies upon analyses of the price premium in new dwellings occasioned by planning restrictions; that is, the sizeable wedge observable between the delivery cost of new housing (in construction and normal profit) and the end price to buyers<sup>8</sup>. Some empirical evidence regarding 'up-zoning' and the consequential impacts on housing supply is adduced, including with reference to planning deregulation in Auckland. But none of this material can be claimed to be conclusive.

The Commission goes on to make several recommendations for changes to substantive planning rules, including;

- Reviewing zoning rules that allow only single detached houses
- Allowing more dense development 'as of right' along key transport corridors, with height limits set up front
- Relaxing regulations limiting the use and tenure of secondary dwellings
- Relaxing minimum carpark requirements for developments where there is good access to public transport, and
- Relaxing minimum floor sizes.

The review also calls for improvements in planning processes to assist in achieving greater density, including:

- fast-tracking or code-assessing small-scale urban infill projects rather than requiring these projects to apply for development approvals.
- using design guides or nominating high-quality designs for medium-density dwellings that would be permitted automatically in middle-ring suburbs.

All of these measures have been rolled out across Australian cities, in one form or another, over the past 2 decades. While there is certainly scope to press further, experience with planning liberalisation

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<sup>8</sup> Kendall, R. and Tulip, P. 2018, The Effect of Zoning on Housing Prices, Research Discussion Paper, RDP 2018-03, Reserve Bank of Australia, Sydney.

to date gives little reason to believe that this line of reform could give rise to the revolutionary shift in supply elasticity that the Commission is relying on in its recommendations.

In our view, the Commission's analysis of planning regulation and its impact on housing supply is flawed. Planning regulation does, indeed, constrain housing supply but arguably only within welfare optimising limits. Arguably, the 'balancing of interests' which the Commission is looking for in determining supply capacity is already being delivered by the thoroughgoing processes of enquiry which most jurisdictions have to assess proposed planning policies and rules. Indeed, the reviews of planning systems across Australian jurisdictions undertaken by agreement between the States and the Commonwealth under the auspices of National Competition Policy (1995 – 2005) generally concluded that the competition limitations associated with land use and development controls delivered a net community benefit.

In any case, at least in the majority of metropolitan areas across Australia, planned capacity for housing supply is demonstrably adequate, measured in multiple years if not decades of annual absorption. Other factors beyond the development capacity allowable under planning rules are likely to be the key constraints on the responsiveness of housing supply. These relate to perverse incentives and rent seeking connected to the regulation of development rights, as well as market failures to do with land fragmentation and availability of infrastructure to support housing construction.

The Commission's implied recommendation for sweeping deregulation in the nation's planning systems could well diminish welfare in net terms. This would ultimately render it unworkable, and with it the vision for responsive housing market that can spontaneously resolve most of the nation's affordable housing challenges.

### **3.2 Regulation of development rights**

As a result of the planning laws which are applied across all States and Territories, development rights are, in fact, nationalised; that is, they are reserved by the State. Ownership of freehold title does not carry with it any rights to use or develop land for any purpose other than that which is currently being carried out lawfully or those which are permitted 'as of right', that is, without a requirement for development permission. Even when zoning may *allow* for higher density or higher order uses, no right to realise this higher value exists for the land owner unless and until they hold a duly issued development consent. Moreover, the State reserves the right to change zoning provisions at any time without compensation, except where a land owner holds a duly issued development consent.

The reservation of development rights by the State is especially transparent in the ACT where the land tenure available to private parties is limited to leasehold. In the Territory, proponents must both secure development consents and pay the Territory Government what is effectively a development licence fee equivalent to 75% of the uplift in site value brought about by the planning approval.

Governments reserve and then ration access to development rights because, as the Commission acknowledges, *laissez faire* city building would likely result in settlement patterns which are inefficient both in a financial and allocative (welfare) sense.

Put another way, development rights *must* be reserved and rationed if a welfare optimising pattern of settlement is to be achieved. The act of rationing will necessarily mean that the award of development rights will carry a scarcity premium.

