MELBOURNE'S AFFORDABILITY CHALLENGE

URBAN DEVELOPMENT INSTITUTE OF AUSTRALIA (VICTORIA)
LEVEL 4, 54 WELLINGTON STREET, COLLINGWOOD VIC 3066

About UDIA Victoria

The Urban Development Industry of Australia, Victoria (UDIA Victoria) is a not-for-profit research, advocacy and educational organisation supported by a membership of land use and property development entities, across the private sector and Victoria's public service.

UDIA Victoria is committed to working closely with industry, local, state and commonwealth government, key housing sector stakeholders, and the community to improve access to diverse, high-quality and affordable housing in Victoria.

UDIA Victoria is a signatory to the State Government's *Affordability Partnership*, whose focus is on meeting the objectives of *Victoria's Housing Statement*: building 800,000 new homes by 2034 – 80,000 homes per year over the next decade.

In 2024¸ UDIA Victoria is laser-focused on establishing the right policy, regulatory and taxation settings to enable the residential development industry to do what it does best: build great housing for the growing number of people who choose to call Victoria home.

We apply a rigorous, research and evidence-based approach to developing policy advice for decision-makers, at all levels of government. UDIA Victoria research tracks market trends, construction costs, regulatory changes, and prevailing economic conditions, providing a comprehensive picture of Victoria's development industry. Our detailed research has informed this submission.

Background

Victoria's population is growing at a rapid rate, outpacing every other state in Australia. Last year, Melbourne surpassed Sydney as Australia's most populace city – almost a decade earlier than previously forecast. **Victoria's population is set to reach 11.2 million by 2056, with Melbourne on track to becoming a city of 9 million by 2050**.

Much of the strong population growth is due to overseas and interstate migration, as more people, attracted to our prized liveability, choose to call Victoria home.

Historically, population growth has fuelled Victoria's economic prosperity. However, the unchecked challenge of housing Victoria's growing population may see this reverse in coming years.

Our competitiveness and prosperity are in jeopardy as demand for housing increasingly outpaces supply, leading to unattainable housing prices and a severely overheated rental market.

Rising cost-of-living pressures and record interest rate hikes have severely diminished consumer buying capacity, seeing more Victorians locked-out of the housing market. In turn we are seeing an increasingly competitive rental market.

A return to steady population growth post-pandemic, coupled with unattended supply shortages, is expected to further exacerbate the State's housing shortage.

Infrastructure Victoria's *Our Home Choices report*, released earlier this year, outlines that to meet forecast demand, we will need to build an additional 1.3 million homes by 2051 – approximately 44,000 homes per year.

Late-2023 saw the release of the eagerly anticipated Victorian Government's *Housing Statement*, which sets a bold target to deliver up to 800,000 new homes before the next decade – 80,000 homes per year. This follows National Cabinet's commitment to deliver 1.2 million new homes over the next 5 years, to July 2029.

In the last decade, half of Melbourne's population growth has occurred in Melbourne's growth areas. However, the State Government is proposing to deliver 70 per cent of all new development in established suburbs.

To meet the State Government's policy aspiration, over 56,000 homes, per year, will need to be built in Melbourne's established suburbs, with 24,000 across the growth areas – an unprecedented volume in any sector, at any year.

UDIA Victoria recognises and supports the need to provide more housing in established areas. A consistent pipeline of new, high-quality and diverse housing will make more homes more affordable to rent and buy for Victorian families.

Executive Summary

Melbourne's deepening housing and rental affordability crisis demands urgent intervention. UDIA Victoria's research highlights the twin challenges facing prospective homebuyers: a long-term lack of supply and a significant reduction in buyers' borrowing capacity.

The State Government's *Housing Statement* proposes a number of initiatives aimed at tackling the housing crisis, including expanding the shared equity scheme to assist prospective homebuyers, and a range of measures to put downward pressure on housing costs. However, more needs to be done.

This paper outlines the depth of the prevailing challenges for prospective homeowners and opportunities to address them.

