

Send the market a price signal where affordable housing is most needed

Written by Martin Payne, Casual Lecturer in Planning, University of Sydney



Interest rate adjustments are crude and fail to target the problems within the housing market. Shutterstock

Current market mechanisms need to be reformed to give better price signals to developers, and to direct subsidies to achieve the goal of affordable housing. Ideally, the [reforms would be comprehensive](#),

including

[road congestion charges](#)

, [capital gains taxes and negative gearing](#)

, [tax-advantaged investment](#)

, and other measures. But such comprehensive reforms are unlikely.

Furthermore, general solutions that apply throughout Australia may be unnecessary for problems concentrated in major cities. It is strategic to focus on more incremental, local responses that target problem areas.

A targeted solution

The suggested package of practical measures would be based on a special rate applying to new residential developments in selected urban centres. This strategic intervention is justified by being a form of [benefit capture](#) – one that would send more efficient price signals to the market.

Also, this rate would improve the capability to deliver affordable housing with appropriate infrastructure.

This approach also creates an asset from the flow of future income from the special rate. This reliable income flow will help attract long-term investment by the private sector at relatively low interest rates (government guarantees or tax-advantaged provisions could also help attract investment).

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The special rate is levied on the land area of a centre. The total income from the rate is enough to service debt used to fund infrastructure provision, as well as to compensate government for the removal of stamp duty and contributions paid by developers.

Removing these costs will [reduce up-front dwelling prices](#) , and make the market more efficient.

How would a special rate work?

The standard rate per dwelling is set according to a target number of dwellings for the centre. A dwelling target and special rate are then allocated to each site based on its area.

The allocated rate for a site is apportioned to individual properties at subdivision. A buyer of a dwelling would purchase property with a known obligation to pay the special rate.

If a development has fewer dwellings than its site target, then the average special rate per dwelling will be correspondingly higher. A denser development would have a lower rate per dwelling. This creates an incentive to supply more affordable dwellings at higher density.

Measures to promote [transit-oriented development](#) would be complementary. So too with [inclusionary zonings](#) that give priority to housing associations or long-term rental investors.

This proposal could be extended by giving the agency responsible for setting the rate and providing infrastructure the authority to acquire and rezone land, and sell it to developers. This would reduce land costs and risks with gaining approvals.

Furthermore, land could be sold for long-term rental housing at reduced prices but with additional special rates.

What's wrong with current approaches?

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Currently, no strategic pricing mechanism applies to infrastructure servicing new development. There are either no charges on development or capped ones with providing water, sewerage, drains, public domain and other infrastructure. This means developers do not have to take into account the costs of providing such infrastructure when considering their proposals.

The lack of pricing discipline does not encourage efficiency. This means subsidies, with unpriced resources used, increase with inefficiency. High-cost infrastructure developments get greater subsidies than low-cost ones, and the lower the density, the greater the subsidy per dwelling. This promotes less dense and more dispersed development.

In essence, current pricing mechanisms are at odds with the policy goals of affordable housing and denser and better-structured urban development. This feeds, in turn, into problems like congestion management, productivity, and economic growth.

Under current arrangements, the wider public bears the cost of subsidies. The criticism here is not against subsidies, but against policies that are not efficient in achieving social objectives. Reforms are needed if markets are to be more efficient at producing affordable housing and improving wider urban outcomes.

Current policies on economic growth and affordable housing presume coherence between them. But this presumption may not be realistic.

Economic and population growth are accompanied by increased demand for housing. The prevailing policy response is for more-of-the-same, prioritising land rezoning. This would work if it led to reduced demand for the lower-priced portion of the housing stock. This portion of the market desirably should increase with increasing prices.

This is not happening and cannot be expected to happen without some major adverse economic event. Complementary market reforms are essential to achieve economic growth with affordable housing.

The risks of blunt policy instruments

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There is also a paradox: even if more-of-the-same policy worked, would it be desirable? Policy based on decreased demand for significant portions of the market may be undesirable as well as unrealistic.

Price decreases would reduce owners' equity. They would also reduce the value of mortgages held by lenders, such as banks. In turn, this would reduce the value of lenders' assets and thus reduce wider lending, affecting the wider economy.

Policies to reduce oversupply by reducing lending are sensible. However, they create a situation where prices are allowed to increase while significant decreases are prevented.

Interest rate adjustments are a crude instrument for managing housing markets. Interest rate increases may curtail oversupply in some parts of the market but would exacerbate under-supply in the lower-priced market.

Furthermore, government concern about perceived housing bubbles may distort interest rate policy to the detriment of the wider economy. Adopting more precise instruments would be strategic.

The proposed measures are complementary to current policies as they promote pricing reforms to make the market more efficient and more effective in producing affordable housing. They are better targeted than wider taxation and interest rate policies, and would make wider economic policy less dependent on housing issues.

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