COVID-19 IMPACTS – BUILDING ACTIVITY HOUSING

ENVIRONMENTAL SCAN

The Australian Bureau of Statistics reports that for every $1 invested in new housing construction, $3 of activity is created for the broader economy. As such, sustaining and maintaining activity in the sector will be critical to supporting and enabling the Australian economy to rebound post COVID-19.

New home building activity reached its highest on record during 2015/16 when about 234,000 new home commencements occurred. Activity had been in retreat over recent years with latest ABS data indicating that work commenced on 174,246 new homes over the year to December 2019.

MBA COVID-19 scenario analysis anticipates 45% reduction in new dwelling starts from current levels. Were this to happen, the annual volume of new dwelling starts would bottom out at about 96,000.

If the annual volume of new home building fell below 100,000, this would be the weakest 12-month period for new home building since modern records were compiled.

The state of owner occupier and investor demand means that the inflow of new orders to residential builders has fallen hugely with many anecdotal accounts of projects 'falling over' or being placed 'on hold.' For this reason, there are genuine fears that residential building is facing a 'cliff' around June/July of this year.

Results from our recent survey of Master Builder's member businesses have confirmed the extreme difficulties that many are facing around the country around forward contracts, supply issues, costs and project delays. 73% of all respondents report a fall of work on their books with the average reduction of 40%. See attached survey results for further information.

Activity

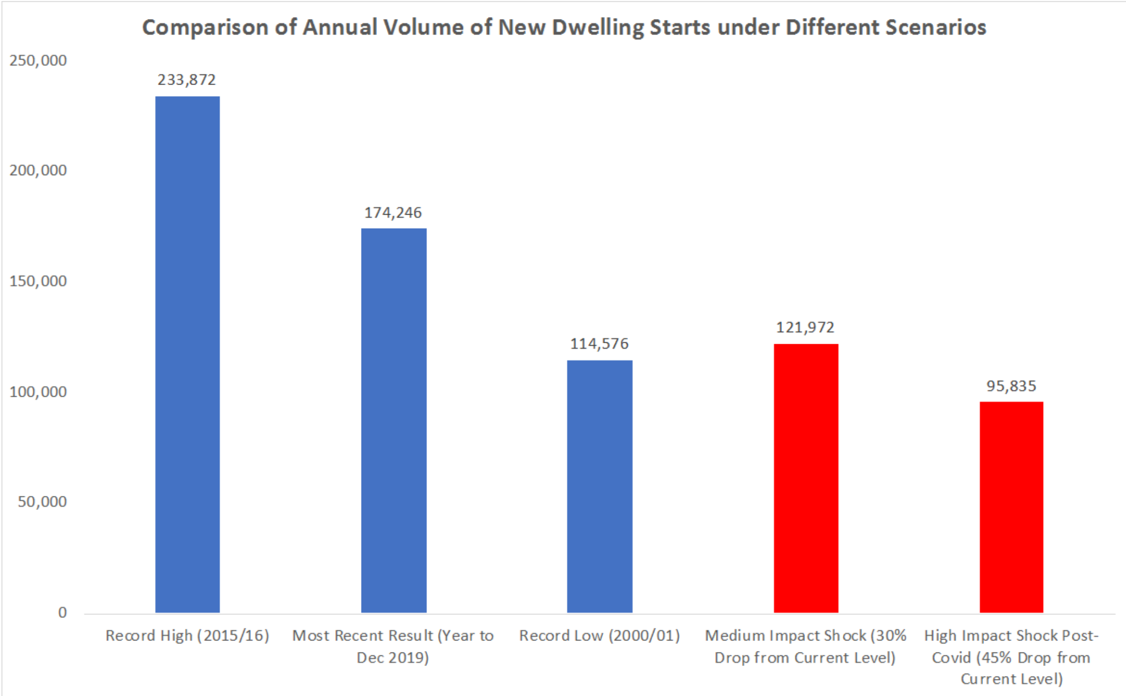
The latest set of Master Builders Australia forecasts were compiled before the Covid-19 crisis began. Then, we envisaged that new home commencements would bottom out at about 160,000 during 2020/21 before recovering strongly and topping 200,000 per year by the end of the forecast horizon in 2024/25.

With the economic backdrop having now changed drastically, the volume of new home building activity is likely to be far lower compared with what we had previously anticipated – at least over the short term.

Based on our analysis of previous home building downturns in Australia, Master Builders Australia anticipates that

- A high-impact downturn could involve a 45% reduction in new dwelling starts from current levels. Were this to happen, the annual volume of new dwelling starts would bottom out at about 96,000.
- A medium-impact downturn would see new home building starts fall by 30% to reach a trough of around 122,000 over a 12-month period (see chart below).

In either event, the reduction in activity is likely to be disproportionately concentrated in the high-density side of residential building which is much more sensitive to changes in the economic environment. If the annual volume of new home building fell below 100,000, this would be the weakest 12-month period for new home building since modern records began compiled.



During 2019, the total value of residential building work done was $76.03 billion which accounted for 61.6% of all building work and 35.7% of construction activity overall. Of the residential work done, $66.69 billion related to the building of new dwellings while home renovations work was valued at $9.07 billion.