Since May 2022, the Reserve Bank of Australia has raised the official cash rate 13 times – the steepest rate rise in decades – which, in addition to stubbornly high inflation is impacting buyer confidence, budgets and borrowing capacity.

Meanwhile, the development industry is experiencing some of the most challenging conditions in decades. Record construction cost escalation; long planning delays; increased red tape; and the introduction and expansion of new property taxes are making it harder to deliver affordable housing in Victoria than ever before.

"There are no conventional house and land packages that meet the budgets of very low and low-income households."

Snapshot

Moderate income earners in Victoria will face are facing growing challenges without significant reform to address the underlying cost of housing.

In-depth greenfield analysis over FY23 and into FY24 shows that there are no conventional house and land packages that meet the budgets of very low and low income households. This has been seen in Metro Melbourne and Regional Victoria's housing estates across Geelong, Ballarat, Bendigo, Warragul and Drouin.

In fact, there has been a **consistent deterioration in the availability of affordable housing for moderate income earners.**

Households in Metro Melbourne with a moderate income only had access to 49 per cent of the house and land product that sold in FY24. Only 14 per cent of house and land packages sold were suitable and affordable to couples with two children on a moderate income.

UDIA Victoria research **shows a significant reduction in buyer capacity of up to $300,000 for the average Victorian couple, and a rise in the median house price in Melbourne to nearly $1 million**. The market is suffering from a lack of supply across-the-board, with demand in the growth areas (27.5 years zoned and unzoned) far outstrips incoming supply (13 years).

Defining housing affordability

UDIA Victoria considers affordable housing to be critical social infrastructure that has direct economic outcomes in terms of Victoria's productivity, liveability, and international competitiveness. Housing affordability underpins our advocacy agenda, which seeks to ensure policy and planning decisions prioritise housing affordability by providing investment certainty, facilitating robust housing supply, and ensuring that State and Local Government policy considers affordability impacts.

Private market affordable housing (for home ownership) is by far the largest contribution to affordable housing annually. Private market housing in growth areas have traditionally been delivered at a price point accessible to moderate and low income earners, and provide a vital supply of new housing for key workers within the Victorian economy.

For the 2022-23 financial year, construction was commenced on 54,097 homes. Slightly above the long-term average of 46,140 homes a year since 1990, but well below the government's target of 80,000 homes per year.

With half of Victoria's housing having been delivered in the growth areas, **Greenfield development has been the key to maintaining housing affordability in Victoria.**

The vast majority of these dwellings were delivered without any tax concessions or subsidies, and comprise the full rate of infrastructure contributions and other development fees and charges. The residential development industry already makes a significant annual contribution to the delivery of affordable housing to the market.

State Government definition of Affordable Housing

The State Government defines affordable in the Planning and Environment Act 1987 as follows:

Affordable housing is housing, including social housing, that is appropriate for the housing needs of very low, low, and moderate income households.

The income ranges relate to affordable housing that is not social housing. The income ranges are published for the Greater Capital City Statistical Area of Melbourne and the Rest of Victoria and are updated annually in a Governor in Council Order which is published in the Government Gazette.

The City of Melbourne Affordable Housing Strategy 2020-2030 states that, in some instances, private market housing may qualify as affordable housing if it is affordable for very low to moderate income households.

In order to improve housing affordability in the short- and medium-term, policy and planning settings need to support the delivery of greenfield land supply.