The wedge identified by Kendall and Tulip (2018) can therefore be interpreted not as evidence that the planning system is failing and adding to housing prices, but rather as a natural outworking of efficient regulation.

Unlike other markets which are regulated in the public interest due to the presence of externalities or latent monopoly (e.g. liquor licencing, commercial fisheries) and/or where Government retains ownership of the resources in question (e.g. minerals, water), planning regulation involves no systematic application of licence fees (other than in the ACT). This creates rent seeking and gaming behaviours which militate against efficient housing supply, amongst other things.

For example, owners of land which *may* be used for higher density housing under current planning rules will be disinclined to sell to a bona fide developer unless the latter transfers all or the lion's share of the uplift in land value attached to a successful planning permit application. Even if the proponent is willing to make this transfer, land owners may wish to retain the site in anticipation of greater gains in the future when development land becomes still more scarce in the locality. The problem is compounded where developable land is in fragmented ownership. A minority of 'hold out' land owners can frustrate the release of viable parcels (see further discussion below).

Thus, as the Commission itself concedes...

*"Availability of zoned land does not guarantee that developers will proceed with developments. The planning system can create opportunities for residential development by rezoning land, but decisions about whether, when and where to subdivide the land and proceed to construction lie with landowners and/or developers. Other factors may also impact on new housing supply, such as the timing of infrastructure, the cost of developer contributions to pay for the infrastructure, and difficulties obtaining land for development in locations where ownership is fragmented. Above all, market forces need to drive demand for dwellings before they will be built."*



Provided ample development capacity is made available to meet projected housing needs in an area, planning per se may not be the handbrake on housing supply which the Commission imagines it to be. Rather, a key constraint may be inadequate regulation to correct for perverse incentives for the owners of developable land and the absence of other interventions – for example land assembly and accelerated provision of enabling infrastructure – to ensure that planned capacity is, in fact, released to bona fide developers when it is needed.

#### Constraints on land supply for housing

Unfortunately, in a lot of economic commentary, this land supply constraint (*on housing development*) is conflated with the effect of planning controls. Yes, planning controls place an ultimate limit on the capacity of a particular urban district to accommodate apartment construction, but as noted, planning systems in Australia typically provide for many years supply of nominal capacity, often under policy direction.

An aspiring ‘definitive’ essay published in the Economist newspaper on January 18, 2020, illustrates the continuing confusion between supply constraints associated with planning regulations and supply constraints associated with private withholding of developable land from the housing production process. The Economist states...

*“To get a sense of the argument that (overtight land regulation is the root cause of high house prices), compare Singapore with Hong Kong. Singapore has a fairly elastic planning system. The government owns most of the land. When house-price growth is too strong or the population is rising quickly, the state can release extra land faster than a barman at the Raffles hotel can mix a Singapore sling. In Hong Kong by contrast, the supply of developable land is controlled by a small clique of oligarchs. What will buy you a cramped bedsit in Hong Kong will buy you a decent sized pad in Singapore” ( Williams, C. (2020) No Place Like Home, The Economist, Jan 18, 2020, p 6)*

Regulation of development in Singapore – that is, the application of a hierarchy of plans governing the prospective development of a district and the enforcement of design controls – is likely to be as restrictive as that in Hong Kong. The key difference in housing outcomes in Singapore is the control of the land supply.

Extract from Spiller, M. (201) *Reserve Barking up the Wrong Tree on Urban*

### 3.3 Efficient planning regulation

While the Commission acknowledges the need for planning regulation it strongly suggests, as noted, that governments at the State and local levels have not got the balance right between enhancing the livability of cities and the need for responsive housing supply.

In its report, the Commission does not examine how State, Territory and local governments go about striking this balance.

Most jurisdictions have an explicit or implicit requirement that proposed planning rules meet a *net community benefit* test. Typically, exhaustive processes of enquiry and, in some jurisdictions, public

contestation, are pursued before such rules become law. These processes are generally seen to perform the role of Regulatory Impact Assessments (RIAs) which are applied in other fields of administrative rules making.