Residential Construction Businesses & Employment

Latest figures indicate that as at 30 June 2019, there were 394,540 construction businesses across Australia. Of these, the overwhelming majority were small businesses employing fewer than 20 people. For the majority of construction businesses (56.0%), turnover is less than $200,000 per year with 15.5% of construction firms having annual income of less than $50,000. About 73,300 businesses are directly classified as residential building businesses. However, 295,655 businesses fall into the broad 'construction services' category and are heavily dependent on residential building activity. These firms include plumbing services, carpentry and electrical services - amongst others.

Of the 1.2 million people employed in the construction industry, it is estimated that up to 923,000 are either directly engaged in or dependent on residential building. Overall, construction employment directly accounts for 9.1% of total employment across the Australian economy. However, the concentration of full-time jobs in the construction industry is much higher than in other sectors of the economy. As a result, construction accounts for an 11.2 % share of full-time employment in the economy.

Financial Health – Australian Households

At present, the financial health of Australian households is mixed. The Non-Performing Loan share is low at about 1% and only about 3% of residential mortgages are estimated to be affected by negative equity. However, debt levels are very high by any standard and latest estimates suggest that they are equivalent to 187% of annual household disposable income. Combined with deep economic uncertainty, the high burden of household debt represents a major constraint on household demand. In its latest Financial Stability Review published on 9th April 2020, the Reserve Bank highlighted the risk that large reductions in employment and income caused by the Covid-19 crisis could force many households to default on their mortgage repayments. Statistics around mortgage stress and arrears are likely to deteriorate sharply over coming months.

Confidence in the market

The 'big ticket' nature of home purchase and the renovations work means that activity is extremely sensitive to changes in confidence amongst consumers and households. Because the Covid-19 crisis has hit the job security and incomes of so many people in such an unprecedented fashion, there is widespread aversion towards taking on large borrowings of the magnitude required to purchase or build a home. Despite the fact that interest rates are at record lows, home prices are still at a high level relative to household incomes.

Because the process of delivering new housing supply is such a lengthy one, the initiation of new projects is heavily dependent on the expectations of builders, developers and their financiers about how market conditions will be 3-4 years down the line – when the project will be complete and ready for sale. At the moment, unprecedented uncertainty about the future shape of Australia's housing market is a massive obstacle to new projects getting off the ground today. In general, any interventions which either speed up the process of building/development new homes and/or reduce the cost of delivering new housing stock would be helpful from the point of view of stimulating building activity. Previously, Master Builders Australia had estimated that, on average, about 200,000 new dwellings need to be built per year over the long term to accommodate future population growth as well as replace existing dwelling stock as it grows obsolete. As described above, latest data show that work began on just 174,246 new homes during 2019 and well below long-term requirements – and that was before the Covid-19 crisis.

Demand for Housing

On the demand side of the market, nearly all new homes are bought either by owner occupiers or investors. From the point of view of owner occupiers' demand, the new home building market is faced with the following combination of circumstances:

- A substantial spike in the unemployment rate
- A reduction in the number of people at work through redundancies, stand downs, hiring freezes and accelerated retirements
- Falling household income as a result of job loss, reduced working hours, shrinking business turnover and the forced closures of large sections of the economy
- Restrictions on activity and interaction have slowed down the mechanics and logistics of the market (e.g. display homes, inspections, etc.)
- A substantial drop in population growth due to severe reductions in overseas migration inflows
- Falling house prices mean that many buyers will defer home purchases for now and wait until a time when prices have stabilised.
- Valuation gap between land/construction and house prices likely to further expand and make construction work untenable.
- Depending on the jurisdiction, the stamp duty bills for owner occupiers purchasing/building new homes can be very high and dissuade potential buyers

In addition to these factors, demand from housing investors wishing to purchase new homes to make available on the rental market is being curtailed by

- Large scale defaults by renters hit by job losses/income cuts have made it far less attractive for investors to involve themselves with the rental market
- Even before the Covid-19 crisis, the pace of rental price growth was at its lowest since the early 1970s – a bad situation for investors.
- Tolerance for bearing risk has declined right across the economy as a result of Covid-19 and dampened the appetite of housing investors.
- As with owner occupiers, falling home prices erode capital gains and are another turn off for investors.
- Stamp duty bills for investors are typically even higher than for owner occupiers and act to suppress demand
- The spending and borrowing capacity of housing investors has been eroded by income drops and steep asset price falls over recent months
- Non-resident investors have been effectively shut out of the housing market through the imposition of enormous stamp duty surcharges on them by state/territory governments since 2015.