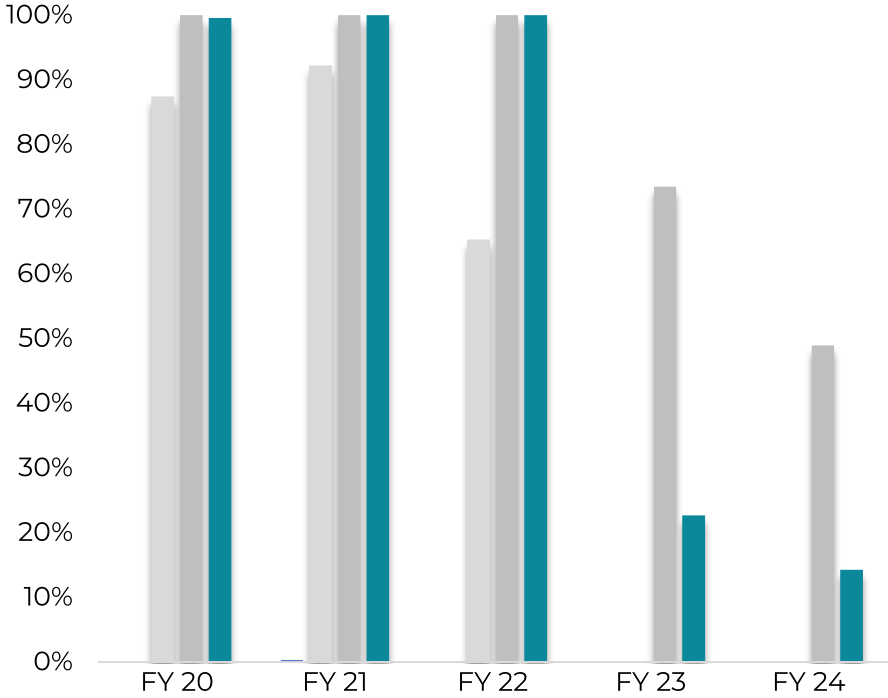
"Reduce barriers to the delivery of greenfield development in existing growth areas. Growth area development remains the most effective way of delivering affordable housing in volume."

Housing Costs: the shifting goalposts of home ownership

Our analysis compared house and land packages across Victoria to the actual borrowing capacity of households on very low, low and moderate incomes. The research shows the median house and land package is no longer affordable to the average household. The outlook is even worse for those with lower incomes.

Compared to pre-pandemic, households today need to have a significantly higher income. For example, a couple with two children seeking a median lot size of 350sqm and a lower quartile build has seen the package price increase from roughly **$455,525** in **FY20** to around **$603,500**. The household income would have had to increase from roughly **$120,000** to **$150,000** over this period to match the price increase. However, this increased income would only make 234 packages (14 per cent) available; the household income would have to be **$175,000** for access to all packages.

% Share of Packages that Fit Budgets



	FY 20	FY 21	FY 22	FY 23	FY 24
Single adult	0%	0.3%	0%	0.0%	0%
Couple, no dependent	87%	92.2%	65%	0.0%	0%
Single parent, one child	100%	100.0%	100%	73.5%	49%
Couple, two children	100%	100.0%	100%	22.7%	14%

With households required to earn this level of income just to afford housing, Melbourne is losing its attractiveness as a place to live.

Additionally, the misalignment between places of employment and the location of affordable housing options will have significant implications for Melbourne's economy, the cost of living, and commuting.

Key challenges

1. Prices rising faster than incomes

- The average price of a house and land package in Melbourne's growth areas [on a 400sqm lot] has increased by roughly 45 per cent or by over $267,000 over the last 5 years to $855,000 in June 2023.
- In contrast average wages have increased by only 18 per cent.
- This has significantly impacted moderate income earners who now face challenges accessing house and land packages in the growth areas.
- Increasingly the proportion of buyers who can afford a house and land package will decline with some growth corridors only supplying house and land packages at $937,500, ultimately only affordable for high income profiles.

- This trend will also influence low-income earners, who will face increasing rent pressure from competition with moderate income earners, who are priced out of new home ownership.
- Restrictions in the market relating to reductions in the number of Precinct Structure Plans (PSP) being approved and released is leading to price inflation which would traditionally apply downward pressure in the market given their faster creation rates.

2. Product choice is more constrained than in recent years

- To combat increased prices, developers and buyers have shifted to accepting smaller lots compared to other Australian cities and the global stage.
- Average lot size in Melbourne have declined from 392sqm to 350sqm over last 5 years with a price of a 350sqm lot now higher than a 483sqm lot in 2017.
- This trend is not sustainable as the downward size trend has limits and will not be accepted by all buyers.
- Buyers are likely to seek peri-urban and regional product or remain out of the market.
- This will accelerate the shift to regional areas on a more permanent basis post COVID – While this shift will have positive benefits, placing further strain on limited supply in the regions and will have broader impacts on Melbourne's competitiveness as a city.
- In addition, the regional affordability and supply matrix is more acute than Melbourne.