Unlike RIAs, planning reviews do not mandate cost benefit analysis prepared according to a pre-defined method. Nevertheless, they usually involve a deep probe across a broad range of impacts, including matters to do with adequacy of land supply for housing and implications for housing affordability.

By ignoring the fact that planning processes carry a range of inbuilt checks and balances to resolve the tension between competing objectives, the Commission's critique that planning 'excessively' constrains housing supply lacks credibility.

The Commission points to recent experience in New Zealand as compelling evidence that planning deregulation can generate substantial improvements in housing supply responsiveness. To deal with a housing affordability 'hyper crisis', the New Zealand Government has directed local authorities to uniformly amend their planning schemes to allow medium density housing development 'as of right' in most residential zones across the nation's larger cities.

In the New Zealand Government's latest initiative, all councils in Tier 1 cities (Auckland, Hamilton, Tauranga, Wellington and Christchurch) are required to up-zone almost all of their residential areas to implement default Medium Density Residential Standards (MDRS) which give proponents automatic permission to build three units of up to three storeys on any site.

Such initiatives may well improve the responsiveness of housing supply. However, it is not clear that planning deregulation of this type is welfare optimising.

A cost benefit analysis of the MDRS policy undertaken by PWC for the New Zealand Government is instructive. Figure 4 summarises the findings of that study.

According to the Base (or middle) scenario, the MDRS is expected to generate an additional 74,600 dwellings across the Tier 1 cities over 5 to 8 years from commencement, compared to what might be expected in these urban areas without the reforms. This is a substantial boost to supply, which is expected to put downward pressure on prices and improve affordability. PWC estimate the added consumer surplus from lower housing prices at NZ\$1.015 billion.

However, this gain in housing affordability is won at the cost of significantly reduced housing utility and neighbourhood livability. PWC's findings show that implementation of MDRS would lead to more congestion (an additional cost for the community of NZ\$1.944 billion compared to business as usual), loss of sunshine to dwellings (NZ\$0.514 billion), loss of views (NZ\$0.434 billion) and loss of environmental values (NZ\$0.409 billion).

Looking at housing and residential amenity issues alone, the MDRS is shown to generate a welfare loss for New Zealand of the order of NZ\$2.2 billion. This is the difference between the gain in consumer surplus from lower housing prices and the costs generated by the policy in lost amenity. The saviour for the policy in headline terms is that the increase in housing densities in well located areas generates a very substantial agglomeration related productivity benefit. This is so large at NZ\$5.487 billion that a net community benefit of NZ\$3.252 is produced.

FIGURE 4: COSTS AND BENEFITS OF MEDIUM DENSITY RESIDENTIAL STANDARDS REFORM – NEW ZEALAND

Variable	Low	Base	High
<b>Policy impacts</b>			
New dwellings added			
Auckland	27,927	39,167	53,683
Hamilton	3,389	8,260	12,191
Tauranga	3,819	5,818	8,462
Wellington	6,516	9,833	14,002
Christchurch	6,535	11,501	17,165
<b>Total additional dwellings</b>	<b>48,186</b>	<b>74,579</b>	<b>105,503</b>
<b>Benefits – all Tier 1 urban areas (\$m)</b>			
Added consumer surplus from lower housing prices	\$437	\$1,015	\$1,998
Agglomeration benefits	\$2,391	\$5,487	\$8,983
<b>Total Benefits</b>	<b>\$2,828</b>	<b>\$6,502</b>	<b>\$10,981</b>
<b>Costs of growth – all Tier 1 urban areas (\$m)</b>			
Supporting infrastructure	-\$33	-\$50	-\$71
New dwellings	\$88	\$136	\$193
- Fewer greenfield developments	-\$121	-\$187	-\$264
Congestion	\$1,261	\$1,944	\$2,765
Loss of sunshine	\$344	\$514	\$684
Loss of views	\$295	\$434	\$604
Environmental costs	\$367	\$409	\$460
Implementation costs	\$2	\$2	\$2
<b>Total external costs</b>	<b>\$2,234</b>	<b>\$3,250</b>	<b>\$4,442</b>
<b>Summary – all Tier 1 urban areas (\$m)</b>			
Total external costs	\$2,234	\$3,250	\$4,442
Total benefits	\$2,828	\$6,502	\$10,981
Net Benefits	\$594	\$3,252	\$4,442
<b>Benefit-Cost Ratio</b>	<b>1.27</b>	<b>2.00</b>	<b>2.47</b>