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STIMULUS MEASURES

BARRIER TO ACTIVITY	STIMULUS MEASURE	DESCRIPTION OF MEASURE
Demand for housing impacted by high household debt levels and lack of discretionary spend capacity	Extend First Home Owner Grant to $40,000 and make available to all new home building activity.	Provide an immediate cash grant of $40,000 to every First Home Buyer who is building or buying a new home. A similar measure was instrumental in reversing the housing slump during the GFC of 2008-09. This should be time limited in order to spur a sense of urgency amongst Home Buyers with respect to entering the market. This should be extended to <u>all new home buyers</u> not just first new home buyers in a time limited capacity with cost and income thresholds. This would extend the reach of stimulus when we expect to see nearly a 50% downturn in new housing starts.
	Support speculative housing through interest free loans for part of the cost (25%) for title ready blocks.	The current interruption to the housing market means that a glut of titled, vacant residential lots could emerge in some areas. To ensure that these are built upon quickly and not left idle, builders should be provided with incentives to purchase these lots and build new homes on them on a speculative basis. Accordingly, we would propose a scheme whereby the government funds interest-free loans to builders, up to 25% of the value of the land lot.
	Establish a National Housing Trust with state/territory/national/institutional equity to invest in affordable housing. This builds on the NHFIC investment bond aggregator and SDA NDIS models.	Establish a joint Federal and State Government investment Trust leveraged with Private Sector Institutional Investment. Investments could be in two classes – Class A (Govts) long term residual asset holders, Class B (Institutional Investors) have capital returned. The Trust invests in Projects delivering affordable housing in partnership with CHP's/Developers. Builder, developer, land developer volume discounts; and CHP GST benefits increase stock numbers to enhance yield.
	Develop a new community housing class that moves the focus from community to affordable. Builds on NHFIC, Indigenous Business Australia, Specialist Disability Accom, Clean Energy Fund). Utilise volume discounts from building and land development sectors with tax (GST & stamp duty) incentives to offset yield gap/cost.	At present, the majority of private rented accommodation is provided by small-scale investors who purchase homes on the new or established market. What's currently lacking is a model whereby rental accommodation is delivered on a large scale in a joined-up fashion. Government support for a Build-to-Rent model would allow for developers to deliver tranches of new housing stock specifically designed to meet the needs of certain segments of the rental market. These models could be expanding by offering developers/builders subsidies and/or tax breaks in return for creating large scale rental accommodation units with the option for long term rentals for tenants. A proposed model is attached for further reference.
	Introduce a Resilience Building Program to support natural disaster, energy efficiency and accessibility construction work. This could include insurance gap cover for bushfire recovery.	The establishment of a Building Resilience Fund by government would meet the twin objectives of supporting residential building activity and addressing challenges like the insurance 'gaps' which were revealed by the Bushfire Crisis in 2019-20. The Program would be designed to fund residential reconstruction work in the aftermath of natural disasters, particular where gaps in insurance coverage are significant. Furthermore, the Program could support improvements in the energy efficiency and accessibility of Australia's existing dwelling stock through remediation works and support the delivery of modifications to existing homes in terms of their accessibility.

	Allow people to access superannuation for home building and renovation activity.	At the end of 2019, superannuation assets totalled $3.0 trillion. While this has fallen as a result of recent financial market developments, it still represents a vital resource capable of supporting activity through the current crisis. Consideration should be given to allowing consumers access a portion of their superannuation balances in order to finance the building or purchase of a new home or the completion of certain classes of home renovations work (e.g. including that which leads to improved energy efficiency).
Supply levers restricting the ability to roll out projects quickly	Fast-track planning approvals.	Delays in receiving planning approval risk dissuading homeowners, developers and/or builders from proceeding with new home building or renovations projects, and add significantly to the cost and risk involved for developers and builders. A significant focus should be placed on minimising the time between the applications between lodged and approval being received through increasing staff numbers and widening the use of technological solutions in this area.
	Relax land and property taxes especially including stamp duty	Stamp duty acts as a huge barrier to housing activity – it makes home purchase more expensive and erodes the margins of builders and developers. In order to stimulate activity, consideration should be given to temporarily reducing or eliminating stamp duty bills on all newly-built homes and on vacant land transactions.
	Fast track and expand investment in defence housing construction activity.	There are currently about 18,000 under the management of Defence Housing Australia. While this is only a small portion of the national dwelling stock, the influence of defence housing is very large in a number of regional markets. Accordingly, the fast tracking and expansion of DHA housing construction would offer crucial support to building businesses in several regional markets including Edinburgh (SA), Toowoomba & Townsville (Qld) and Stirling (WA).
	Fast track payment and delays in construction contracts (public and private).	The vast majority of residential building activity is undertaken by small businesses, many of which are sole traders or employees only a couple of people. At this time, cashflow is absolutely vital to their survival. For this reason, payment times from government to small businesses must be reduced to be as short as possible. The government must also maximise its leverage with the private sector in order to pressurise – and penalise if necessary - large private companies to speed up their payments to smaller construction businesses.
	Release more Commonwealth land for housing development.	Land is the single largest ingredient of every new home so changes in its cost have a major impact on the final ticket price paid by homebuyers. Accordingly, an orderly increase in the supply of serviced residential land would have very favourable effects on housing affordability both for those buying their first home as well as people relying on the rental market. As a first step, the release of Commonwealth land should be speeded up now so as to produce better affordability outcomes over the medium term and improve the chances that we meet our long-term housing needs.