3. Impacts to labour force growth in Melbourne and the State's economy

- While a shift in buyers away from Melbourne to regional Victoria may appear to be positive there are significant impacts;
- Melbourne's population and labour force growth will be impacted
- Impacts will be heavily felt in industrial sector and service workers who can't work remotely
- Melbourne's competitiveness as a global city will be impacted with a lack of affordable product
- Regional cities face their own challenges with social infrastructure delivery and labour shortages. Land supply is an issue in major regional centres.

Buyer Budgets (Melbourne and regional Victoria)

- Buyer budgets based on lending assumptions rose significantly in FY20 and FY21 (during COVID). These were further strengthened by the historically low interest rates.
- Local and international supply disruptions saw costs rise and inflation reach 7.83 per cent - a 50-year high - by Q4 2022.

- The RBA embarked on aggressive cash rate increases between May 2022 and June 2023 to bring inflation to its target band of 2-3 per cent. This resulted in a rate not seen since the early 1990s (from 0.10 to 4.10 per cent).
- Following a four-month pause, November 2023 saw the RBA raise the cash rate by a further 25 basis points to a 12-year high of 4.35 per cent. This is the 13th rate rise in 18 months as the RBA concedes inflation will "likely stay around at a higher level for longer". While the RBA did not raise the cash rate in February, they did not rule out future hikes.
- This sharp rise in the cash rate is likely to remain elevated for a longer period. It has resulted in the cost of finance (combined with increased cost of living pressures) dramatically reducing purchaser capacity. This is despite borrowing capacity improving for some household types.
- Increased rates for the purpose of providing housing assistance are set by the Governor in Council (under section 3AB of the Planning and Environment Act, 1987). While these rates have been indexed recently, the increases have been modest.
- Between FY20 and FY23, the annual average increase across each household type was 0.68 per cent.
- While this increase was not adversely impacted by borrowing rates (due to the record low cash rate during the pandemic) there was a sharp rise in land prices as the Commonwealth Government's HomeBuilder Grant overheated the market.
- Overall housing costs and living expenses rose sharply between 2020 and 2022. As a result, even though borrowing capacities increased, households that fell into the 'affordable household' segment of the market largely missed out.
- Single parent households have seen a 22 per cent reduction in their borrowing capacity. Singles and couples with no dependents saw slightly lower reductions (9 – 16 per cent).

The following data highlights how these factors have combined to severely erode consumer borrowing and buying capacity to some of the lowest rates in recent decades.

Methodology

- *All buyer profiles assume income levels based on the State Government definition agreed by Governor in Council under section 3AB of the Planning and Environment Act, 1987.*
- *Deposit of 10 per cent factored in with interest rates based on a 90 per cent LVR.*
- *Escalation has been applied to income levels from the time of application for June 2022 and assumes the midpoint of the band for low and moderate income borrowers.*
- *Borrowing capacities use the Household Expenditure Method (HEM) which sees half of all loans following this method. This method is updated quarterly to take into account the current inflationary environment.*