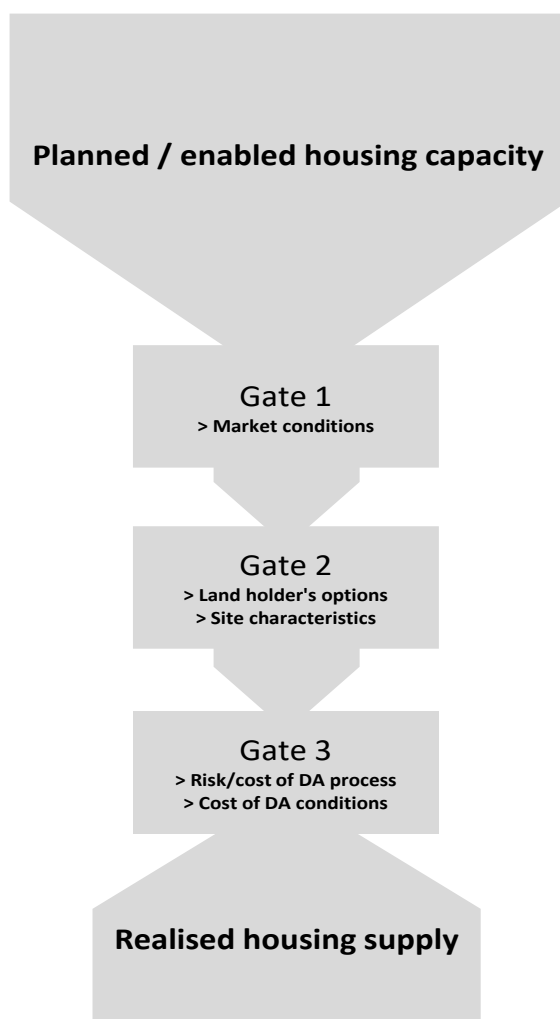
Source (PWC and Sense Partners, 2022)

If planning deregulation along the lines of the MDRS initiative were the *only* means by which housing supply responsiveness might be improved to the extent of producing an additional 75,000 dwellings over the medium term, the policy might be regarded as economically justified, notwithstanding the loss of amenity. However, as we discuss below, there are several alternative and additional ways in which supply elasticity could be significantly improved without having to destroy amenity.

### 3.4 Improving supply elasticity

The following diagram illustrates the role of planning regulation in housing supply. At the top of the diagram is the planned capacity for housing development in a given district or city. This represents the allowable quantity of housing construction based on planning rules for the area(s) in question, including those relating to density, site coverage, setbacks, parking provision and other requirements which determine the developable envelope for a site. These provisions are set out in schedules that attach to different zones that enable residential development. They are typically determined via a strategic planning process which identifies the need for future housing in the area and appraises the various constraints on development including environmental factors, heritage and the preferred character for the neighbourhoods under survey.

**FIGURE 5: FROM PLANNED CAPACITY TO REALISED HOUSING SUPPLY**



Source: SGS Economics & Planning Pty Ltd

For planned capacity to translate into realised housing supply, a number of gates need to be negotiated. Only some of these are connected with the planning system.

Firstly, as acknowledged by the Commission, market conditions must support the type of housing development envisaged in the statutory plans for an area. A planning scheme may identify several precincts for medium and high density development, thereby nominally adding significantly to the developable stock of housing. However, this will be of limited value if the demand for housing across the relevant district is primarily for low density dwellings, to the point where achievable prices for higher density typologies are not sufficient to sustain commercial viability.

Assuming the land is both available for development under the planning rules and viable for development under market conditions, its further progress towards realised housing supply will depend on the land owner's preferences and expectations. As discussed, owners of development sites who not developers – which will be the majority of owners – may be inclined to reserve the latent value in their site for later.