Buyer Budgets

Greater Melbourne

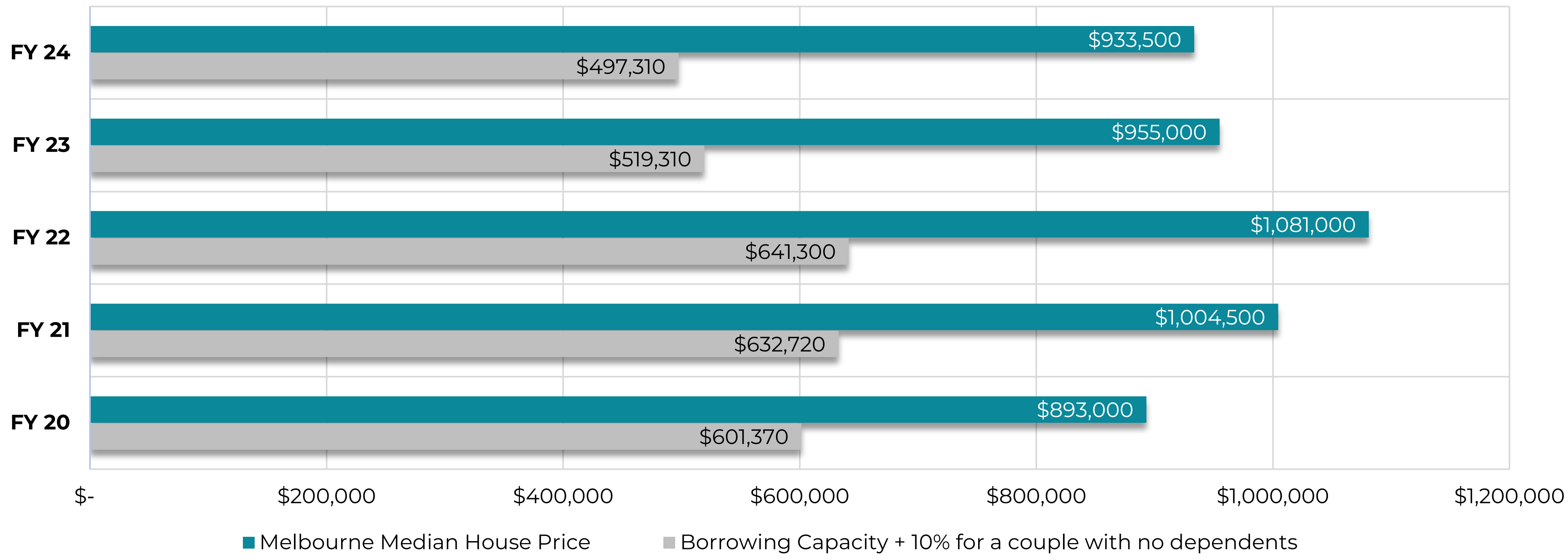
Household Type	Income Type	Income Level					Purchase Price (borrowing capacity + 10%)				
		FY 20	FY 21	FY 22	FY 23	FY 24	FY 20	FY 21	FY 22	FY 23	FY 24
Single adult	very low	$25,970	$26,090	$26,200	$26,680	$29,770	$118,580	$125,180	$127,380	$104,390	$115,610
	low	$41,550	$41,750	$41,920	$42,680	$47,630	$266,640	$280,720	$284,790	$231,330	$241,450
	moderate	$62,310	$62,610	$62,860	$64,020	$71,450	$408,870	$430,100	$435,820	$352,770	$364,540
Couple, no dependent	very low	$38,950	$39,130	$39,290	$40,010	$44,650	$117,150	$125,070	$128,370	$109,560	$142,890
	low	$62,320	$62,620	$62,870	$64,030	$71,450	$326,150	$344,300	$350,020	$286,770	$315,700
	moderate	$93,470	$93,920	$94,300	$96,030	$107,170	$601,370	$632,720	$641,300	$519,310	$497,310
Single parent, one child	very low	$54,520	$54,780	$55,000	$56,010	$62,510	$298,210	$314,160	$318,780	$259,160	$254,100
	low	$87,250	$87,670	$88,020	$89,630	$100,030	$518,980	$546,370	$554,180	$449,680	$431,860
	moderate	$130,870	$131,500	$132,030	$134,450	$150,030	$793,430	$834,790	$867,130	$685,300	$664,400
Couple, two children	very low	$54,520	$54,780	$55,000	$56,010	$62,510	$165,550	$175,560	$179,190	$149,710	$162,140
	low	$87,250	$87,670	$88,020	$89,630	$100,030	$433,180	$457,270	$464,750	$380,600	$368,720
	moderate	$130,870	$131,500	$132,030	$134,450	$150,030	$709,170	$746,790	$757,900	$616,440	$609,730