Another non-planning factor that could impede the progress of land into the housing production pipeline is the size and configuration of the properties in question. Fragmentation or odd lot sizes could deter development because of the additional expense and risk associated with title consolidation.

At the third gate, planning system factors come back into prominence. Land that is zoned for development at particular densities will typically still be subject to planning permission, to ensure compliance with rules and performance standards pertaining to design and development contributions. Potentially, these requirements could be so burdensome in cash and/or risk terms, that a project will be rendered unviable, at least until achievable sale prices rise sufficiently to cover the costs in question.

Applying the 'supply gates' framework to the evidence and logic presented by the Commission, a number of points are evident:

- Rezoning to increase nominal development capacity may not, by itself, lead to responsive delivery of housing supply.
- Planned / enabled capacity should be optimised within a net community benefit structure. Determination of the macro-envelope for development should balance the gamut of societal expectations around housing availability, housing utility, landscape value, environmental constraints and place making using cost benefit analysis or a similar. Housing supply ought not be automatically privileged in this analysis, unless there is clear evidence of community willingness to pay for this to be so.
- Supply responsiveness can be improved by applying a range of levers beyond changing planning rules, for example, by governments asserting their ownership of development rights (to mitigate withholding of development sites) and governments intervening to overcome land fragmentation and infrastructure barriers to feasible development.
- Within the planning system, supply responsiveness can be improved by streamlining approvals process to mitigate risk and uncertainty for proponents.

In short, there are several ways of boosting the elasticity of housing supply beyond sweeping and crude reforms to planning regimes.

Such planning reforms in New Zealand appear to have worked in inducing additional housing supply, at least based on early evidence. However, as shown in the cost benefit analysis of the NZ Government's Medium Density Residential Standards initiative, these reforms are expected to *reduce* welfare at the neighbourhood level; gains to home buyers (and renters) in lower prices will be outweighed by losses in sunshine, views and environmental quality for residents. In other words, livability in Auckland is potentially being compromised to improve housing supply flexibility in built up areas.

The supply gates analysis suggests that an alternative array of reforms – focussed on land assembly, licencing of development and infrastructure provision could similarly improve housing supply flexibility without an erosion of livability. The *In Need of Repair* report does not explore these alternative reforms which could provide a superior net community benefit to crude 'up-zoning,' preferring, instead, to urge emulation of the Auckland model.

### 3.5 Conclusion

The Commission puts great store on planning deregulation to correct housing supply inelasticity in Australia. Its vision is that this will free the market to provide most of the country's affordable housing requirements through normal rental transactions, assuming that governments provide adequate income support for households otherwise in stress.

However, a process of deep and far-reaching planning de-regulation, such as that pursued in New Zealand over the past 5 years, would most likely diminish urban livability to a significant degree. This is likely to render the idea impractical for State and local governments, regardless of the fiscal incentives on offer to undertake such politically unpalatable reforms. This underlines the riskiness of the PC's preferred reform strategy.

Enabling greater housing supply, within welfare optimising limits, is clearly a worthwhile policy objective. However, it is more likely to be achieved by addressing blockages to producer responsiveness that range well beyond the capacity for development enabled in planning schemes. Amongst other things, this would call for greater public sector intervention to acquire and de-risk sites in already planned medium and high density areas with a view to creating a strong pipeline for private sector investment in these parts of our cities.

In any case, even if supply shortcomings were to be mitigated through this alternative, more workable, strategy, it cannot be concluded that the market, acting on its own devices, will necessarily produce an adequate stock of affordable distributed across all neighbourhoods. We now turn to this issue.

## 4. Social housing

Notwithstanding its faith in better income support and better housing supply to fix Australia's affordability problem, the Commission acknowledges that the nation will need a significant stock of social housing to address demand that cannot be realistically filled by the private rental market. Unfortunately, the Commission has no advice on how big this stock of social housing should be and how it should be funded.