- Monthly repayments calculated on commbank.com.au Home Loan Repayment calculator based on the Standard Variable Home Loan Rate of 7.49% pa (as of 12th November 2023, Principal and Interest repayments over 30-year loan term)
- Note: Net Pay after Tax is calculated at ato.gov.au and assumes that the purchaser is an Australian resident, is claiming the tax-free threshold, does not have any Study or Training Support loans, has no tax offsets, no credit cards, or personal loans and is not claiming a Medicare levy exemption or reduction.
- Where the borrowers are a couple, income is assumed evenly split between the two adults, meaning that tax is estimated at a minimum rate.

Buyer Budgets

Greater Melbourne

Melbourne Median House Price compared to Borrowing Capacity



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Buyer Budgets

Regional Victoria

Household Type	Income Type	Income Level					Purchase Price (borrowing capacity + 10%)				
		FY 20	FY 21	FY 22	FY 23	FY 24	FY 20	FY 21	FY 22	FY 23	FY 24
Single adult	very low	$18,920	$19,020	$19,090	$19,440	$21,700	$47,630	$51,370	$52,580	$45,650	$63,470
	low	$30,280	$30,430	$30,550	$31,110	$34,730	$159,720	$168,520	$171,270	$140,250	$154,330
	moderate	$45,420	$45,640	$45,820	$46,660	$52,090	$304,590	$320,210	$324,500	$262,460	$259,270
Couple, no dependent	very low	$28,390	$28,520	$28,640	$29,160	$32,550					$30,800
	low	$45,420	$45,640	$45,820	$46,660	$52,090	$199,870	$211,530	$215,270	$177,760	$189,090
	moderate	$68,130	$68,460	$68,730	$69,990	$78,140	$387,860	$409,200	$415,470	$339,460	$338,580
Single parent, one child	very low	$39,740	$39,930	$40,090	$40,830	$45,570	$178,420	$188,540	$191,840	$157,630	$175,890
	low	$63,590	$63,900	$64,150	$65,330	$72,930	$349,800	$368,390	$373,780	$303,820	$321,970
	moderate	$95,380	$95,840	$96,220	$97,980	$109,400	$590,590	$621,610	$630,300	$510,950	$493,350
Couple, two children	very low	$39,740	$39,930	$40,090	$40,830	$45,570	$16,830	$20,350	$22,770	$26,290	$67,650
	low	$63,590	$63,900	$64,150	$65,330	$72,930	$228,800	$242,550	$247,390	$205,810	$244,750
	moderate	$95,380	$95,840	$96,220	$97,980	$109,400	$506,880	$534,160	$541,860	$440,880	$428,890