### 4.1 No guidance on how much is needed

Local availability of social and affordable housing generates multiple and substantial positive externalities including access to essential workers and formation of more cohesive and inclusive neighbourhoods. Nevertheless, the Productivity Commission does not recognise such housing as essential infrastructure for successful and sustainable communities.

In the Commission's vision, the social and affordable housing 'system' will continue to play a residual safety net function, but hopefully, with a considerably lessened case load made possible by a housing market liberated from unduly restrictive planning controls.

Accordingly, *'In need of repair'* eschews discussion of backlogs in social and affordable housing provision akin to the analysis it might make of deficiencies in transport, water, telecommunications and other infrastructure. Indeed, the Commission is dismissive of supply benchmarks for social housing.

*"Comparing the proportion of social housing stock with historical levels, with other countries and across Australian jurisdictions, or estimating housing need based on the number of people on social housing waiting list, provides little insight into the amount of social housing there should be." p 263*

At the same time, the Commission acknowledges that social housing will need to play a not insignificant part in a revamped national housing assistance policy, even proffering its own estimate of the supply gap left behind by a responsive rental housing market.

*"However, rent reductions can only do so much to improve rental stress. For many, even significantly lower rents are not enough to achieve housing affordability. The Commission estimates that there are around 180 000 households in the private rental market who have incomes of less than \$500 per week (Commission analysis of SIH 2019-20 data). For these households not to be in rental stress, they would need to find a rental property for less than \$150 per week, and to not be in severe rental stress, their rent would have to be less than \$250. While low-cost rental options may be a possibility for these households — for example, secondary dwellings such as granny flats (chapters 13 and 14) — the private rental market may not have enough options for these households without a rise in wages, or reforms to Australia's income support system." p 484*

When 180,000 households is added to those already in social housing (who can safely be assumed to require very deep subsidies given the tight rationing of existing places), the accommodation need that is beyond fulfilment by efficient markets would be around 5.4% of the total housing stock. Social housing represented 3.6% of the nation's occupied stock in 2021, down from 4.0% in 2016.

The measured gap in what an efficient market can provide expands to be between 10% and 15% of housing stock if allowance is made for the fact that affordable housing will also be needed by low and moderate income households in higher rent areas, in order to meet both household income and local area labour requirements<sup>9</sup>.

Regardless of the scale of the shortfall left by an efficient market, the fact is that there will be a gap. Unfortunately, the Commission provides little guidance on how best to fill it.

## 4.2 No guidance for how best to provide a social housing safety net

Policy experience in Australia is that governments may seek to fill market gaps in affordable housing provision through one or a combination of the following strategies;

1. **Income support:** topping up the incomes of lower income households enabling them to access market housing (on the presumption that the market will come forth with the required supply)
2. **Head-leasing** stock in the private market and on-renting it to eligible households at an affordable price (again on the presumption that the market will deliver required supply)
3. **Providing subsidies to private investors** or developers by way of grants or tax breaks to produce stock that will be made available to eligible households at an affordable rent with such housing retained as affordable stock indefinitely or for a limited number of years
4. **Providing subsidies to not for profit providers** who can leverage operating surpluses plus community provided assets (land etc) to build own and operate permanent affordable housing
5. **Investing government equity** to build, own and operate state housing, and
6. Forcing the owners of development sites to pay for the subsidies/equity required for affordable housing supply via **inclusionary zoning** and other planning mechanisms.

The Commission endorses Strategy 1 but, as noted, recognises that this will still leave a requirement for social housing provision. However, rather perplexingly, *'In need of reform'* finds issue with all of the other supply strategies.

Providing subsidies to private investors as per the erstwhile National Rental Affordability Scheme (NRAS) or through availability payments as occurs in public private partnerships for social infrastructure,

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<sup>9</sup> For a recent assessment of the aggregate requirement for social and affordable housing, see van den Nouwelant, R., Troy L. and Soundararaj, B. (2022) *Quantifying Australia's unmet housing need; a national snapshot* <https://www.communityhousing.com.au/wp-content/uploads/2022/11/CHIA-housing-need-national-snapshot-v1.0.pdf?x91874>



is criticised for being expensive and for potentially displacing housing production that would have occurred elsewhere in the market anyway.

Inclusionary zoning is dismissed as ill-advised because it (supposedly) adds to development costs, creates risk and uncertainty in the development approval process and cannot guarantee fairness in the allocation of any affordable housing that might be produced.

Provision of social housing through government equity investment is regarded as ‘relatively costly’ (p 231, p 261).

### **4.3 Unsubstantiated claims that social housing is expensive**

These views are generally at odds with the findings of the Productivity Commission’s predecessor, the Industry Commission, which undertook the last major review of the housing assistance system in Australia in 1993. While the Industry Commission cautioned against relying exclusively on public housing provision, this method of delivering assistance was found to be cost effective compared to other options.

*The options for delivering housing assistance to people on low incomes include cash payments, effective housing allowance schemes (that induce supply of appropriate rental housing), public housing and headleasing. In Chapter 5, these options are assessed against social justice criteria — accessibility, affordability, appropriateness, security of tenure and equity. They are also assessed against economic criteria such as efficiency and cost-effectiveness.*

*Public housing and headleasing are assessed to be more cost-effective than cash payments and housing allowances. Discrimination and security of tenure problems of low-income people are overcome and better targeting is achieved.*

*They avoid the monitoring and administration costs of ensuring that recipients receive appropriate housing.*

*Public provision of rental housing is shown to be more cost-effective than headleasing over the longer term — that is, there are benefits in terms of financial savings. This finding is subject to the condition that housing administration in the public sector is efficient, or at least not so inefficient as to negate these savings. There are often inefficiencies in public sector provision, but with public housing there is also the potential for efficiency gains through economies of scale, scope and density<sup>10</sup>.*

In the ‘*In need of repair*’ report, the Productivity Commission lists the Industry Commission’s 1993 report in the bibliography. However, the body of the report makes no reference at all to the above findings about the cost effectiveness of social housing.

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<sup>10</sup> Industry Commission (1993) Public Housing; Volume 1: Report, p xviii

#### 4.4 Funding the social housing system

The Commission would have the social housing system operating with greater attention to price signalling effects. In particular, it sees income based rents which apply in State owned and operated social housing as problematic in that they dampen incentives for tenants to relocate as their circumstances change. The Commission urges the extension of Commonwealth Rent Assistance to tenants of State owned housing, with these institutions then applying discounted market rents as applies in community housing sector.

This move would cost the Commonwealth around \$1.4 billion per year, roughly the amount that the Government currently distributes to the States and Territories under the NHHA. The Commission may, or may not, be alluding to a potential re-orientation of Government outlays from a mix of capital and program support in social housing provision towards income support. Such re-orientation has been canvassed in previous enquiries and has some merit. However, *'In need of repair'* is disturbingly silent on how social housing should be funded and financed once the federal government switches to 'universal CRA'.

Bearing in mind the Commission's own analysis that rent payable by very low income households cannot support market provided rental housing, even with availability of CRA, State housing authorities and, indeed, community housing providers would find themselves unable to finance housing acquisition unless there is a very substantial supplement to CRA for their tenants and/or they have access to free equity/grants. The Commission's report does not address this issue.

The Commission is advising that potentially 5% or more of Australian households are beyond the reach of an efficient rental housing market complemented by a targeted CRA program, but it offers no advice as to where the capital for this 5% safety net might be sourced. In fact, as noted above, the Commission appears to advise against all known potential sources of capital funding for social housing, including traditional government equity investment, leveraging private capital through tax breaks/grants and inclusionary zoning.

An alternative conceptualisation of social housing as infrastructure may have led to a more constructive discussion of funding. As infrastructure, social housing fulfills three functions – poverty mitigation (primarily a Commonwealth obligation), better labour markets (primarily State Government) and better places (local government and the urban development process). This might suggest a three way funding split – Commonwealth, State and inclusionary zoning. How funding could be orchestrated under each of these areas in turn for maximum efficiency and least distortion of housing markets is outside the radar of the Commission because of the way it has framed Australia's housing assistance challenge. Unfortunately, this leaves governments with little practical policy guidance.



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