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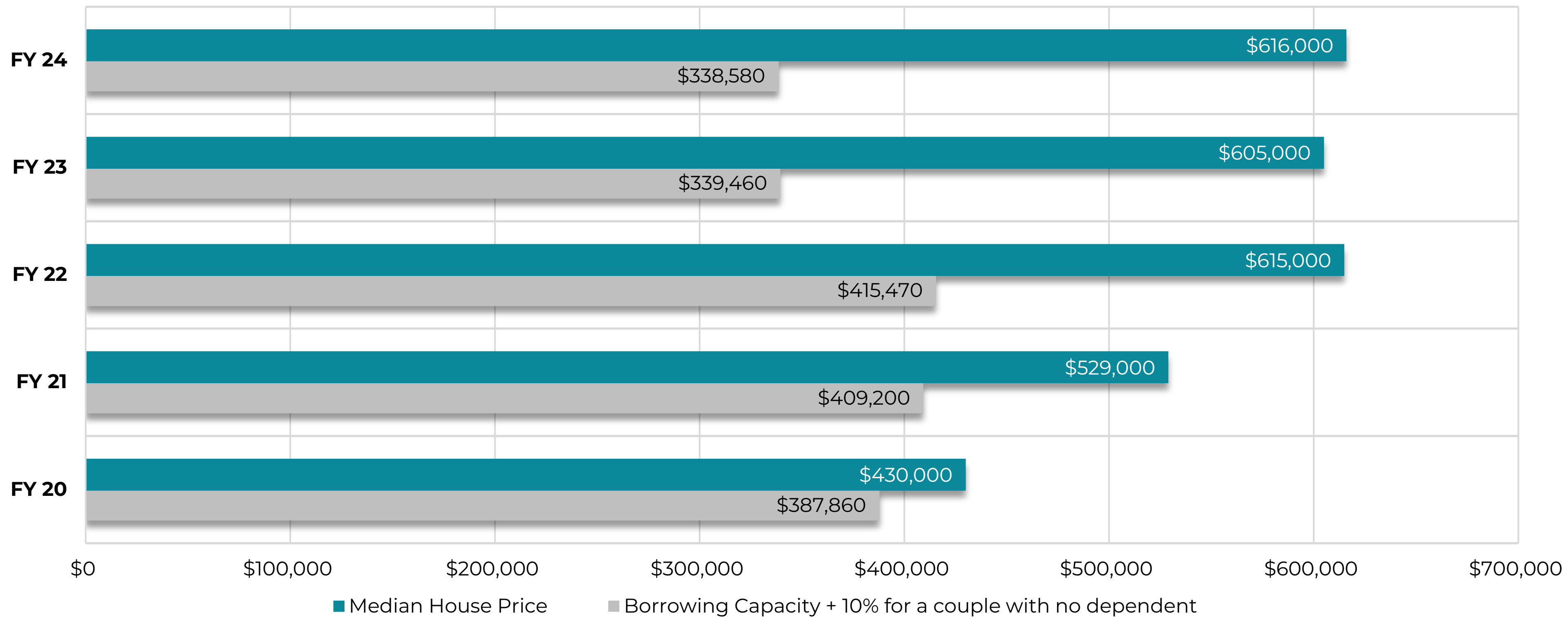
Buyer Budgets

Regional Victoria

Regional Victorian Median House Price compared to Borrowing Capacity



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- Where the borrowers are a couple, income is assumed evenly split between the two adults, meaning that tax is estimated at a minimum rate.

Actions to improve housing affordability

1. **Increase new supply**
   - Reduce barriers to the delivery of greenfield development in existing growth areas. Growth are development remains the most effective way of delivering affordable housing in volume.
   - Greater funding to the Victorian Planning Authority to enable them to undertake critical and timely strategic planning in the growth areas and Metropolitan Activity Centres.
   - Encourage investment in the regions, especially where they increase diverse housing, including detached dwellings, townhouses and apartments.
   - Cut red tape to enable innovative housing solutions, including modular developments and mobile housing.
   - Incentives for the private sector to develop affordable housing projects, including yield uplifts.
2. **Reform development costs, taxes and planning regulations**
   - Reduce timeframes for delivery of planned PSPs and fast-track strategic PSPs that unlock the greatest volume of housing.
   - Cross council talent sharing to speed up the planning process and limit delays i.e. VicSmart planning permit process.
   - Reduce the thresholds to qualify for the VicSmart planning permit process to enable more permits to be processed faster.
   - Targeted tax and levy relief and further guidance relating to the quantum, liability and timing of taxes.
   - Clearly define affordable housing to provide certainty and consistency across municipalities.
   - Rethink the funding model for enabling infrastructure. Reform Development Contribution Plans and infrastructure contribution arrangements.
3. **Government investment in catalytic infrastructure**
   - Prioritise capital works and infrastructure delivery associated with unlocking new housing supply.
   - Adopt the recommendations of Infrastructure Victoria's "Fast, Frequent, Fair report into the metropolitan bus network.
   - Releasing funds progressively through the works cycle rather than on completion to accelerate delivery.
   - Provide greater certainty and clarity regarding commitments to infrastructure planning, cost and delivery timing.

Urban Development Institute of Australia (Victoria)

Level 54, Wellington Street, Collingwood VIC 3066
info@udiavic.com.au
+61 3 9832 9600
udiavic.com.au
au.linkedin.com/company/udiavic